THE FALSE OR MISLEADING NATURE OF THE EXCLUSION FOR FALSE OR MISLEADING STATEMENTS UNDER RULE 14A-8(I)(3)

I. INTRODUCTION

Rule 14a-8 of the Securities Exchange Act of 1934, as amended, requires public companies to include shareholder proposals in proxy materials.[1] The provision also contains thirteen grounds for exclusion.[2] Subsection (i)(3) permits the omission of proposals and supporting statements that violate the proxy rules, including those containing "materially false or misleading statements."[3]

Subsection (i)(3) has at least two unique attributes. First, the exclusion applies both to the proposal and to the supporting statement.[4] Despite this, inaccurate information in the supporting statement does not necessarily result in the exclusion of the entire proposal. Second, the provision expressly cross-references, and necessarily relies upon, Rule 14a-9, the antifraud provision set out in the proxy rules.[5] Rule 14a-9 aims to protect investors by forbidding materially false or misleading statements in any proxy communication.[6] Not a strict liability provision, Rule 14a-9 includes a state of mind requirement.[7]

Although the language of the exclusion has hardly changed since its adoption in 1976, the Staff of the U.S. Securities and Exchange Commission's Division of Corporation Finance (the Staff) interpretation has evolved significantly. While the Staff initially employed a narrow approach, the exclusion for false or misleading disclosure eventually emerged as the most frequently employed basis for omitting proposals or portions of proposals from proxy statements. In 2004, however, that changed when the Staff embraced a more objective approach, resulting in a dramatic reduction in the use of the exclusion.[8] Under the current inter-

1. *See* 17 C.F.R. § 240.14a-8 (2011).
2. *Id.*
3. *Id.*
4. *Id.*
5. *See* 17 C.F.R. § 240.14a-9 (2011).
6. *Id*.
7. While the Supreme Court has not determined the requisite state of mind for a violation of Rule 14a-9, or more broadly Section 14(a) of the 1934 Act, most lower courts have held a showing of negligence is sufficient to demonstrate liability under Rule 14a-9. *See, e.g.,* Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1289 (2d Cir. 1973); Herskowitz v. Nutri/System, Inc., 857 F.2d 179, 190 (3d Cir. 1988); Shidler v. All Am. Life & Fin. Corp., 775 F.2d 917, 927 (8th Cir. 1985); *But see* Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 428 (6th Cir.) (holding an element of scienter should be an element of Section 14(a) liability.).
8. *See e.g.*, *infra* note 57.

pretation, the Staff rarely allows for exclusion of shareholder proposals or supporting statements as false or misleading.[9]

This Article traces the administrative interpretation and resulting application of subsection (i)(3). Part II addresses the administrative history prior to 1998. Part III approaches the exclusion through the practical lens of SEC no-action letters after 1998. Finally, Part IV argues that the broad application of subsection (i)(3) differs significantly in practice than the actual language of the provision would suggest.

II. ADMINISTRATIVE HISTORY

A. Pre-1976: The Informal Application of the Anti-Fraud Provisions

The U.S. Securities and Exchange Commission (the Commission or the SEC) has prohibited materially false or misleading statements or omissions in proxy materials since the infancy of the proxy rules.[10] The initial shareholder proposal rule, however, did not directly address the issue.[11] Nonetheless, the Staff took the position that the proxy rules implicitly allowed the exclusion of proposals containing false or misleading disclosure.[12]

For instance, in *United States Steel Corp.*,[13] the proposal accused the company of engaging in employment age discrimination and urged abandonment of such a policy.[14] The issuer sought exclusion of the

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9. Since September 15, 2004, when the SEC released Staff Bulletin No. 14B, there have only been nine occasions when an issuer has successfully argued for partial or total exclusion of a shareholder proposal or supporting statement as false or misleading.

10. In 1938, the SEC adopted the first antifraud provision in the proxy rules. *See* Exchange Act Release No. 1823, 1938 WL 33169 at *4 (Aug. 11, 1938) ("Rule X-14A-5. False or misleading statements. No solicitation subject to Section 14(a) of the Act shall be made by means of any form of proxy, notice of meeting, or other communication containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or omits to state any material fact necessary in order to make the statements therein not false or misleading.").

11. In 1942, the shareholder proposal rule was titled "Rule X-14a-7. Duty of Management to Set For Stockholders' Proposals." Under rule X-14a-7, the only substantive limit on a shareholder's proposal was that it must have been a "proper subject for action by security holders." *See* Exchange Act Release No. 3347, 1942 WL 34864 at *10 (Dec. 18, 1942) ("In the event that a qualified security holder of the issuer has given the management reasonable notice that such security holder intends to present for action at a meeting of security holders of the issuer a proposal which is a proper subject for action by the security holders, the management shall set forth the proposal . . . .").

