CHAPTER 07

Shareholder Proposals in the United States and Canada

Shareholder proposals have long been an effective tool for investors to raise environmental, social and governance issues and foster engagement with a public company. That said, compliance with the shareholder proposal regime can impose costs and burdens on companies. For years, the U.S. Securities and Exchange Commission (SEC) has been trying to balance the benefits and costs of shareholder proposals. A bill proposed in 2018 and statements from the SEC Chairman indicate that the SEC will propose revisions to the shareholder proposal regime in the near future, especially with respect to the requirements for resubmitting proposals that were previously rejected by shareholders. In this chapter, we review the existing shareholder proposal regime in the United States and discuss potential changes to the resubmission thresholds. We also take a look at the rising number of shareholder proposals in Canada, a regime not likely to change in the near future.

Existing U.S. Shareholder Proposal Regime

The shareholder proposal regime in the United States, governed by rule 14a-8 under the *Securities Exchange Act of 1934*, gives shareholders an opportunity to recommend or require that a company and/or its board of directors take a specific action, often relating to environmental, social and governance (ESG) issues. Proponents of shareholder proposals include activist investors, public pension funds, hedge funds and special interest groups. For years, the U.S. Securities and Exchange Commission (SEC) has been trying to balance the benefits of the rule and the scope of its application with the resulting burdens and costs associated with compliance. We expect the SEC will propose revisions to the rule in the near future, particularly as they relate to the thresholds for resubmitting previously defeated proposals.

Under the current rule, an eligible shareholder that satisfies certain requirements may submit a proposal to be voted on at a company's upcoming shareholders' meeting. To submit a proposal, a shareholder must have continuously held at least US$2,000 in market value, or 1%, of the company's voting securities for at least one year before submitting the proposal and must continue to hold those securities through the meeting date. The shareholder or its representative must attend the meeting to present the proposal. Unless the proposal is excluded on certain procedural or substantive grounds enumerated in the rule, the company must include the proposal in its proxy materials for the applicable shareholders' meeting.

A company may exclude a proposal from its proxy materials on 13 substantive grounds enumerated in rule 14a-8, including if the proposal:

- does not present a proper subject for action by shareholders under the laws of the company's jurisdiction of organization;
- would, if implemented, cause the company to violate any applicable state, federal or foreign law;
- relates to a personal claim or grievance against the company or any other person, or is designed to result in a personal benefit or further a personal interest not shared by other shareholders at large;
- relates to operations that account for less than 5% of the company's total assets at the end of its most recently completed fiscal year and for less than 5% of its net earnings and gross sales for such year, and is not otherwise significantly related to the company's business; or
- deals with a matter relating to the company's ordinary business operations (which should be addressed by the board of directors, not by the shareholders).

A company that intends to exclude a proposal from its proxy materials must file its reasons (together with any supporting materials) with the SEC. The SEC staff is responsible for deciding which proposals may be excluded, until recently, through the issuance of no-action letters. On September 6, 2019, the SEC staff announced that it is changing its process for administering rule 14a-8. In cases where a company seeks to exclude a proposal, the SEC staff will inform the proponent and the issuer of its position, which may be that staff concurs, disagrees with or declines to state a view, with respect to the company's asserted basis for exclusion.[157] Starting with the 2019 to 2020 proxy season, the SEC staff may also respond orally instead of in writing to some no-action requests. The SEC staff intends to issue a response letter where it believes doing so would provide value, such as more broadly applicable guidance about complying with rule 14a-8.

