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Eliminating the Post-Submission Holding Period under Rule 14A-8

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ELIMINATING THE POST-SUBMISSION HOLDING PERIOD UNDER RULE 14A-8

INTRODUCTION

Rule 14a-8 (the Rule) allows shareholders to include proposals in the proxy materials of public companies.[1] The Rule, however, also contains a number of eligibility requirements. Specifically, shareholders must continuously hold "at least $2,000 in market value" or one percent of the company's voting securities "for at least one year" before submitting a shareholder proposal in a company's proxy statement.[2] In addition, the Rule imposes a "post-submission" holding period requiring proponents to continuously retain the shares through the date of the annual meeting.[3] Violation of the "post-submission" holding period results in a penalty; the proponent cannot submit another proposal to the same company for the following two calendar years.[4]

Initially, the Rule did not contain minimum ownership requirements or mandatory holding periods.[5] The Securities and Exchange Commission (SEC or Commission) added a "post-submission holding period," first through informal interpretation and later through an amendment to the Rule.[6] In addition, the Commission included a "pre-submission" holding period. In an effort to ensure that shareholders had "some measured economic stake or investment interest in the corporation"[7] and "curb abuses" in the proxy process, proponents had to own shares for twelve months prior to the submission of the proposal.[8] The two holding periods came into the Rule for related reasons. Yet the Commission never examined the impact of one on the other.

Part I of this Article will discuss the administrative history of the post-submission holding period and the two-year penalty under Rule

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1. 17 C.F.R. § 240.14a-8 (2012).
2. *Id.* § 240.14a-8(b)(2).
3. *Id.* § 240.14a-8(f)(2) (Rule 14a-8(f)(2) provides that if the shareholder "fails in [his or her] promise to hold the required number of securities through the date of the meeting of shareholders, then the company will be permitted to exclude all of [the same shareholder's] proposals from its proxy materials for any meeting held in the following two calendar years.").
4. Id.
5. J. Robert Brown, Jr., *The Evolving Role of Rule 14a-8 in the Corporate Governance Process*, 93 DENV. L. REV. ONLINE 151 (2016).
6. *See* Release No. 34-12999 (Nov. 22, 1976).
7. Exchange Act Release No. 20091 (Aug. 16, 1983) ("Many of those commentators expressed the view that abuse of the security holder proposal rule could be curtailed by requiring shareholders who put the company and other shareholders to the expense of including a proposal in a proxy statement to have some measured economic stake or investment interest in the corporation. The Commission believes that there is merit to those views and is adopting the eligibility requirement as proposed.").
8. *See* The LTV Corp., SEC No-Action Letter, 2000 WL 36699154.

14a-8(f)(2). After providing some history on the requirement, Part II will examine the SEC's interpretation of shareholder eligibility and the obligation to hold shares through the date of the shareholder meeting. Finally, Part III considers the problems presented by the exclusion and suggests some changes to the Rule.

I. ADMINISTRATIVE HISTORY

Corporate law has long recognized the importance of shareholder participation in the governance process.[9] Shareholders have the right to attend meetings[10] and vote their shares.[11] At early common law, shareholders exercised voting rights through personal attendance.[12] The development of large corporations with dispersed ownership,[13] however, "rendered this requirement problematic."[14]

State statutes responded by permitting the appointment of a proxy to allow owners to designate another person to "vote the shares in accordance with their instructions."[15] State law, however, proved inadequate in regulating the proxy process. As a result, Congress provided the Commission with the authority to oversee the process used by public companies through the adoption of Section 14(a) of the Securities Exchange Act of 1934 (Exchange Act).[16]

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9. David C. Bayne et al., *Proxy Regulation and the Rule-Making Process: The 1954 Amendments*, 40 VA. L. REV. 387, 390 (1954) ("shareholder participation at personally-attended corporate meetings was so fundamental to the English common-law system that it refused to recognize either shareholder proxy voting or other share- holder authorization, consent, or action taken without the convening of a shareholders' meeting.").

10. *See* Hoschett v. TSI Int'l Software, Ltd., 683 A.2d 43, 44 (Del. Ch. 1996) ("The obligation to hold an annual meeting at which directors are to be elected… is one of the very few mandatory features of Delaware corporation law.").

11. *See* J. Robert Brown, *The Proxy Rules and Restrictions on Shareholder Voting Rights*, 47 SETON HALL L. REV. 45, 46 (2016).

12. *See* Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulatio*n, VAND. L. REV. 1120, 1134 (1993).

13. *Id.* at 1135 ("A national corporation may have shareholders spread over fifty states and abroad, making it impossible for many shareholders to attend the annual meeting.").

14. *Id.* at 1134.

