

**MEMO# 9288**

September 30, 1997

## **SEC PROPOSES AMENDMENTS TO SHAREHOLDER PROPOSAL RULES**

1 SEC Release Nos. 34-39093 and IC-22828, File No. S7-25-97 (Sept. 18, 1997) ("Release").  
2 SEC No-Action Letter (pub. avail. Oct. 13, 1992). [9288] September 30, 1997 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 36-97 SEC RULES COMMITTEE No. 97-97 RE: SEC PROPOSES AMENDMENTS TO SHAREHOLDER PROPOSAL RULES

The Securities and Exchange Commission has proposed amendments to several shareholder proposal rules under the Securities Exchange Act of 1934, with particular emphasis on rule 14a-8.1 The proposed amendments are part of a "package" of reforms, which the Commission believes will make it easier for shareholders to include a broad range of proposals in companies proxy materials, and provide companies with clearer ground rules and more flexibility to exclude proposals that failed to attract significant shareholder support in prior years. Two noteworthy proposals include recasting rule 14a-8 into a more understandable Question & Answer format, and reversing the staffs interpretive position in Cracker Barrel Old Country Store, Inc.,<sup>2</sup> the no-action letter that established a "bright-line" approach for applying the "ordinary business" exclusion to employment-related shareholder proposals involving social policy issues. The proposed amendments are summarized below, and a copy of the Release, including a separate concurrence by SEC Commissioner Wallman, is attached. Comments on the proposed amendments must be filed with the Commission by November 25, 1997. We will be discussing the proposals at the upcoming meetings of the SEC Rules Committee (October 22nd) and the Closed-End Fund Committee (October 23rd). If you are not planning to attend either meeting, please provide any comments on the proposal to Dorothy M. Donohue at 202/326-5821 (phone), 202/326-5827 (fax), or donohue@ici.org (e-mail), by October 21, 1997.

A. Plain-English, Question & Answer Format The Release proposes to amend and recast rule 14a-8 into a Question & Answer format to make the requirements of the rule more easily understood by shareholders and companies who use it. As proposed, the Q&A format will contain 14 questions covering, among other things, procedural and eligibility requirements and technical and clarifying modifications. Examples of some of the procedural modifications proposed include requiring a shareholder proponent to have continuous ownership of \$2,000 in market value of the companys voting 2shares, thereby adjusting for inflation the current \$1,000 requirement, and establishing a single "shareholder response period" of 14 calendar days in which a shareholder must respond to a companys intention to exclude the shareholders proposal from its proxy materials. In addition, the Release proposes to permit both companies and shareholders to send their rule 14a-8 submissions to the Commission by electronic mail.

B. Personal Claim or Grievance Exclusion: Rule 14a-8(c)(4) The Release proposes to modify the application of rule 14a-8(c)(4), which permits companies to exclude proposals that relate to personal claims or grievances against the company or any other

person, or that results in a benefit to the proponent or furthers a personal interest, which benefit or interest is not shared by the company's other shareholders. The Release notes that the difficulty in applying the exclusion to "neutral" proposals, i.e., proposals that, by their terms, do not relate to a personal grievance or special interest of the proponent, has resulted in the staffs having to make factual determinations. In practice, the staff has infrequently concurred in the exclusion of neutral proposals under rule 14a-8(c)(4). The Release proposes that to the extent a company makes a submission under this rule intending to omit a "neutral" proposal, the staff would automatically express a "no view" response, rather than concur or decline to concur in its exclusion, thereby allowing the company to omit the proposal if they believe they possess adequate factual records demonstrating the personal grievance or interest.