An issuer may also exclude certain shareholder proposals dealing with substantially the same subject matter that had been voted on in recent years. Specifically, an issuer may exclude a resubmitted proposal if in the preceding five years the proposal:

- was voted on once and received less than 3% of the votes cast;
- was voted on twice and received less than 6% of the votes cast the last time it was voted on; or
- was voted on three or more times and received less than 10% of the votes cast the last time it was voted on.[158]

The existing minimum percentage thresholds for resubmitted proposals were established in the 1950s. Until institutional investors became more active participants in shareholder voting, these thresholds prevented the majority of proposals from winning sufficient support for resubmission. In recent years, with institutional investors becoming more active participants in shareholder voting, the vast majority of shareholder proposals now receive the required minimum percentage of the vote and are therefore eligible for resubmission. In fact, research published by the CII Research and Education Fund in 2018 concluded that at least 90% of failed shareholder proposals would be eligible to be resubmitted under the current regulatory regime.[159]

Proposed Changes to U.S. Proposals: Raising the Resubmission Thresholds

On May 10, 2018, Representative Sean Duffy introduced a bill (H.R. 5756) to direct the SEC to revise rule 14a-8(c)(12) to raise the minimum percentage thresholds for resubmitting a shareholder proposal from 3%, 6% and 10% to 6%, 15% and 30%, respectively.[160] The U.S. House of Representatives Committee on Financial Services stated that the objective of raising the resubmission thresholds, as proposed in H.R. 5756, was to reduce the burdensome costs borne by companies in connection with shareholder proposals and enable companies to focus their resources on getting the greatest returns for their shareholders.[161] The committee argued that, due to the extremely low bar for qualification to submit a proposal, as well as the SEC's increasing tendency to err on the side of the shareholders, special interest activists were taking advantage of the current regulatory regime to advance their social, environmental or political agendas at the expense of other shareholders. The cost of a proposal, according to the committee, could run up to US$150,000 per proposal, with some companies facing 15 or more a year, equating in such instances to US$2 million in time and resources that were purportedly being diverted from the core fiduciary responsibility to maximize shareholder value. The CII Research and Education Fund estimated that, if adopted, the higher proposed resubmission percentages would triple the number of proposals that would be ineligible for resubmission under the current U.S. rule.[162]

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The minority view of the committee members who opposed H.R. 5756 argued that the bill was "premised on the misconception that shareholders are abusing the shareholder proposal process to promote activist interests to the detriment of public companies. To the contrary, shareholder proposals have benefited public companies in terms of increased shareholder

engagement and improved performance." They cited, for example, improving gender diversity on corporate boards, which has enhanced board decision-making. According to one committee member, such progress in diversity would not have occurred had the resubmission thresholds been enacted during the early stages of board diversity proposals. On this basis, the minority view of the committee was that higher submission thresholds would defeat many important shareholder proposals on the environment, diversity, corporate governance and other critical issues.[163] It is also important to bear in mind that the majority of companies never face any proposals, with the average number of proposals faced by issuers being typically very low (fewer than two).

TABLE 7-1:
U.S. Shareholder Proposal Regime: Existing Rule and Potential Amendments

Eligibility Requirements	Existing 14a-8 Requirements	Potential Amendments
Ownership thresholds	Shareholder must have continuously held at least US$2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year before submitting the proposal. Shareholder must hold the securities through the date of the meeting and agree to present (or have a qualified representative present) the proposal at the meeting.	Unknown.
Resubmission thresholds	If the proposal deals with substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the preceding five years, the new proposal may be excluded from proxy materials for any shareholders' meeting held within three years of the last submission if the proposal received: – less than 3% of the vote if proposed *once* within the preceding five years; – less than 6% of the vote on its last submission to shareholders if proposed *twice* previously within the preceding five years; or – less than 10% of the vote on its last submission to shareholders if proposed *three* times or more previously within the preceding five years.	If the proposal deals with substantially the same subject matter as another proposal that has been previously included in the company's proxy materials within the preceding five years, the new proposal may be excluded from proxy materials for any shareholder meeting held within three years of the last submission if the proposal received: – less than 6% of the vote if proposed *once* within the preceding five years; – less than 15% of the vote on its last submission to shareholders if proposed *twice* previously within the preceding five years; or – less than 30% of the vote on its last submission to shareholders if proposed *three* times or more previously within the preceding five years.

