

rules, including rules that go beyond disclosure.

⁵See Adoption of Amendments to Proxy Rules, Release No. 34-4979 (Jan. 6, 1954) [19 FR 246 (Jan. 14, 1954)]. Other procedural requirements, including the initial submission thresholds, were last substantively updated in 1998. See Amendments to Rules on Shareholder Proposals, Release No. 34-40018 (May 21, 1998) [63 FR 29106 (May 28, 1998)].

⁶See Marcel Kahan and Edward Rock, *Embattled CEOs*, 88 Tex. L. Rev. 987 (2010).

⁷See U.S. Department of the Treasury, *A Financial System that Creates Economic Opportunities: Capital Markets* (Oct 2017), available at <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>.

⁸See Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5325 (Aug. 21, 2019) [84 FR 47420 (Sept. 10, 2019)].

⁹See Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Release No. 34-86721 (Aug. 21, 2019) [84 FR 47416 (Sept. 10, 2019)].

¹⁰See, e.g., Item 404 of Regulation S-K [17 CFR § 229.404].

¹¹The proposed shareholder thresholds would still make it significantly easier for a shareholder to submit a proposal in the United States than in most European countries where shareholders are required to own between 0.5% and 5% of a company in order to be able to submit a proposal. See Maximilian Horster, and Kosmas Papadopoulos, *Climate Change and Proxy Voting in the U.S. and Europe*, Harvard Law School Forum on Corporate Governance and Financial Regulation (Jan. 7, 2019), available at <https://corpgov.law.harvard.edu/2019/01/07/climate-change-and-proxy-voting-in-the-u-s-and-europe>.

¹²Nickolay Gantchev & Mariassunta Giannetti, *The Costs and Benefits of Shareholder Democracy* 8-9, 37 (European Corporate Governance Institute, Working Paper No. 586/2018, 2018).

SEC/SRO UPDATE: SEC PROPOSES AMENDMENTS TO MODERNIZE SHAREHOLDER PROPOSAL RULE; SEC ADOPTS NEW RULE TO ALLOW ALL ISSUERS TO “TEST-THE-WATERS”; SUPREME COURT AGREES TO HEAR *LIU V. SEC*

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SEC Proposes Amendments to Modernize Shareholder Proposal Rule

On November 5, the Securities and Exchange Commission (“SEC”) proposed five rule amendments to modernize the shareholder proposal rule (Rule 14a-8 under the Securities Exchange Act of 1934).¹ The proposed amendments would, if adopted, revise Rule 14a-8 both substantively and procedurally. The amendments are subject to a 60-day comment period.²

Background

A company subject to the federal proxy rules must include in its proxy statements any properly submitted shareholder proxy proposals in compliance with, among other things, Rule 14a-8. By giving

shareholder-proponents the ability to have their proposals included alongside management's proposals in the company's proxy statement, Rule 14a-8 seeks to provide shareholders the opportunity to easily present their proposals to other shareholders at little or no expense.³

Pursuant to Rule 14a-8, a company may exclude a shareholder proposal from its proxy statement if the proposal fails to meet certain substantive requirements, eligibility criteria, or other procedural requirements.

Amendment to Rule 14a-8(b)—Eligibility Requirements

Current Rule: To be eligible to submit a proposal, a shareholder must have continuously held at least \$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 as of the date the shareholder submits the proposal, and must continue to hold those securities through the date of the shareholder meeting.

Amendments: To submit a Rule 14a-8 proposal, the shareholder must have continuously held at least:

- \$2,000 of the company's securities entitled to vote on the proposal for at least three years;
- \$15,000 of the company's securities entitled to vote on the proposal for at least two years; *or*
- \$25,000 of the company's securities entitled to vote on the proposal for at least one year.

The 1% threshold has been eliminated. Additionally, the shareholder submitting a proposal for inclusion must provide a statement that he or she is able to meet with the company in person or via teleconference no less than 10 calendar days, nor more than 30 calendar days, after submission of their proposal. The shareholder must also provide contact information

and available business days and times to discuss the proposal with the company.

Finally, any shareholder using a representative to submit a proposal will be required to provide documentation clarifying that the representative is authorized to act on the shareholder's behalf and provide "a meaningful degree of assurance as to the shareholder-proponent's identity, role, and interest in the proposal."⁴

SEC Reasoning: The SEC believes that "holding \$2,000 worth of stock for a single year does not demonstrate enough of a meaningful economic stake or investment interest in a company to warrant the inclusion of a shareholder's proposal . . . a longer holding period is particularly important if the dollar value of the ownership interest is minimal because a person seeking to misuse the shareholder-proposal process could more easily purchase the smallest possible stake in a company to take advantage of the process."⁵

Amendment to Rule 14a-8(c)—Permitted Number of Proposal Submissions

Current Rule: Each shareholder may submit no more than one proposal to a company for a particular shareholders' meeting.