15. The proxy holder has no control over the stock but simply has the right to vote the stock. Brown, *supra* note 12, at 50. *See* Staff Report on Corporate Accountability, Division of Corporate Finance, Securities and Exchange Commission, presented to Committee on Banking, Housing & Urban Affairs, U.S. Senate, 96th Cong., 20 Sess. 34-35, 143 (Sept. 4, 1980) [hereinafter Staff Report]; Arthur H. Dean, *Non-Compliance with Proxy Regulations: Effect on Ability of Corporation to Hold Valid Meeting*, 24 CORNELL L. REV. 483, 487 (1939) (explaining that no right to vote by proxy existed at common law); Fisch, *supra* note 13, at 1135 ("Proxy voting is governed by agency principles that permit a shareholder to authorize another person to vote on his or her behalf."); Leila N. Sadat-Keeling, *The 1983 Amendments to Shareholder Proposal Rule 14a-8: A Retreat from Corporate Democracy?*, 59 TUL. L. REV. 161, 197 (1984); *see also* David C. Bayne et al., *Proxy Regulation and the Rule-Making Process: The 1954 Amendments*, 40 VA. L. REV. 387, 391 (1954) ("The proxy rules were evolved with the objective of simulating the early common-law, personally-attended shareholders' meeting.").

16. 15 U.S.C. § 78n(a) (2012).

The first set of proxy rules appeared in 1935.[17] Seven years later,[18] the Commission added the shareholder proposal Rule requiring exchange traded companies to include initiatives submitted by owners in their proxy materials.[19] The provision sought to align shareholder rights under state law with the federal proxy process.[20] "[N]ot an invention of the SEC,"[21] the Rule only allowed companies to exclude proposals that were not "proper subjects" for shareholder action under state law.[22] Similarly, any shareholder could submit proposals without regard "to a minimum ownership threshold or holding period."[23]

A. Establishing the "Holding Periods"

For three decades, the Rule did not expressly require a holding period of any kind. The Rule did reinforce the requirement that proponents attend the meeting and introduce the proposal.[24] State law, however, did not necessarily condition attendance and participation on continued own-

17. *See* Exchange Act Release No 378 (Sept. 24, 1935).

18. *See* Exchange Act Release No. 3347 (Dec. 18, 1942).

19. *See* Timothy L. Feagans*, SEC Rule 14a-8: New Restrictions on Corporate Democracy*, 33 BUFF L. REV. 225 n.1 (1984) (explaining that Rule 14a-8 was formerly known as Rule A-14A-7 before being renumbered in 1947).

20. *See* David C. Bayne, S.J. *The Basic Rationale of Proper Subject*, 34 U. DET. L. REV. 575, 588 (1957) (reiterating former SEC Chairman Ganson Purcell's statement ". . . [T]he rights that we are endeavoring to assure to the stockholders are those rights that he has traditionally had under State law, to appear at the meeting; to make a proposal; to speak on that proposal at appropriate length; and to have his proposal voted on.") (quoting *Hearings Before the Committee on Interstate and Foreign Commerce of the House on H.R. 1493, H.R. 1821 and H.R. 2019,* 78th Cong., 1st Sess. at 172 (1943)); *see also* Brief for SEC at 17, SEC v. Transamerica Corp., 163 F.2d 511 (3d Cir. 1947) (indicating the SEC goal, through proxy rules, of duplicating as closely as possible the conditions for effective self-governance that prevailed at the type of annual meeting that shareholders attended in person); Opinion of Baldwin B. Bane, Exchange Act Release No. 3638, 1945 WL 27415, at 2 (Jan. 3, 1945); Fisch, *supra* note 13, at 1142 ("The proxy rules reflect this deference to state law. The earliest version of the rules simply required a minimal degree of disclosure and prohibited false and misleading statements.").

21. Milton V. Freedman, *An Estimate of the Practical Consequences of the Stockholder's Proposal Rule*, 34 U. DET. L. REV. 549, 549 (1956-1957) (Rule 14a-8 "in its fundamental aspects is not an invention of the SEC . . . A shareholder always could stand up at a stockholders meeting and make a motion that in the future the meeting should be held in some other city, that the auditors should be elected by stockholders rather than selected by the directors alone, etc.").

22. *See* Fisch, *supra* note 13, at 1145 ("It soon became clear, however, that state statutory... law had not fully defined proper subjects for shareholder action."); Freedman, *supra* note 22, at 551 ("The basis of the rule remains essentially what it was before there was any rule, i.e. the right of the stockholder under state law to present at the shareholders meeting a proposal which is a proper subject for action at that meeting."); *see also* Opinion of Baldwin B. Bane, Exchange Act Release No. 3638, 1945 WL 27415, at 2 (Jan. 3, 1945) ("speaking generally, it is the purpose of Rule X-14A-7 to place stockholders in a position to bring before their fellow stockholders matters of concern to them as stockholders in such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized.").

23. Brown, *supra* note 12, at 51.

24. *See* Exchange Act Release No. 4114 (July 6, 1948).

ership.[25] Those holding shares on the record date could vote, attend and make proposals, even if selling the shares before the meeting.[26]

The Commission nonetheless imposed a "post-submission holding period" on an informal basis.[27] The Commission regularly excluded proposals from proponents who sold the shares prior to the annual meeting.[28] The Commission amended the Rule to explicitly require the "post-submission" holding period in 1976.[29] Proponents thereafter had to own voting securities "through the date on which the meeting is held."[30] In adding the requirement to the Rule, the Commission also included a penalty for noncompliance. Management would "not be required to include any proposals submitted by the proponent in its proxy soliciting materials for any meeting held in the following two calendar years."[31] The penalty sought to "assure that the proponent will maintain an investment interest in the issuer through the meeting date."[32]

The post-submission holding period, however, did not require ownership of any specific number of shares.[33] Shareholders merely had to retain some interest through the date of the meeting. As a result, commentators asserted that shareholders could still "put the company and other shareholders to the expense of including a proposal in a proxy statement with no meaningful investment in the corporation."[34]

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25. *See* Fisch, *supra* note 13, at 1149 ("No uniform state or common law principle requires that a shareholder hold one percent or one thousand dollars' worth of a corporation's stock for a minimum of one year before making a motion at a shareholders' meeting.").