12. *See* J. Robert Brown, Jr., *The Proxy Rules and Restriction on Shareholder Voting Rights*, 47 SETON HALL L. REV. 45, 46–47 (2016) (proxy cards, for instance, did not have to include matters that violated Rule 14a-9); *see also* Exchange Act Release No. 5200, 1967 WL 88215 at *2 (Dec. 14, 1967) ("Paragraph (c) of the rule has been further amended to provide that a proxy may confer discretionary authority to vote with respect to any proposal omitted from the proxy material pursuant to Rule 14a-8 or 14a-9.").

13. *See* United States Steel Corp., SEC No-Action Letter, 1972 WL 9383 (Feb. 9, 1973).

14. *Id.* at *1 ("Resolved: That the systematic separation of numerous employees with over 10 years service, not eligible for union membership, be discontinued as a company policy." In support of the proposal, the shareholder cited an alleged investigation into the matter be the Department of Labor, which the issuer denied having any knowledge of, and further stated any similar past investigations had not resulted in discipline. *Id.*).

shareholder proposal asserting, among other things, that the submission was "false and misleading within the prohibition of Rule 14a-9 of the Commission's regulation."[15] Specifically, the issuer contended that no employment policy was in place to terminate older workers and the proponent had failed to supply any evidence to the contrary.[16] The Staff agreed and permitted exclusion because, without any supporting evidence, the proposal could mislead shareholders.[17]

Reliance on Rule 14a-9 meant that the exclusion applied only to materially[18] false disclosure made with the required state of mind.[19] The Staff, however, did not give effect to all of the requirements of the anti-fraud provision in the no-action context. Issuers did not have to establish falsity but would seek exclusion of proposals or supporting statements that "may be" as opposed to "are" false or misleading.[20] Nor did issuers have to show that the proponent made the statements with the requisite state of mind.[21]

Reliance on Rule 14a-9 also resulted in the identification of certain categories of problematic disclosures, including statements impugning character.[22] In *Ford Motor Corp*.,[23] a shareholder asserted that franchise

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15. *Id*. at *3.("[I]t is my opinion that the proposal is false and misleading within the prohibition of Rule 14a–9 of the Commission's regulation 14 A governing the solicitation of proxies.").

16. *Id*. ("Insofar as [proponents'] contention in their January 3 letter that the Wage and Hour Division of the Department of Labor is and has been conducting an intensive investigation into this matter, this is not correct.").

17. *Id.* at *5 ("Similarly, there appears to be some basis for your suggestion that the proposal may be in violation of Rule 14a–9, in that it contains statements that might give shareholders the misleading impression that the company has a policy for the systematic separation of employees with over ten years service without providing sufficient factual basis for such statements.").

18. *See* Exchange Act Release No. 4775, 1952 WL 5254 at *9 (Dec. 11, 1952) ("No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication written or oral containing any statement which at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.").

19. *See* Michael J. Hetzer, *Proxy Regulation: Ensuring Accurate Disclosure Through A Negligence Standard*, 50 FORDHAM L. REV. 1423, 1425–30 (1982) ("The three major elements that a plaintiff must prove in a private action under section 14(a) are: (1) that the proxy materials contained a false or misleading statement of a material fact; (2) that the proxy solicitation was an essential link in effecting the proposed corporate transaction; and (3) that the defendant acted with some level of culpability. . . . Several courts have stated that they favor the adoption of a negligence standard, one court has left open the possibility of strict liability, and one court has held that scienter is required.").

20. *See* USM Corp., SEC No-Action Letter, 1973 WL 9183 at *3 (May 23, 1973) (the Staff found statements false or misleading by "implication and innuendo" in violation of Rule 14a-9); *see also* United States Steel Corp., SEC No-Action Letter, 1972 WL 9383 at *5 (Jan. 3, 1972) (entire proposal omitted. "Similarly, there appears to be some basis for your suggestion that the proposal *may* be in violation of Rule 14a–9, in that it contains statements that *might* give shareholders the misleading impression . . . .") (emphasis added).

21. From 1970 to November 22, 1976, the Staff allowed for the partial or total exclusion of fifty-three proposals as false or misleading. In no case did the no-action letters discuss whether the allegedly misleading statements had been made negligently or otherwise.

22. *See* Exchange Act Release No. 5276, 1956 WL 7757 at *4 (Jan. 17, 1956) (adopting amendments to the proxy rules including a note after the text of Rule 14a-9 stating, "[t]he following

dealers sold cars under a false warranty and submitted a proposal creating liquidated damages for those affected by the practice.[24] The issuer argued for omission alleging that the proposal included unsupported charges damaging to the image of the company.[25] The Staff issued no-action relief under 14a-9 because "statements contained in the whereas clauses of [the shareholder's] proposal directly impugn the character, integrity and reputation of all of the Company's dealers without any factual basis."[26]

At the same time, the Staff added elements not present in the anti-fraud rule. Shareholders sometimes received a right to revise proposals or supporting statements to avoid exclusion.[27] The right typically applied to misstatements considered minor.[28] In *Standard Oil Company of California*,[29] the proposal sought to "affirm . . . non-partisanship" by avoiding certain practices with respect to political contributions by employees.[30] In the supporting statement, the proponent cited an alleged instance

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are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this rule: . . . (b) Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation. . . .").