What's Next in the United States? SEC Likely to Propose Changes

In a speech outlining the SEC's agenda for 2019, SEC Chairman Jay Clayton suggested that the SEC consider reviewing the ownership and resubmission thresholds for shareholder proposals under the rule, including whether there are factors, in addition to the amount invested and the length of time shares are held, that reasonably demonstrate that the proposing shareholder's interests are aligned with the company's long-term investors.[164] Similarly, in the SEC's semi-annual regulatory agenda published on May 22, 2019, the SEC's Division of Corporation Finance indicated that it is considering recommending that the SEC propose amendments to the thresholds for shareholder proposals under rule 14a-8.

Although the SEC has yet to propose any specific amendments to the rule, it is widely expected that amendments will be proposed in the coming months.

Canadian Shareholder Proposal Regime

Similar to the United States, shareholders of Canadian corporations can avail themselves of the shareholder proposal regimes under Canada's applicable federal or provincial corporate statutes to raise ESG issues and to submit nominations for the election of directors, albeit rarely used for the latter purpose. For example, under Canada's federal corporate statute – the *Canada Business Corporations Act* (CBCA) – to be eligible to submit a shareholder proposal, the shareholder must hold voting shares equal to at least 1% of the outstanding voting shares or with a fair market value of at least $2,000 through the date of the applicable shareholders' meeting.[165] If the proposal involves the nomination of one or more directors, it must also be signed by one or more shareholders representing in the aggregate at least 5% of the shares entitled to vote at the meeting (and, in that case, there is no limit on the number of nominees that may be submitted by proposal).[166] A corporation that receives an eligible proposal is required to include it in its management proxy circular for the shareholders' meeting.

Under the CBCA, a corporation can reject a proposal and exclude it from its proxy circular on the basis of certain specified procedural or substantive grounds, some of which are similar to those under existing U.S. rule 14a-8. One such basis for excluding a proposal is when substantially the same proposal was submitted to shareholders in the corporation's proxy circular or in a dissident proxy circular relating to a shareholders' meeting held not more than a prescribed period before the receipt of the proposal and the proposal did not receive the prescribed minimum amount of support at the meeting.[167] For these purposes, the prescribed period and the prescribed minimum amounts of support for being eligible to resubmit a previously submitted proposal under the CBCA generally correspond to those under existing U.S. rule 14a-8 – namely, within five years and with support thresholds of 3%, 6% and 10% of the total number of shares voted.[168]

Unlike the U.S. proposal regime, however, Canada's securities regulators do not oversee (or issue no-action letters or advice to public companies) with respect to proposals that issuers reject. Rather, the issuer's board would determine whether or not to accept or reject a proposal, and a shareholder claiming to be aggrieved by a corporation's refusal to include a proposal in a proxy circular only has recourse to the Canadian courts.

Shareholder Proposals in Canada on the Rise

Following a three-year downward trend, 2019 witnessed a resurgence in shareholder proposal activity in Canada. As Table 7-2 demonstrates, this year an aggregate of 62 proposals were put forward to 30 Canadian issuers on the Composite and SmallCap indices, in line with the high levels witnessed in 2015.

TABLE 7-2:
Shareholder Proposals at Issuers on the TSX Composite and SmallCap Indices (2015–2019)

	2019	2018	2017	2016	2015
Number of proposals	62	37	46	47	65
Number of issuers receiving proposals	30	22	22	24	26
Number of financial institutions receiving proposals	7	4	7	7	7
Average percentage of votes cast "for" (all proposals)	13%	16%	18%	14%	19%
Average percentage of votes cast "for" (excluding proposals approved by shareholders)	12%	10%	12%	7%	11%

In Canada, the most common topics subject to shareholder proposals in 2019 included the following:

- requiring an advisory say-on-pay vote on executive compensation, integrating ESG criteria and sexual misconduct measures into executive compensation, disclosing equity ratios used to set compensation and reviewing relative compensation inequality;
- climate change–related proposals, such as requiring setting and publishing greenhouse gas emissions-reduction targets, producing an annual sustainability report, disclosing measures supporting the transition to a low-carbon economy and reporting on sustainable packaging, deforestation and the social impacts of food waste;
- creating a new technology committee;
- social issues, such as minimum requirements for workforce practices, Indigenous people's rights, human rights policies and the adoption of a living wage policy;
- adopting a policy on the representation of women on the board and within senior management;
- requiring separate disclosure of voting results by classes of shares and related disclosures; and
- director independence issues.