26. State statutes provide voting to owners holding shares on the record date. *See* § 31:12. Date on which eligibility is determined, 20 TEX. PRAC., Business Organizations § 31:12 (3d ed.) ("A person who sells or transfers his shares after the record date has the power to vote shares he no longer owns."); § 7.11 Record Dates- General, 2006 WL 2452477 ("Unlike the prior practice of closing the books, the use of a record date permits transfers of stock between the record date and the meeting date. Transferees after the record date are not eligible to vote as record owners, but a transferee of stock after the record date can compel the record holder to grant him a proxy.").

27. *See* Cont'l Illinois Realty, SEC No-Action Letter, 1975 WL 9950 (finding that the proponent was not a "security holder entitled to vote" at the annual meeting because the proponent sold all of his shares prior to the record date for the meeting).

28. *See* Indianapolis Power & Light Co., SEC No-Action Letter, 1976 WL 10939.

29. *See* Exchange Act Release No. 34-12999 (Nov. 22, 1976).

30. Exchange Act Release No. 34-12999 (Nov. 22, 1976).

31. *Id.*

32. Exchange Act Release No. 35-19602 (July 7, 1976).

33. The Commission proposed, but did not adopt, a "pre-submission holding period" a few years later. Proposed Amendments, Release No. 19135 (Oct. 14, 1982); *see also* Exchange Act Release No. 34-12999 (Nov. 22, 1976) (ignoring commentator concerns about adopting additional eligibility requirements finding that the current eligibility requirements have been in operation for many years and generally have not been abused.").

34. Exchange Act Release No. 20091 (Aug. 16, 1983). *See also* Black & Sparks, *SEC Rule 14a-8: Some Changes in the Way the SEC Staff Interprets the Rule*, 11 U. TOL. L. REV. 957, 964 (1980); Exchange Act Release No. 20091 (Aug. 16, 1983) ("Many of those commentators expressed the view that abuse of the security holder proposal rule could be curtailed by requiring shareholders who put the company and other shareholders to the expense of including a proposal in a proxy statement to have some measured economic stake or investment interest in the corporation. The Commission believes that there is merit to those views and is adopting the eligibility requirement as proposed.").

Imposition of the penalty, however, depended upon the timing of the sales. To the extent known to the issuer, the sale of securities after submission of a proposal became a basis for exclusion. In *American Electric Power Company*,[35] the proponent introduced a proposal, divested his interests, and thereafter "affirmatively indicated his intention" not to respond to the company's written request for documentary evidence of continued ownership.[36] Although the proponent claimed possession of some shares in a trust, he declined to prove ownership. The Commission permitted exclusion.[37] Where, however, companies learned of the divestiture only after inclusion in the proxy materials, the two-year penalty applied.

The Commission amended the Rule in 1983 to include a "pre-submission" holding period of one year and a minimum ownership threshold.[38] These requirements would curtail abuse[39] by requiring shareholders to demonstrate "some measured economic stake or investment interest in the corporation" before submitting a proposal.[40] The approach limited access to the Rule to long-term investors who were "most likely to have interests aligned with all shareowners and [were] less likely to use the proxy access rule for short-term benefit."[41]

The amendment also affected the post-submission holding period. The change defined the quantity of shares that proponents had to retain. Proponents had to hold, through the date of the meeting, the quantity of shares needed to qualify for submission in the first instance. Nonetheless, the Rule did not require that proponents provide evidence of continued ownership or revalue the securities during the post-submission period.[42]

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35. Am. Elec. Power Co., Inc., SEC No-Action Letter, 1977 WL 13926.

36. *Id.*

37. *Id.*

38. *See* Exchange Act Release No. 20091A (Aug. 16, 1983).

39. *Id.* ("Many of those commentators expressed the view that abuse of the security holder proposal rule could be curtailed by requiring shareholders who put the company and other shareholders to the expense of including a proposal in a proxy statement to have some measured economic stake or investment interest in the corporation. The Commission believes that there is merit to those views and is adopting the eligibility requirement as proposed.").

40. *Id.*; *see also* Bevis Longstreth, *The S.E.C. and Shareholder Proposals: Simplification in Regulation*, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶83,067, at 84,708 (Dec. 23, 1981) (pioneering the idea that "the limitation is intended to assure that shareholders seeking to use the process are indeed investors… rather than activists of one kind or another using a share of stock as the passkey to the proxy bullhorn.").