23. *See* Ford Motor Corp., SEC No-Action Letter, 1972 WL 9368 (Nov. 21, 1972).

24. *Id.* at *10 ("WHEREAS, this activity has been detrimental to the good name of Ford Motor Company and has resulted in claims for damages, it is therefore RESOLVED: That any dealer of the corporation which regularly sells products of the corporation shall pay the sum of five thousand dollars ($5,000.00) in damages to the buyer of any FOMOCO vehicles . . . .").

25. *Id.* at *9. ("[Proponent]'s statements contained in the whereas clauses of her proposal directly impugn the character, integrity and reputation of all of the Company's dealers without any factual basis by indicating that all such dealers misrepresent the number of prior owners a used vehicle has had.").

26. *Id.* at *10 ("Similarly, there appears to be some basis for your suggestion that the proposal may be in violation of Rule 14a–9, in that it contains statements that directly impugn the character, integrity and personal reputation of the company's franchised dealers without any supporting factual data.").

27. Initially, a proponent did not have the opportunity to revise a proposal or supporting statement, rather, the Staff only responded to no-action requests in one of two ways: (1) it would not take enforcement action if the company omitted the proposal; or (2) it did not agree with the company's ground for exclusion. In an effort to include more shareholder proposals in a company's proxy statement, however, the Staff adopted a policy allowing limited revisions under certain circumstances. *See* Interview by SEC Historical Society with Peter J. Romeo at 5 (Feb. 20, 2014) [hereinafter *Romeo Interview*] ("[Shareholder proposals] were the only realistic method by which rank and file security holders could get corporate managements to pay attention to their concerns."). Without a formal opportunity to cure, a proponent's only chance to amend its proposal was communication directly with the issuer – largely without success. *See, e.g.,* Exxon Corp., SEC No-Action Letter, 1973 WL 20878 at *5 (Feb. 6 1973) (proponent attempts, without success, to cure the issuer's perceived deficiencies through two-party correspondence in absence of an opportunity to communicate directly with the Staff.).

28. *See Romeo Interview* at 5 ("Innovative ways sometimes were found in these discussions to allow more proposals to be included in proxy statements than had previously been the case. One such method was to allow the proponent of a proposal that was potentially false or misleading in relatively minor respects to revise the proposal to eliminate the concerns raised by the company.").

29. *See* Standard Oil Company of California, SEC No-Action Letter, 1975 WL 9860 (Feb. 13, 1975).

30. *Id.* at *4 ("RESOLVED: That the shareholders of Standard Oil Company of California, assembled in annual meeting in person any by proxy, affirm the political non-partisanship of the company. To this end such practices are to be avoided: (a) The handling of contribution cards of a single political party to an employee by a supervisor. (b) Requesting an employee to send a political

of secret political cash contributions by an officer of the company.[31] The issuer argued the language improperly implied that the act was illegal.[32] The Staff agreed but provided a right to revise.[33] In accordance with the Staff's revisions, the proponent replaced "secret" with "anonymous" contributions.[34]

In part, a proponent's right to revise paralleled the Staff's treatment with respect to issuers.[35] Issuers prefiled proxy materials, providing the Staff with an opportunity to review the contents before distribution.[36] The right to revise proposals extended the same opportunity to shareholders.

The right to revise, however, also limited shareholder's ability to effectively oppose allegations of false or misleading disclosure. The Staff would highlight phrases, sentences, or paragraphs deemed problematic and allow for revision "in a manner that will eliminate any false or misleading statements or implications."[37] The process did not create an additional forum for a shareholder to argue the merits of the revisions or sug-

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contribution to an individual in the Corporation for subsequent delivery as part of a group of contributions to a political party or fund raising committee. . . .").

31. *Id.* ("Under oath former Chairman of the Board . . . testified that the company had given secret cash contributions to defeat an initiative that would have provided funds for mass transit.").

32. *Id.* at *6 ("It appears that there may be some basis also for your position that the third sentence of that paragraph may violate Rule 14a–9 because it implies that the 'secret' cash contributions mentioned therein were illegal.").

33. *Id.* at *5 ("Accordingly, in the absence of direct verification of the allegation in question, this Division believes that the sentence should promptly either be deleted or revised in a manner that will remove any false or misleading statements or implications.").

34. *Id.* at *2 ("We believe that secret and anonymous are synonymous, but will accept the judgment of the SEC if it wishes to have secret changed to anonymous.").