Amendment: Each person may submit no more than one proposal, directly or indirectly, to a company for a particular shareholders' meeting.

SEC Reasoning: Under the amendment, a shareholder may not submit one proposal in its own name and simultaneously serve as a representative to submit a different proposal on another shareholder's behalf. Additionally, a representative would not be permitted to submit more than one proposal, even if the representative would be submitting each proposal on behalf of different shareholders. In the SEC's view, "a shareholder submitting one proposal personally and additional proposals as a representative . . .

, or submitting multiple proposals as a representative . . . , would constitute an unreasonable exercise of the right to submit proposals at the expense of other shareholders and also may tend to obscure other material matters in the proxy statement.”⁶

Amendment to Rule 14a-8(i)(12)— Proposal Resubmission Eligibility Requirements

Current Rule: If the shareholder proposal deals with substantially the same subject matter as another proposal previously included in a company’s proxy materials within the preceding five calendar years, a company may exclude from its proxy materials for any meeting held within three calendar years of the last time it was included, if the proposal received:

- Less than 3% of the vote if proposed once within the preceding five calendar years;
- Less than 6% of the vote on its last submission to shareholders if proposed twice previously within the preceding five calendar 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 calendar years.

Amendment: The 3%, 6%, and 10% thresholds of the current rule are revised to 5%, 15%, and 25%, respectively. In addition, proposals previously voted on by shareholders three or more times in the preceding five calendar years that would not otherwise be excludable under the amended 25% threshold could still be excluded by a company if *i*) the most recently voted on proposal received less than majority of the votes cast; *and ii*) support declined by 10% or more compared to the immediately preceding shareholder vote on the matter (the Momentum Requirement).

SEC’s Reasoning: The increases to the resubmission thresholds “are intended to reduce the number

of proposals eligible for resubmission that have little or no chance of gaining meaningful, or majority, shareholder support while still providing shareholders with the opportunity to build support for their proposals.”⁷ The Momentum Requirement is intended to “relieve management and shareholders from having to repeatedly consider, and bear the costs related to, matters for which shareholder interest has declined.”⁸

SEC Adopts New Rule to Allow All Issuers to “Test-the-Waters”

On September 26, the SEC adopted new Rule 163B and related amendments under the Securities Act of 1933, permitting the expanded use of “test-the-waters” communications to all prospective issuers.⁹ The SEC had previously proposed in February to expand the “test-the-waters” modernization reform that would allow all prospective issuers, not just emerging growth companies (“ECGs”), to communicate with potential investors in order to gauge market interest prior to filing a registration statement with the SEC.¹⁰

In 2012, Congress passed the Jumpstart Our Business Startups Act (the “JOBS Act”), which created a new class of issuers—ECGs—with less than \$1 billion in annual revenues. The JOBS Act lessened the restrictions under Section 5 of the Securities Act on communications from ECGs by permitting ECGs to solicit, orally or by written communication, nonbinding indications of interest from potential investors. The purpose of lessening restrictions on pre-registration communications from ECGs was to “foster capital formation in the public markets.”¹¹

The adoption of new Rule 163B is intended facilitate additional domestic, capital-raising transactions by providing additional flexibility for larger issuers in the offering process. New Rule 163B, available to all issuers, is summarized below:¹²

- Any issuer is permitted to engage in oral or

written communications with potential investors that are, or are reasonably believed to be, qualified institutional buyers¹³ or institutional accredited investors.¹⁴ In order to provide issuers with flexibility, Rule 163B does not specify the steps an issuer is to take to establish reasonable belief. The basis for reasonable belief must be “appropriate in light of the facts and circumstances of each contemplated offering and each potential investor.”¹⁵

- Communications with potential investors under Rule 163B are not required to be filed with the SEC. However, the SEC noted that it or its staff, when reviewing offerings, could request an issuer to furnish any “test-the-waters” communications used in connection with the offering.
- “Test-the-waters” communications are not required to include any specified legends.
- “Test-the-waters” communications are exempt under Sections 5(b)(1) and 5(c) of the Securities Act, but are subject to Section 12(a)(2) liability¹⁶ in addition to the anti-fraud provisions of the federal securities laws.
- Rule 163B is non-exclusive and issuers may continue to rely on other rules or exemptions regarding communications with investors under the Securities Act.
- The proposed rule observed that information in a Rule 163B communication must not conflict with material information in the related registration statement. The SEC clarified this statement in the final rule by noting the possibility that circumstances may change between the time the pre-filing Rule 163B communication is made and the time of filing to reflect a change in circumstances or offering terms. General material information about the issuer itself—

such as financial condition and performance, business operations and strategy, and information about management—will remain consistent between the “test-the-waters” communication and the filing. However, the statement that a Rule 163B communication must not conflict with material information contained in the related registration statement is intended to provide guidance and is not a condition to the availability of Rule 163B.