41. Council of Institutional Investors, *Facilitating Director Nominations (File No. S7-10-09)*, U.S. SECURITIES AND EXCHANGE: ENFORCEMENT (Feb. 2, 2018), www.sec.gov/comments/s7-10-09/s71009-78.pdf.

42. Shareholders had to own at least $1000 worth of voting securities at the time of submission, an amount eventually raised to $2000. *See* Rule 14a-8, 17 C.F.R. 240.14a-8 (minimum dollar amount or 1% of shares, which ever was less). Investments could conceivably decline in value following submission of the proposal. For purposes of the "post-submission threshold," however, the Rule never required an updated valuation of the shares. In theory, therefore, shareholders may have retained ownership that, at the time of the meeting, would not have been adequate to qualify for submission of the proposal.

Subsequent amendments clarified the documents required to establish the ownership threshold and holding period.[43] In particular, the Commission amended the Rule in 1987 to highlight the obligation to "submit a written statement" of intent "to continue beneficial ownership through the meeting date."[44] Absent that representation, proposals could be excluded.

B. Final Revisions

The Commission eventually rewrote the Rule into plain English.[45] At the same time, the ownership threshold increased to $2,000[46] to "improve the efficiency of the [proxy] process" and to "adjust for the effects of inflation."[47] The new "Question & Answer" format of the Rule provided companies with "clearer guidance." With respect to the post-submission holding period, the revised Rule continued to require an "affirmation of intent" to hold shares through the date of the meeting. Any failure "in [the owner's] promise to hold the required number of securities" would allow the company "to exclude all of [the owner's] proposals from its proxy materials for any meeting held in the following two calendar years."[48]

II. STAFF INTERPRETATIONS

Although rarely addressing the post-holding period,[49] the Commission has rigorously enforced the requirement. The Staff has allowed ex-

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43. *See* Exchange Act Release No. 25217 (Dec. 21, 1987) ("At that time, the proponent also must provide the registrant in writing with his or her name, address, the number of the registrant's voting securities held of record or beneficially, the dates on which the securities were acquired, and, in the case of beneficial ownership, documentary support for such a claim. If the proponent fails initially to furnish documentary support for a claim of beneficial ownership, the registrant must request such support before the proposal is excludable under the Rule."); *see also* Exchange Act Release No. 24403 (June 4, 1987) ("a written representation by an independent third party, such as a depository, a record holder, or broker-dealer holding the securities in street name, of the proponent's holding of the registrant's securities for the relevant one year time period would be considered appropriate documentation for a proponent's beneficial ownership claim.").

44. Exchange Act Release No. 25217 (Dec. 21, 1987) (The Commission emphasized that "[r]egardless of the form of documentation utilized, the proponent is required to submit a written statement that he intends to continue beneficial ownership through the meeting date.").

45. *See* Exchange Act Release No. 23200 (May 21, 1998).

46. *Id.*

47. Proponents, however, could still satisfy the eligibility requirements with proof of ownership of 1% of the company's voting securities for at least one year before the date of submission. Exchange Act Release No. 39093 (Sept. 18, 1997) ("We sought to avoid increasing the threshold further out of concern that a more significant increase could restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in maintaining channels of communication with management and fellow shareholders."); Exchange Act Release No. 23200 (May 21, 1998) ("There was little opposition to the proposed increase among commenters... [and] [t]here was no significant support for any modifications to the rule's other eligibility criteria, such as the one-year continuous ownership requirement."); Sean Patrick O'Brien, *The 1983 Amendments to SEC Rule 14A-8: Upsetting a Precarious Balance*, 19 VAL. U. L. REV. 221, 224 (1984).

48. Amendments to Rules on S'holder Proposals, Release No. 23200 (May 21, 1998).

49. This statement was made by a company seeking omission. The LTV Corp., SEC No-Action Letter, 2000 WL 217919 ("Because the ownership requirement in the Rule is so clear and

clusion of proposals where the representation of continued ownership has been deemed inadequate. The Staff has not, however, permitted challenges to these representations on the basis of their credibility.[50]

A. Continuous Retention

The Commission developed a practice, outside the language of the Rule, that allowed for immediate exclusion of a proposal upon a showing that the proponent did not intend to maintain continuous ownership.[51] In *Centerior Energy Corporation*,[52] the proponent sought inclusion in the company's proxy materials then sold "all securities held of record." The proponent failed to respond to the company's request to provide evidence of beneficial ownership of shares. In those circumstances, the Staff permitted exclusion.[53]

Similarly, shareholders must maintain an "economic interest" through the date of the meeting, something not accomplished in the case of a revocable proxy.[54] In *LTV Corp.*,[55] a proxy holder submitted a letter stating that his fully revocable proxies gave him "the requisite interest" in the company.[56] The company argued that the instrument provided "no assurance that the proxies will not be revoked and, therefore, no assurance that [the proxy owner] will hold his interests through the date of the 2000 Annual Meeting."[57] The Commission granted the relief, reasoning that the proponent failed to provide "a written statement regarding his or her intent to hold LTV's common stock through the date of the shareholder meeting."[58]

Proponents must commit to holding a sufficient investment; merely agreeing to remain an investor will not suffice. In *EMC2*,[59] the proponent

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because the requirement so clearly mandates a specific economic stake that must be continuously held as a threshold for eligibility, the Staff has not had to respond to many no-action letter requests on this requirement. When it has, it has reiterated the Commission's position set forth in the 1983 Release.").