35. *See* Memorandum from Linda Quinn, Bill Morley and John Gorman on Outline for Revisions of Rule 14a-8 to Lee Spencer and John Huber at 17 (Jun. 7, 1983) (on file with the Securities and Exchange Commission Historical Society) [hereinafter *1983 Memo*] ("In this regard it should be noted that the staff practice of permitting proponents to make changes to correct statements which would be violative of Rule 14a-9 is consistent with the staff practice in reviewing preliminary proxy materials filed by issuers.").

36. *See* Exchange Act Release No. 61335, 2010 WL 105669 at *4 (Jan. 12, 2010) ("Rule 14a-6 under the Exchange Act generally requires registrants to file proxy statements in preliminary form at least ten calendar days before definitive proxy materials are first sent to shareholders, unless the items included for a shareholder vote in the proxy statement are limited to matters specified in the rule. During the time before final proxy materials are filed, our staff has the opportunity to comment on the disclosures, and registrants are able to incorporate the staff's comments in their final proxy materials."); *See also* 17 C.F.R. 240 14a-6 (2011) (in its current form, Rule 14-6(a) eliminates the prefiling requirement for proxy statements where the only matters acted on are, among others, "(1) The election of directors; (2) The election, approval or ratification of accountant(s); (3) A security holder proposal included pursuant to Rule 14a–8.").

37. *See* Standard Oil Company of California, SEC No-Action Letter, 1975 WL 9860 at *6 ("[The] Division believes that such sentences should promptly either be deleted or revised in a manner that will eliminate any false or misleading statements or implications.").

gest alternative approaches.[38] Shareholders, therefore, received a binary option: make the changes or accept exclusion.[39]

B. Codification of the False or Misleading Exclusion

The SEC formally codified the false or misleading exclusion in 1976.[40] The exclusion provided that "a proposal or supporting statement may not be contrary to any of the Commission's proxy rules and regulations, including rule 14a–9."[41] Although the language extended the exclusion to the violation of any proxy rule, the Staff noted that the issue most commonly arose in connection with the submission of "items that contain false or misleading statements."[42]

Adopting the exclusion confirmed reliance on Rule 14a-9. The codification did not, however, include a specific right to cure.[43] Nonetheless, the practice remained, sparking some debate and criticism.[44] Issuers expressed dissatisfaction with the frequency of permitted revisions,[45] preferring instead "the omission of the entire proposal and supporting statement" whenever "any information contained therein [was] misleading."[46]

Nonetheless, the right to revise became a fixture of the process. To some degree the authority allowed the Staff to broadly construe the false

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(. i) [38] Nor would an appeal likely change the outcome. *See* Courtney E. Bartkus, *Appealing No-Action Responses under Rule 14a-8: Informal Procedures of the SEC and the Availability of Meaningful Review,* 93 DENV. L. REV. ONLINE 199 (2016).

39. *See* Standard Oil Company of California, SEC No-Action Letter, 1975 WL 9860 at *6 ("If, however, the foregoing revisions are not promptly made by the proponents, this Division will not recommend any enforcement action to the Commission if the entire proposal and supporting statement are omitted from the company's proxy material.").

40. *See* Exchange Act Release No. 12999, 1976 WL 160347 at *9 (Nov. 22, 1976) ("In light of the foregoing, the Commission has adopted a new subparagraph (c)(3) to Rule 14a–8 *expressly providing* that a proposal or supporting statement may not be contrary to any of the Commission's proxy rules and regulations, including rule 14a–9.") (emphasis added).

41. *Id.* at *18. ("The management may omit a proposal and any statement in support thereof from its proxy statement . . . . If the proposal or the supporting statement is contrary to any of the Commission's proxy rules and regulations, including Rule 14a–9 [17 CFR 240.14a–9], which prohibits false or misleading statements in proxy soliciting materials . . . .")

42. *Id*. at *8. ("Most often, this situation has occurred when proponents have submitted items that contain false or misleading statements. Statements of that nature are prohibited from inclusion in proxy soliciting materials by Rule 14a–9 of the proxy rules.")

43. *See generally*, *supra* note 38.

44. *See 1983 Memo* at 16, 17; *See also* Memorandum from Bill Morley and Mike Kargula on Proposed Revision of Rule 14a-8 to Lee B. Spencer, Jr, John Huber and Linda Quinn (Mar. 18, 1982) at 12–13 (on file with the Securities and Exchange Commission Historical Society) [hereinafter *1982 Memo*].

45. *See 1983 Memo* at 16 ("A few commentators were critical of the latitude given to proponents to makes changes."); *See also 1982 Memo* at 13 ("One complaint occasionally voiced by issuers in connection with this provision is that the staff to frequently permits proponents the opportunity to amend misleading statements included in the proposal.").