C. Rule 14a-8(c)(5): The "Relevance" Exclusion The Release proposes to narrow and clarify rule 14a-8(c)(5), which permits the exclusion of proposals that are of little or no economic relevance to a company and its business. Specifically, the rule permits companies to exclude proposals relating to operations that, at the end of the company's most recent fiscal year, account for less than 5% of the company's total assets, gross sales, or net earnings, provided that the proposal is not otherwise significantly related to the registrant's business. The Release notes that because of the subjectivity of the "otherwise significantly related" language, that portion of the rule frequently overshadows the 5% economic standard. The Release, therefore, proposes to amend the rule by deleting the "otherwise significantly related" provision and applying instead a purely economic standard, which, as revised, would allow companies to exclude proposals relating to matters involving the purchase or sale of services or products that represent \$10 million or less in gross revenue or total costs, whichever is appropriate, for the company's most recently completed fiscal year. An economic threshold lower than \$10 million would apply, however, if 3% of the company's gross revenues or total assets (whichever is higher) for its most recently completed fiscal year results in a number lower than \$10 million. The revised rule would also contain certain safeguards to prevent it from excluding proposals that may be significant to the company despite a low quantifiable value.

D. The Interpretation of Rule 14a-8(c)(7): The "Ordinary Business" Exclusion 3 The Release proposes to amend rule 14a-8(c)(7), which allows companies to exclude proposals that relate to matters falling within the province of management. The Release notes that because the rule provides little guidance on how to analyze proposals involving both an "ordinary business" matter and a social policy issue, the staff has applied the most well-reasoned standards possible, adjusting its approach along the way. Consequently, the staff, in the Cracker Barrel no-action letter, established a "bright line" approach in dealing with employment-related proposals raising social policy issues. There, the staff stated that such proposals are properly governed by the employment-based nature of the proposal, and thus are included within the realm of a company's ordinary business operations. The Release proposes, however, to reverse this interpretive position and replace the "bright line" approach with the case-by-case analysis that prevailed previous to Cracker Barrel, thereby eliminating automatic exclusion of such proposals under the "ordinary business" exclusion.

E. Rule 14a-8(c)(12): The Resubmission Thresholds The Release proposes to amend rule 14a-8(c)(12), which permits a company to exclude a proposal focusing on substantially the same subject matter for a three-year period if it fails to receive a specified level of support. In order to avoid possible exclusion, the proposal must receive at least 3% of the vote on its first submission, 6% on the second, and 10% on the third. The Release proposes to increase these thresholds to 6%, 15%, and 30%, respectively, noting that a proposal that fails to achieve these levels of voting support has been fairly tested and stands no significant chance of obtaining the level of support required for approval.

F. Proposed Override Mechanism The Release proposes to revise rule 14a-8 to permit a shareholder proponent to override a company's decision to exclude a proposal under rules

14a-8(c)(5) and (7), if the proponent demonstrates that at least 3% of the companys outstanding voting shares support the submission of the proposal for a shareholder vote. As proposed, the override mechanism, which is not presently contained in rule 14a-8, would broaden the spectrum of proposals that may be included in a companys proxy materials where a certain percentage of the shareholder body believes that all shareholders should have an opportunity to express a view on the proposal. The Release also provides that the shares held by the shareholder proponent may be included in calculating the 3% threshold necessary to accomplish the override. G. Safe Harbor under Section 13(d); Qualified Exemption from Proxy Rules To address concerns that a proponents efforts to utilize the proposed override mechanism might be deterred by the prospect of triggering filing and other obligations under section 13(d) or 14(a) of the Exchange Act, the Release proposes a new safe harbor from the 13(d) "group" beneficial ownership reporting requirements and a new exemption from the proxy rules in rule 14a-2. 4H. Rule 14a-4: Discretionary Voting Authority The Release proposes to amend rule 14a-4(c) to clarify when a company may exercise discretionary voting authority on a shareholder proposal where the proponent has not invoked the mechanism of rule 14a-8 (e.g. where the shareholder presents the proposal from the floor of the companys annual meeting or solicits proxy votes independently by distributing its own proxy statement and form of proxy). Barry E. Simmons Assistant Counsel Attachment (in .pdf format)