50. Transocean Ltd., SEC No-Action Letter, 2013 WL 178201.

51. The SEC response was not available when the letter was obtained by Thomas Reuters. This following argument was made by a company seeking omission. The S. Co., SEC No-Action Letter, 2015 WL 274203 ("Since the proponents sold their shares and *repurchased* them on the following day, they were disqualified from being eligible to submit a proposal because they did not "demonstrate that they maintained continuous ownership of the Company's stock for the full one-year period preceding and including the date they submitted the Proposal.").

52. Centerior Energy Corp., SEC No-Action Letter, 1991 WL 176607.

53. *Id.*

54. The LTV Corp., SEC No-Action Letter, 2000 WL 217919 ("The key requirement for eligibility is that you have an economic interest in the Company by owning stock in the Company. The proxies purporting to grant you voting power do not meet that requirement because they don't give you ownership in Company stock. Without an investment in Company stock, you cannot submit a stockholder proposal.").

55. *Id.* (Fully revocable proxies fail to ensure an intent to continue to hold the securities through the date of the shareholder meeting.).

56. *Id.*

57. *Id.*

58. *Id.*

59. EMC2, SEC No-Action Letter, 2002 WL 571685.

submitted a statement that he intended to "continue to be an investor" through the date of the annual meeting. The company argued that the statement was insufficient because the proponent merely "could sell all but one share... [and] continue to be an investor."[60] The Commission granted the company's request to exclude the proposal "in reliance on rule 14a-8(b)" but was unable to concur with some of the company's other grounds for exclusion.[61]

The Staff has left unaddressed whether shareholders can eliminate the post-submission holding period. In *McDonalds Corp.*,[62] the proponent requested that the board adopt a bylaw allowing the company to include proposals submitted by proponents who sold their shares before the meeting and therefore "no longer maintain[ed] any investment interest."[63] The company reasoned that:

> [t]he idea that the Board would be required to include in the Company's proxy materials a proposal submitted by a proponent who no longer held shares at the time of the Company meeting is … plainly inconsistent with the well-established paradigm that the proxy should closely approximate the shareholder meeting: '[o]ur regulations have been designed to facilitate the corporate proxy process so that it functions, as nearly as possible, as a replacement for an actual, in-person gathering of security holders 'to control the corporation as effectively as they might have by attending a shareholder meeting... Nothing could be more clearly antithetical to this principal than requiring shareholders to vote on a proposal offered by a proponent who is not even a shareholder at the time of the shareholder meeting.[64]

The proposal was withdrawn and the Commission did not address the matter.[65]

B. Representations of Continuous Ownership

Some companies have challenged as inadequate statements addressing the post-submission holding period made by the record owner rather

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60. *Id.*
61. *Id.*
62. McDonald's Corp., SEC No-Action Letter, 2008 WL 308206.
63. *Id.* (The company reasoned that "[t]he Proposal, if implemented, would ... [have] force[d] the Company to completely disregard the Commission's policy concerns by requiring the Board to include in the proxy materials and consider at annual meetings shareholder proposals submitted by proponents who, at the time of the annual meeting, no longer own shares of, and hence no longer maintain any investment interest in, the Company.").
64. The proponent ultimately withdrew the proposal and the Commission did not comment on the matter. *Id.* (Comments from the issuer's letter quoting Securities Exchange Act Release No. 34-56160 (July 27, 2007) at 10-11.).
65. *But see* Securities Exchange Act Release No. 34-56160 (July 27, 2007) ("[o]ur regulations have been designed to facilitate the corporate proxy process so that it functions, as nearly as possible, as a replacement for an actual, in-person gathering of security holders 'to control the corporation as effectively as they might have by attending a shareholder meeting.'").

than the proponent.[66] In *Milacron, Inc.*,[67] the proponent, a beneficial owner, did not submit a written statement of intent. The record holder of the securities, however, represented that the proponent "intend[ed] to retain ownership of at least $2000 worth of [the company's] common stock through the date of [the company's] 2005 annual meeting." The company reasoned that the statement did "not fulfill the requirement that a statement of written intent be received from the [p]roponent." The shareholder, however, withdrew the proposal before the Commission responded.[68]

Companies have sometimes challenged statements of continuous ownership as excessively vague. In *Wal-Mart Stores, Inc.*,[69] the cover letter accompanying the proposal provided that the proponent "plan[ed] o continue ownership through the date of the 2014 annual meeting."[70] The company asserted, however, that the proponent needed to remedy this defect by subsequently submitting "a written statement that it intends to continue holding the requisite number of Company shares" through the date of the company's annual meeting.[71] The proponent, however, withdrew the proposal before the Staff could address the matter.