46. *See* Exchange Act Release No. 19135, 1982 WL 600869 at *13 (Oct. 14, 1982) ("These issuers would prefer the omission of the entire proposal and supporting statement if any information contained therein is misleading.").

or misleading standard.[47] Rather than apply an entirely objective test,[48] the Staff construed statements considered confusing, poorly phrased, or subject to reasonable disagreement, as false or misleading. In these more problematic circumstances, proponents often received a right to revise.

For example, in *Barris Industries Inc*.,[49] the proposal requested an amendment to the issuer's bylaws requiring a majority of the board of directors to be independent.[50] The issuer argued that the characterization of other board members as "associates" was misleading and implied improper activity.[51] Although agreeing,[52] the Staff noted that the substitution of "colleagues" for "associates" would remedy any violation of 14a-9.[53] By allowing for a simple revision, the Staff effectively required deletion of a term opposed by the company while allowing the proposal to remain in the proxy materials.

In 1998, the Staff recast Rule 14a-8 and the accompanying grounds for exclusion into a plain-English question and answer format.[54] Additionally, the amendments specifically referenced the need for "materially" false or misleading statements for the issuer to successfully seek exclusion.[55] With materiality already part of the Staff analysis, the changed

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47. *See 1982 Memo* at 13 ("Companies would prefer omission of any material judged to be misleading. In our view, the subjective nature of what may or may not be misleading would suggest that such an approach would be inappropriate.").

48. *See* Exchange Act Release No. 9344, 1976 WL 160411 at *3 (July 7, 1976) (entitled, *Statement of Informal Procedures for the Rendering of Staff Advice with Respect to Shareholder Proposals*, the Staff acknowledged, "With its limited staff and the need for rapid examination, the Commission necessarily cannot do more in each case than make a quick analysis of the material submitted that, perforce, lacks the kind of in-depth study that would be essential to a definitive determination . . . .").

49. *See* Barris Industries Inc., SEC No-Action Letter, 1988 WL 235023 (Sep. 30, 1988).

50. *Id.* at *2 (Proposal requested that, "A majority of Directors, numbering no less than five, shall be independent "Outside Directors" who are not employed by or in any way related to the Company, its management or its directors (or to companies affiliated therewith).").

51. *Id.* at *4 ("[T]he second sentence of paragraph 1 uses the word "associates" in such a manner as to imply that the Company's other Board members are "associates" of [the Company's CEO], which is clearly incorrect . . . . Lastly, the second sentence of paragraph 1 incorrectly and misleadingly implies that the individuals who became directors were not properly elected as directors, by stating that control of the Company's Board was "assumed by [the Company's CEO] and associates . . . ."").

52. *Id.* at *1–3.

53. *Id.* at *1 ("We note, however, that the proponent has indicated his willingness to substitute the word 'colleagues' for 'associates'. Assuming the proponent promptly revises the final clauses of the second sentence of the first paragraph of supporting statement and the first sentence of the eighth paragraph of the supporting statement to replace 'associates' with 'colleagues', this Division does not believe that the Company may rely on Rule 14a–8(c)(3) as a basis for omitting those clauses.").

54. *See* Exchange Act Release No. 23200, 1998 WL 254809 at *2 (May 21, 1998) ("Most commenters who addressed this proposal expressed favorable views, believing that it would make the rule easier for shareholders and companies to understand and follow.").

55. *Id*. at *26 (rule 14a-8, as amended, recast the false or misleading exclusion as "14a-8(i)(3)", reading, "(i) Question 9: If I have complied with the procedural requirements, on what other bases may a company rely to exclude my proposal? . . . (3) Violation of proxy rules: If the proposal or supporting statement is contrary to any of the Commission's proxy rules, including §240.14a-9, which prohibits *materially* false or misleading statements in proxy soliciting materials . . . .") (emphasis added).

did not significantly alter the reach of the exclusion.[56] The language of subsection (i)(3) has remained unchanged since 1998.

III. STAFF INTERPRETATION SINCE 1998

The Staff continued to interpret the false or misleading exclusion broadly. Likewise revisions remained common.[57] In 2004, the administration changed radically when the Staff imposed an objective burden on issuers seeking no-action relief.[58] As a result, use of the exclusion declined significantly. Moreover, adoption of a more objective standard largely rendered the right to revise moot.[59]

A. A New Approach to Revision?

In the aftermath of the 1998 amendments, the Staff continued to identify false or misleading statements and provide an opportunity for revisions.[60] The provision continued as a common basis for exclusion and had the potential to generate "frivolous" claims by issuers.[61] In 2001, however, the Staff issued a bulletin that sought to curb the use of the exclusion.[62] The Staff advised *shareholders* to provide factual support for statements of fact or, in the alternative, phrase such statements as

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56. *See* Exchange Act Release Re Union Electric Co., , 1957 WL 8352 at *3 (Apr. 17, 1957) ("It is only where upon the basis of the information appearing in the record, a statement appears to be false or misleading with respect to any material fact, or omits to state any material fact necessary in order to make the statement therein not false or misleading, that we believe change should be required.").