Supreme Court Agrees to Hear *Liu v. SEC*

On November 1, the U.S. Supreme Court agreed to hear a case about whether the SEC may seek and obtain disgorgement from a court as “equitable relief” for a securities law violation even though the Supreme Court has held that such disgorgement is a penalty.¹⁷

In 2016, the SEC brought a civil action against Charles Liu and Xin Wang, alleging that the couple had obtained about \$27 million from 50 Chinese investors who wanted to avail themselves of the federal EB-5 visa program that provides immigration visas to foreigners who invest at least \$500,000 in businesses that create jobs in the United States.¹⁸ According to the SEC, Liu and Wang told the investors that the funds would be used to build a cancer-treatment center, but instead they transferred most of the money to their own overseas accounts.

In 2017, the SEC won a ruling in a federal district court in California that required Liu and Wang to disgorge almost \$27 million, the same amount they raised from the foreign investors. The U.S. Court of Appeals for the Ninth Circuit upheld the decision of the lower court.¹⁹

The case will likely be scheduled for argument before the Supreme Court in early in 2020, with a decision to follow by summer.

ENDNOTES:

¹See SEC Press Rel. No. 2019-232, available at <https://www.sec.gov/news/press-release/2019-232>.

²See SEC Proposed Rule Rel. No. 34-87458 (Nov. 6, 2019), available at <https://www.sec.gov/rules/proposed/2019/34-87458.pdf>.

³SEC Proposed Rule Rel. No. 34-87458 (Nov. 6, 2019) at 6.

⁴SEC Proposed Rule Rel. No. 34-87458 (Nov. 6, 2019) at 31.

⁵SEC Proposed Rule Rel. No. 34-87458 (Nov. 6, 2019) at 19-20.

⁶SEC Proposed Rule Rel. No. 34-87458 (Nov. 6, 2019) at 38.

⁷SEC Proposed Rule Rel. No. 34-87458 (Nov. 6, 2019) at 52.

⁸SEC Proposed Rule Rel. No. 34-87458 (Nov. 6, 2019) at 58.

⁹See SEC Press Rel. No. 2019-188, available at <https://www.sec.gov/news/press-release/2019-188>.

¹⁰See SEC Press Rel. No. 2019-14, available at <https://www.sec.gov/news/press-release/2019-14>.

¹¹See SEC Press Rel. No. 2019-14.

¹²See SEC Final Rule Rel. No. 33-10699 (effective December 3, 2019), available at <https://www.sec.gov/rules/final/2019/33-10699.pdf>.

¹³As that term is defined in paragraph (a) of 17 CFR 230.144A.

¹⁴Any institutional investor that is also an accredited investor as defined in 17 CFR 230.501.

¹⁵See SEC Final Rule Rel. No. 33-10699, at 28.

¹⁶Section 12(a)(2) provides purchasers of an issuer's securities in a registered offering private rights of action under the Securities Act for materially deficient disclosure in oral communications and prospectuses and imposes liability on sellers for offers or sales by means of an oral communication or prospectus that includes an untrue statement of material fact or omits to state a material fact that makes the statements made, in light of the circumstances under which they were made, misleading.

¹⁷See *Liu v. SEC*, 2019 WL 5659111 (U.S. 2019). See also Bloomberg News, "Supreme Court to Consider Challenge to SEC Disgorgement Powers," Investment News (Nov. 1, 2019), available at <https://www.investmentnews.com/article/20191101/FREE/191109985/supreme-court-to-consider-challenge-to-sec-disgorgement-powers>; and Lawrence Hurley, "U.S. Supreme Court to Review SEC's Power to Recover Ill-gotten Gains" Reuters (Nov. 1, 2019), available at <https://www.reuters.com/article/us-usa-court-sec/u-s-supreme-court-to-review-secs-power-to-recover-ill-gotten-gains-idUSKBN1XB4VD>.

¹⁸See *SEC v. Liu et al.*, Litig. Rel. No. 23556 (June 2, 2019), available at <https://www.sec.gov/litigation/litrelases/2016/lr23556.htm>.

¹⁹See *Securities and Exchange Commission v. Liu*, 754 Fed. Appx. 505, Fed. Sec. L. Rep. (CCH) P 100295 (9th Cir. 2018), cert. granted, 2019 WL 5659111 (U.S. 2019).