The Staff has not granted relief to companies because of the mere possibility that a proponent may, in the future, need to sell the shares. In *Chipotle Mexican Grill, Inc.*,[72] a Fund submitted a "written statement of intent to continue to hold the subject company's securities through the date of the meeting."[73] The company argued that the Fund "failed to meet its burden of proof that it intends to hold the requisite" securities through the meeting because, "if the company were omitted from the S&P 500 index . . . the Fund's publicly-advertised investment strategy" would require the Fund to dispose of its company securities.[74] The Fund's trust documents, however, provided that if the S&P "drops a company from

66. Amendments to Rules on S'holder Proposals, Release No. 23200 (May 21, 1998) (Proponents are required to submit a "written statement" that they "intent to continue ownership of the shares through the date of the company's annual or special meeting."); Bank of Am. Corp., SEC No-Action Letter, 2015 WL 81901; *see also* Pfizer Inc., SEC No-Action Letter, 2011 WL 550008 ("Staff guidance demonstrates that it is not sufficient to submit written statements of a proponent's ownership of a company's securities other than from the record holder of such securities.").

67. Milacron Inc., SEC No-Action Letter, 2005 WL 484380.

68. *Id.*

69. Wal-Mart Stores, Inc., SEC No-Action Letter, 2014 WL 409084.

70. *Id.*

71. *Id.*

72. Chipotle Mexican Grill Inc, SEC No-Action Letter, 2013 WL 1654723.

73. *Id.* (the proponent claimed that "Chipotle seems to be inviting the Division to wade deeply into questions of a proponent's "intent" and to make factual findings based on written submissions.").

74. *Id.* (the company asserted that "in view of the Fund's public indications regarding its investment strategy, any statements of its intent to own the Company's securities through the date of the annual meeting are implicitly qualified by the Fund's descriptions of its investment strategy -- most notably its statements that the Fund will "invest in all the stocks that are contained in the targeted S&P Index" and "will... rebalance the equity index strategies due to changes in the composition of the applicable index.").

an index whose shares a Fund is using to make a proposal, the Fund will maintain enough shares to maintain the requirement of continuously holding $2000 of shares through the date of the meeting."[75] The Staff did not grant the requested relief.

C. The Credibility of Representations of Continuous Ownership

Companies have also challenged the credibility of "affirmations of intent" of an intent to hold shares through the date of the meeting on the basis of public information.[76] In *Transocean Ltd.*,[77] the proponent expressed the requisite intent to continue to hold shares through the date of meeting. The statement, however, did not confirm both voting authority and investment discretion over the shares. The company argued that "the Fund may have surrendered investment discretion over the shares to certain other entities"[78] As a result, the proponent "provided [no] evidence that it may vote the shares of the company that it claims to hold."[79]

The proponent asserted that the claim entailed a challenge to the credibility of the representation of continuous ownership. Describing the challenge as "novel," the shareholder asserted that the claim, if allowed to prevail, "would undermine the Rule 14a-8 shareholder proposal process and create much more work for both shareholders and the Staff."[80] The Commission allowed exclusion on other grounds without addressing the issue.[81]

A similar argument was made a few months later. In *National Fuel*,[82] an investment manager submitted a proposal "on behalf of" the Social Justice Fund Northwest (Fund), the beneficial owner of the shares.[83] The Fund made the required commitment to meet the post-submission holding period. The company, however, claimed that the proponent had not adequately established the ability to "exercise voting authority or investment discretion."[84] The company reasoned that "a pro-

75. *Id.*

76. Transocean Ltd., SEC No-Action Letter, 2013 WL 178201. (The proponent expressed the requisite intent to continue to hold shares through the date of meeting. The statement, however, did not confirm both voting authority and investment discretion over the shares. The company argued that the proponent "may have surrendered investment discretion" and, therefore, did not provide a "credible" statement of ownership.).

77. *Id.*

78. *Id.*

79. *Id.*

80. Argued by a Proponent seeking inclusion. *Id.*

81. *Id.*

82. Nat'l Fuel Gas Co., SEC No-Action Letter, 2013 WL 5864640 (decision rendered 9 months after Transocean).

83. The Commission granted exclusion because "the proponent provided a written statement erroneously verifying beneficial ownership of 'Transocean Management Ltd.' [rather than] . . . Transocean Ltd." *Id.*

84. The proponent referenced *Transocean Ltd.* (Mar. 15, 2013) as a supplementary argument urging the Staff not to "begin an expedition" into "unchartered minutiae of share ownership structures and arrangements." *Id.*

ponent that has surrendered its investment discretion . . . cannot credibly claim any intent to continue to hold the securities through the date of the company's meeting."[85] The company, however, included the proposal and the Commission did not address the issue.[86]

III. ANALYSIS: WHOSE SKIN IS IN THE GAME?

The Rule contains two holding periods. Proponents must have held shares for the twelve-month period prior to submission of a proposal. In addition, they must meet a post-submission holding period that requires continuous ownership through the date of the meeting. The Commission has traditionally justified the first holding period as necessary to ensure that investors submitting proposals have a long-term interest in the company.