57. *See e.g.*, *infra* note 66.

58. *Id.* ("Prior to the issuance of Staff Legal Bulletin No. 14B (SLB 14B) in 2004, the staff received many requests that asserted deficiencies in nearly every line of a proposal and its supporting statement in an effort to get the entire proposal excluded. The staff spent a significant amount of time analyzing the alleged deficiencies for factual accuracy and essentially editing the proposals line-by-line. Because this effort may not have yielded better disclosure for shareholders to make voting decisions, and imposed on the staff's limited resources an unrealistic due diligence burden, we concluded in SLB 14B that we would limit the circumstances in which we would consider a Rule 14a-8(i)(3) request to exclude or modify a statement in a proposal.").

59. *Compare* Rite Aid Corp., SEC No-Action Letter, 2015 WL 332191 at *1 (Mar. 13, 2015) (proposal sought the adoption of a bylaw requiring additional disclosure of information related to election of directors on the proxy card. Issuer argued a particular segment of the supporting statement it was "patently false" under the false and misleading exclusion that the "SEC fully supports this Proposal." The Staff, noting the SEC had indeed never stated any position on the proposal at issue, allowed omission of the supporting statement with no right to revise."), *with supra* notes 37, 39 (Staff accepting issuer's twelve arguments under the false and misleading exclusion while supplying revisions for, and permitting the proponent to cure, all twelve statements.).

60. *Compare* Ferro Corp., SEC No-Action Letter, 1997 WL 45461 at *1 (Jan. 28 1997) *with* Ursradt Biddle, SEC No-Action Letter, 1998 WL 886893 at *1 (Dec. 17, 1998) (in both instances, one example before the 1998 amendments and one after, the Staff calls attention to specific portions of the proposal or supporting statement deemed to be false or misleading and offers explicit revisions for the proponent to become compliant.).

61. *See 1982 Memo* at 12 ("We would, however, like to reiterate the request made in Release 33-6253 and some of our letters that issuers avoid frivolous objections and concentrate on significant points under paragraph (c)(3)").

62. *See* SEC Staff Legal Bulletin No. 14, 2001 WL 34886112 at *14 (July 13, 2001) ("Despite the intentions underlying our revisions practice, we spend an increasingly large portion of our time and resources each proxy season responding to no-action requests regarding proposals or supporting statements that have obvious deficiencies in terms of accuracy, clarity or relevance.").

opinions.[63] The bulletin reaffirmed the right to revise[64] but only for proposals that did not require detailed and extensive editing.[65] Notably, the approach sought to reduce use by imposing additional obligations only on shareholders without mention of altering issuer behavior.

Despite the efforts, the use of the exclusion did not subside.[66] In the 2003 proxy season, nearly half of all no-action requests sought partial or total exclusion based upon alleged inaccuracies in proposals or supporting statements.[67] Moreover, the Staff continued to provide extensive edits, a resource consuming task. In *Northrop Grumman Corp*.,[68] the proponent requested that the company reinstate a simple majority voting system to the fullest extent possible.[69] The issuer sought exclusion, pointing to multiple allegedly inaccurate statements.[70] The Staff agreed but rather than allow total exclusion, provided an extensive opportunity to cure. The proponent had to: (1) cite specific source for two separate sentences, (2) recast an entire discussion as an opinion, (3) delete a sentence, (4) revise a sentence to include factual support, (5) delete an entire discussion, and (6) recast a sentence as an opinion.[71]

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63. *Id*. at *19 (for decades, proposals and supporting statements had been deemed false and misleading, thereby invoking Staff revisions, simply because statements of fact were unsupported or improperly phrased as an opinion. If proponents phrased these materials in a more precise manor, in accordance with SLB 14, perhaps issuers would challenge fewer items and revisions would become less frequent.).

64. *Id.* at *13 (referring to allowing for minor revisions that do not alter the substance of the proposal, the Staff stated, "In these circumstances, we believe that the concepts underlying Exchange Act section 14(a) are best served by affording an opportunity to correct these kinds of defects.").

65. *Id*. at *14 ("Therefore, when a proposal and supporting statement will require detailed and extensive editing in order to bring them into compliance with the proxy rules, we may find it appropriate for companies to exclude the entire proposal, supporting statement, or both, as materially false or misleading.").

66. *See* Staff Legal Bulletin No. 14B, 2004 WL 3711971 at *3 (Sep. 15, 2004) [hereinafter *SLB 14B*] ("The discussion in SLB No. 14 has resulted in an unintended and unwarranted extension of rule 14a-8(i)(3), as many companies have begun to assert deficiencies in virtually every line of a proposal's supporting statement as a means to justify exclusion of the proposal in its entirety.").