Of the 62 proposals put forward to Canadian issuers in our sample study, in 2019 only one received majority shareholder approval: a proposal to Waste Connections, Inc., to adopt a policy on board diversity (also discussed in Chapter 6, Navigating Gender Diversity in 2019). Shareholder support for the remaining shareholder proposals that did not achieve majority approval was consistent with the five-year average at 12%.

Our Take: Eligibility for Making Shareholder Proposals May Change in the United States

As discussed in several previous Davies Governance Insights reports, including *Davies Governance Insights 2018*,[169] shareholders of Canadian and U.S. companies have long had the ability to use the shareholder proposal regime to raise concerns regarding the companies in which they invest. Proposals can be an effective tool, not only for raising proposals or issues at a shareholders' meeting, but also for encouraging engagement between companies and investors on topics of potential importance. In fact, proposals are often withdrawn by shareholders and never presented at shareholders' meetings when meaningful engagement between the issuer and the submitting shareholder has occurred. In Canada, there appear to be no plans or appetite for making the shareholder proposal regime any more onerous to shareholders, viewing it as a fundamental element of facilitating shareholder democracy. And while the U.S. shareholder proposal regime may face changes in the future that could make it more onerous for some shareholders to utilize, boards should remain aware that activism and engagement, including by historically more passive institutional investors, is now relatively mainstream. Consequently, boards and senior management should engage with, listen to and strive to be responsive to the reasonable demands or requests of their owners.

Notes

Chapter 7 – Shareholder Proposals in the United States and Canada

157 SEC, "Announcement Regarding Rule 14a-8 No-Action Requests" (September 6, 2019), online: https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests. The SEC staff announcement also states that if staff declines to state a view on any particular request, it is not taking a position on the merits of the arguments made and the parties should not interpret that as indicating that the proposal must be included in management's proxy circular. It is possible that an issuer may have a valid basis to exclude the proposal under rule 14a-8. In such circumstances, the parties may seek formal, binding adjudication of the merits of the issue in court.

158 *Securities Exchange Act of 1934*, Rule 14a-8(i)(12).

159 CII Research and Education Fund, *Clearing the Bar: Shareholder Proposals and Resubmission Thresholds* (November 2018), online: https://docs.wixstatic.com/ugd/72d47f_092014c240614a1b9454629039d1c649.pdf.

160 These proposed new thresholds are based on a 1997 SEC proposed rule to raise the thresholds, which the SEC ultimately did not adopt. See Proposing Release, Exchange Act Release No. 39093 (September 18, 1997) (62 Fed. Reg. 50682), online: https://www.sec.gov/rules/proposed/34-39093.htm. This proposal was not adopted by the SEC as many commenters were concerned that the increased thresholds would operate to exclude too many proposals, particularly those focusing on social policy issues, which tend to receive a lower percentage of the shareholder vote. See Securities Exchange Act Release No. 34-40018, 63 Fed. Reg. 29 (May 21, 1998), online: https://www.sec.gov/rules/final/34-40018.htm.

161 U.S. House of Representatives, Committee on Financial Services, Committee Report, *To Require the Securities and Exchange Commission To Adjust Certain Resubmission Thresholds For Shareholder Proposals*, H.R. Rep. No. 115-904 (August 24, 2018), online: https://www.govtrack.us/congress/bills/115/hr5756/text.

162 *Supra* note 159 at 4.

163 *Supra* note 161.

164 Jay Clayton, *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (December 6, 2018), online: https://www.sec.gov/news/speech/speech-clayton-120618.

165 *Canada Business Corporations Act* (CBCA), RSC 1985, c C-44, section 137(1.1) and *Canada Business Corporations Regulations, 2001* (CBCA Regulation), SOR/2001-512, section 46.

166 CBCA, section 137(4).

167 CBCA, section 137(5)(d).

168 CBCA, section, 137(5)(d); CBCA Regulation, section 51.

169 Davies, online: https://www.dwpv.com/en/Insights/Publications/2018/Governance-Insights-2018.