The same rational, however, does not justify the second holding period. The need to ensure a long-term perspective occurs at the time of submission. Continued ownership through the date of the meeting does not alter or enhance this perspective. Nor can the post-submission holding period be justified as necessary to ensure that the proponent attends the meeting and answers questions posed by shareholders. Even absent continuous ownership, the Rule mandates attendance by the proponent.[87]

At the same time, the post-submission holding period imposes unnecessarily harsh penalties on shareholders. The provision applies irrespective of the reasons for selling the shares. In some cases, proponents may have legal obligations to sell. Investment advisors and pension plans have fiduciary obligations towards their beneficiaries.[88] These obligations may trigger a duty to sell shares that results in the application of the two-year time-out penalty.[89] In addition, the penalty applies even when the shareholder quickly repurchases the shares and, on the date of the meeting, has a significant holding in the company.

The post-submission holding period also presents a number of logistical difficulties. First, the Commission never reconciled the pre- and post-submission holding periods. If voting shares are sold before the

85. *Id.* (explaining that "If the present challenge were allowed to prevail, it would undermine the Rule 14a-8 shareholder proposal process and create much more work for both shareholders and the Staff.").

86. *Id.* (Despite the company's efforts to explain that the proponent is "incapable of fulfilling the eligibility requirements" the company eventually included the proposal and the Commission did not address the issue.).

87. 17 C.F.R. § 240.14a-8(h)(1) (2012). To the extent that state law required continuous ownership as a condition of attending the meeting and making a proposal, the need for a post-submission holding period would already exist, without the need for an explicit requirement in Rule 14a-8.

88. *See* Lori A. Richards, *Fiduciary Duty: Return to First Principles*, SPEECH BY SEC STAFF: U.S. SECURITIES AND EXCHANGE COMMISSION, Feb. 27, 2006 ("Fiduciary duty is the first principle of the investment adviser — because the duty comes not from the SEC or another regulator, but from common law.").

89. Transocean Ltd., SEC No-Action Letter, 2013 WL 178201.

meeting, the proponent will not likely meet the pre-submission holding period the following year.[90] As a result, the provision does not actually impose a multi-year penalty. Only in the second year will proponents incur the consequences of having sold voting shares before the meeting.[91] The deterrent effect of a time-out penalty applicable only once, two years in the future, remains unclear.

Second, the post-submission holding period presents issues of verification that can result in inconsistent application. With respect to record owners, companies can easily confirm the sale of shares prior to the meeting.[92] The "vast majority of investors in . . . U.S. companies, however, are beneficial owners"[93] who are not listed on the company's stock ledger.[94] As a result, companies will not have an easy mechanism for determining whether beneficial owners[95] "continuously owned" the

90. Proponents must submit proposals at least 120 days before the date of the prior year's proxy distribution date. They must have held the shares for twelve consecutive months on the submission date. 17 C.F.R. § 240.14a-8(e)(2) (2012) ("The proposal must be received at the company's principal executive officers not less than 120 calendar days before the date of the company's proxy statement released to shareholders in connection with the previous year's annual meeting."). Consequently, proponents who sell the shares after submission but before the annual meeting will likely not meet the twelve-month holding period the following year. The lack of eligibility eliminates the need for a "penalty" resulting from premature sale of the shares.

91. Proponents who divest of their shares before the annual meeting cannot submit a proposal the following year because, by divesting of their interests, they will not satisfy the requisite twelve month holding period necessary for eligibility the following year. For example, a proponent who submits a proposal in October and sells their shares in November before the company's annual meeting will not satisfy the Rule's ownership requirements the following year. Even if the same proponent buys back their shares the following day, they will not satisfy the one-year continuous ownership requirement if they seek to submit a proposal the preceding October because they will not have held their shares for twelve consecutive months.

92. With respect to evidence of the pre-submission holding period, proponents must provide a letter from the relevant broker and a written statement of intent to hold the securities through the date of shareholder meeting. *See* Staff Legal Bulletin No. 14 (July 13, 2001) ("The shareholder must provide this written statement regardless of the method the shareholder uses to prove that he or she continuously 2001 owned the securities for a period of one year as of the time the shareholder submits the proposal."); McDonald's Corp., SEC No-Action Letter, 2008 WL 308206; Comcast Corp., SEC No-Action Letter, 2015 WL 274199 ("If a shareholder is a registered owner, the company can independently confirm that the shareholder's holdings satisfy Rule 14a-8(b)'s eligibility requirement."); *see also* Bank of Am. Corp., SEC No-Action Letter, 2015 WL 81901 (finding that the proponents written statement that they "intend to hold the securities through the date of the 2015 annual meeting" needed to be revised and state that the proponent "intends to continue to hold the required number of Company shares through the date of the Company's Annual Meeting of Stockholders.").

93. Bank of Am. Corp., SEC No-Action Letter, 2015 WL 81901 ("[A] beneficial owner can provide proof of ownership to support his or her eligibility to submit a proposal by submitting a written statement "from the 'record' holder of [the] securities (usually a broker or bank)," verifying that, at the time the proposal was submitted, the shareholder held the required amount of securities continuously for at least one year.").