67. *Id*. at *3 ("During the last proxy season, nearly half the no-action requests we received asserted that the proposal or supporting statement was wholly or partially excludable under rule 14a-8(i)(3).").

68. *See* Northrop Grumman Corp., SEC No-Action Letter, 2002 WL 730716 (Mar. 22, 2002).

69. *Id.* at *24 ("By adopting a policy to allow simple majority vote, our board could demonstrate a commitment to the greatest management concern for shareholders and shareholder value.").

70. *Id.* at *14 ("For the reasons discussed above, we submit that all the following should be deleted pursuant to subsection (i)(3) of the Rule: (i) the Majority Vote Caption; (ii) the Why Require Caption and all the statements made under that caption; (iii) the Equal Votes Caption and all the statements made under that caption, (iv) the One Step Caption and all the statements made under that caption, (v) the final three bold-face captions and all the statements made under those captions, and (vi) the final sentence of the Proposal.")

71. *Id.* at *1 ("However, there appears to be some basis for your view that portions of the second proposal's supporting statement may be materially false or misleading under rule 14a-9. In our view, the proponents must . . . .").

B. Narrowing the Meaning of "False or Misleading"

The Staff ultimately admitted that the approach had evolved "well beyond" the original intent of the exclusion.[72] To reverse the unwieldy application of the exclusion, the Staff shifted the approach, adopted an objective standard, and imposed the burden of establishing false or misleading disclosure on issuers.[73] Issuers relying on the exclusion would need to demonstrate "objectively that a proposal or statement [was] materially false or misleading."[74] To this end, the Staff employed a three part analysis.[75] First, the exclusion only applied to misstatements or omissions of fact, not to inferences or opinions.[76] After 2004, issuers could address objections to nonfactual references in their opposition statement.[77] Second, issuers bore the burden of objectively demonstrating falsity.[78] Finally, the exclusion would only apply to false or misleading statements of fact considered "material".[79]

In the aftermath of the 2004 changes, issuers only successfully employed the exclusion in narrow circumstances. For example, in *The Bear Stearns Companies Inc*.,[80] the proponent requested that the board of directors permit shareholders to vote, on an advisory basis, at each annual meeting to improve the "Compensation Committee report."[81] The issuer requested omission because the proponent cited outdated disclosure rules

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72. *See SLB 14B* at *3 ("Unfortunately, our discussion of rule 14a-8(i)(3) in SLB No. 14 has caused the process for company objections and the staff's consideration of those objections to evolve well beyond its original intent.").

73. *Id.* at *4 ("Further, rule 14a-8(g) makes clear that the company bears the burden of demonstrating that a proposal or statement may be excluded.").

74. *Id*. ("As such, the staff will concur in the company's reliance on rule 14a-8(i)(3) to exclude or modify a proposal or statement only where that company has demonstrated objectively that the proposal or statement is *materially* false or misleading.") (In harmony with the Supreme Court's interpretation of Rule 14a-9 in *TSC v. Northway*, 426 U.S. 438, 449 (1976), the Staff finds a perceived false or misleading fact when, "there [is] a substantial likelihood that the disclosure of the omitted fact [or the misstatement] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

75. *See* Keith F. Higgins, Director, Division of Corporate Finance, Speech at the Practicing Law Institute Program on Corporate Governance: Rule 14a-8: Conflicting Proposals, Conflicting Views (Feb. 10, 2015)) [hereinafter *Higgins Speech*] ("From our perspective, there are three threshold questions we consider when asked to exclude a proposal or supporting statement as false or misleading.").

76. *Id*. ("First, is it really a "fact"? Sometimes, we are asked to exclude based on inferences or opinions. These generally seem like issues best addressed in the opposition statement.").

77. SEC Staff Legal Bulletin No, 14B, 2004 WL 3711971 at *4.

78. *See Higgins Speech* ("Second, is it false or misleading? The Commissions rules make clear that the company has the burden of demonstrating it is entitled to exclude the proposal."); *See e.g.* Mylan Inc., SEC No-Action Letter, 2013 WL 6830156 at *1 (Jan. 16, 2014) ("We are unable to concur in your view that Mylan may exclude the proposal under rule 14a-8(i)(3). We are unable to conclude that you have demonstrated objectively that the proposal and the portions of the supporting statement you reference are materially false or misleading.").

79. *Id.* ("Finally, is it "material"?").

80. *See* The Bear Stearns Companies Inc., SEC No-Action Letter, 2007 WL 316370 (Jan. 30, 2007).