94. The Brink's Co., SEC No-Action Letter, 2014 WL 556034 ("The vast majority of investors in shares issued by U.S. companies, however, are beneficial owners, which means that they hold their securities in book-entry form through a securities intermediary, such as a broker or a bank... Rule 14a-8(b)(2)(i) provides that a beneficial owner can provide proof of ownership to support his or her eligibility to submit a proposal by submitting a written statement "from the record' holder of [the] securities (usually a broker or bank)," verifying that, at the time the proposal was submitted, the shareholder held the required amount of securities continuously for at least one year.").

95. The term "beneficial owner" is not defined in Rule 14a-8. Rule 14a-13 refers to beneficial owners as those who own securities that are "held of record by a broker, dealer, voting trustee, bank,

shares.[96] Beneficial but not record owners violating the requirement may therefore go undetected and avoid application of the time-out penalty.

Finally, the provision interferes with the goal of having the Rule align with state law.[97] The Commission has sought to use the Rule to "better facilitate shareholders' effective exercise of their traditional state law rights."[98] In connection with the annual meeting, state law provides authority to make proposals and vote shares on the record date. State law does not explicitly require that shareholders also own the shares on the date of the meeting.[99] The post-submission holding period therefore imposes an obligation not mandated by state law.

The Commission should repeal the obsolete provision. The post-submission holding period and its adjoining two-year penalty imposes unnecessary burdens on shareholders, provides few actual benefits, and prevents the Rule from aligning with state law.[100] Moreover, as a practi-

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association, or other entity that exercises fiduciary powers in nominee name or otherwise." 17 C.F.R. § 240.14a-13.

96. The Brink's Co., SEC No-Action Letter, 2014 WL 556034. *See also* Comcast Corp., SEC No-Action Letter, 2015 WL 274199 ("If a shareholder is a registered owner, the company can independently confirm that the shareholder's holdings satisfy Rule 14a-8(b)'s eligibility requirement."); WD-40 Company, SEC No-Action Letter, 2016 WL 4436137 ("If the DTC participant knows the proponent's broker or bank's holdings, but does not know the proponent's holdings, the proponent can satisfy Rule 14a-8 by obtaining and submitting two proof of ownership statements verifying that, at the time the proposal was submitted, the required amount of shares were continuously held for at least one year - one from the proponent's broker or bank confirming the proponent's ownership, and the other from the DTC participant confirming the broker or bank's ownership."); Robert S. Karmel, *Voting Power Without Responsibility or Risk: How Should Proxy Reform Address the Decoupling of Economic and Voting Rights?*, 55 VILL. L. REV. 93, 119 ("The existence of stock ownership requirements creates issues regarding the computation and proof of stock ownership.").

97. Investment Company Act Release No. 28765 (June 10, 2009), FED. SEC. L. REP. P 88639 ("Based on the feedback we have received over the last few years, it appears that the federal proxy process may not be adequately replicating the conditions of the shareholder meeting. Second, we believe that parts of the federal proxy process may unintentionally frustrate voting rights arising under state law, and thereby fail to provide fair corporate suffrage. These two potential shortcomings in our regulations provide compelling reasons for us to reform the proxy process and our disclosure requirements relating to director nominations."); *see also* Mark J. Roe, Delaware's Competition, 117 HARV. L. REV. 588, 590, 633 (2003) ("[N]otwithstanding the internal affairs doctrine, the federal government can displace state corporate law, and rather easily. Legislation can preempt state corporate law, and it has. Judicial interpretation of open-ended legislation can leave little or no room for state corporate law, and it has. And the securities laws themselves can directly pull corporate law issues away from the states, and they have for voting and more.").

98. Exchange Act Release No. 34-62764 (Aug. 25, 2010). *See also* Exchange Act Release No. 34-56160 (July 27, 2007) ("[A]n important function of the proxy rules is to provide a mechanism for shareholders to present their proposals to other shareholders, and to permit shareholders to instruct their proxy how to vote on these proposals. Our regulations have been designed to facilitate the corporate proxy process so that it functions, as nearly as possible, as a replacement for an actual, in-person gathering of security holders, thus enabling security holders 'to control the corporation as effectively as they might have by attending a shareholder meeting.'").

99. Commonwealth Assocs. v. Providence Health Care, Inc., 641 A.2d 155, 158 (Del. Ch. 1993) ("This holding... does not purport to recognize any obligation on the part of the corporation to recognizer the rights of a post-record date acquirer who has for some reason failed to obtain a proxy to which it may be entitled.").

100. To the extent that state law requires continued ownership, even after the record date, to make a proposal at a meeting, the requirement in the Rule that shareholders actually attend the meeting will effectively result in the creation of a post-implementation holding period. The period, however, will depend upon state law rather than the language of Rule 14a-8.

cal matter, selling shareholders will often not meet the holding period requirements the following year, essentially resulting in a one-year time out without the need to impose an additional penalty.[101]

At a minimum, the Commission should amend the Rule to include a "good cause" exception. Shareholders who, in good faith, intend to retain the shares through the date of the meeting but are subsequently compelled to sell, should not be subject to the two-year penalty. Moreover, the Staff has experience applying good cause exceptions to other requirements in the Rule.[102]

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101. *See* Exchange Act Release No. 34-12999, *supra* note 34 and accompanying text.
102. 17 C.F.R. §§ 240.14a-8(h)(3), 240.14a-8(j)(1) (2012).

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