81. *Id.* at *1 ("RESOLVED, shareholders ask our board of directors to adopt a policy that shareholders be given the opportunity to vote on an advisory management resolution at each annual meeting to approve the Compensation Committee report in the proxy statement.").

that no longer applied, making the entire proposal objectively misleading.[82] In response, the Staff denied the right to cure and permitted omission of the entire proposal.[83]

The Staff has also applied the exclusion to images.[84] In *General Electric Company*,[85] to illustrate the perceived advantages of cumulative voting in the election of directors,[86] the proponent employed an image[87] comprising of charts, graphs, equations, and emojis. The image was used to demonstrate that the CEO had traded the company's stock with greater success than a theoretical shareholder during the same period of time. Specifically, the proponent illustrated the issuer's "very high" debt to earnings ratio with a standard graph but included a "frowny face" emoji alongside. Conversely, a smiley face emoji appeared for company's with "very low" or "perfect" debt to earnings ratios.

Initially, the Staff denied the no-action request.[88] Upon the issuer's request for reconsideration, the Staff permitted exclusion under 14a-8(i)(3) as "irrelevant to consideration of the subject matter of the proposal."[89] The shareholder, however, received a right to cure. The proposal could remain but not the chart. Thereafter, the Staff issued new guidance addressing the use of images in shareholder proposals.[90] Guid-

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82. *Id.* at *1–2 ("The Proposal clearly envisions that an advisory stockholder vote on the Compensation Committee Report (the 'Report') will give stockholders more 'influence over pay practices,' which could 'help reduce excessive pay.' However, pursuant to the amended executive compensation disclosure rules of Item 402 of Regulation S-K, the Report is no longer required to include disclosure of the Company's executive compensation practices and policies.").

83. *Id.* at *1 ("There appears to be some basis for your view that Bear Steams may exclude the proposal under rule 14a-8(i)(3), as materially false or misleading under rule 14a-9. Accordingly, we will not recommend enforcement action to the Commission if Bear Steams omits the proposal from its proxy materials in reliance on rule 14a-8(i)(3).").

84. *See SLB 14B* *4 (the Staff explicitly stated that the exclusion would continue to apply where " . . . substantial portions of the supporting statement are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which she is being asked to vote.").

85. *See* General Electric Co., SEC No-Action Letter, 2017 WL 831664 (Feb. 23, 2017).

86. *See Fact Answers: Cumulative Voting*, U.S. SECURITIES AND EXCHANGE COMMISSION, (Oct. 14, 2014), *available at* https://www.sec.gov/fast-answers/answers-cumulativevotehtm.html.

87. Original image *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2017/martinharangozorecon022317-14a8.pdf.

88. *See* General Electric Co., SEC No-Action Letter, 2015 WL 9002923 at *1 (Feb. 23, 2016) ("We are unable to concur in your view that GE may exclude the proposal under rule 14a-8(i)(3). . . . We are also unable to conclude that you have demonstrated objectively that the image is materially false or misleading. Accordingly, we do not believe that GE may omit the proposal from its proxy materials in reliance on rule 14a-8(i)(3).").

89. *See* General Electric Co., SEC No-Action Letter, 2017 WL 821664 at *1 (Feb. 23, 2017) ("In our view, the Images are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which he or she is being asked to vote.").

90. *See* Staff Legal Bulletin No. 14I, 2017 WL 5167479 at *6 (Nov. 9, 2017) [hereinafter *SLB 14I*] ("In two recent no-action decisions,14 the Division expressed the view that the use of "500 words" and absence of express reference to graphics or images in Rule 14a-8(d) do not prohibit the inclusion of graphs and/or images in proposals."). The "two recent no-action decisions" *SLB 14I* refers to are: General Electric Co., SEC No-Action Letter, 2015 WL 9002923; and General Electric Co., SEC No-Action Letter, 2017 WL 821664.

ance acknowledged the "potential for abuse" without explicitly prohibiting the use of graphs and images in proposals.[91] Notably, an issuer could argue that an image renders a proposal "false or misleading" or contains content "irrelevant to the consideration of the subject matter."[92]

The approach in both the bulletin and the letter issued to General Electric reflected a return to the pre-2004 approach. In finding the chart with emojis as false or misleading,[93] the Staff essentially relied on a subjective determination, an approach that could portend wider use of the exclusion. Commentators labeled the approaches in the Bulletin as "issuer-friendly."[94]

IV. ANALYSIS

The language of the false or misleading exclusion has remained largely constant. Yet the Staff interpretation evolved significantly over time. Until 2004, the phrase applied to a broad category of statements, many of which did not truly qualify as false or misleading. The Staff balanced the broad interpretation and deference to issuer allegations with a liberal application of the right to cure. The approach, however, created substantial work for the Staff and provided limited benefit to the proxy process. Moreover, by providing shareholders with little ability to challenge the interpretations, the approach represented a largely issuer friendly gloss to the exclusion.

The changes made in 2004 reflected an admission by the Staff that the administrative interpretation had strayed from the actual language of Rule 14a-8(i)(3). The Staff's subsequent interpretation sought to solve this concern by elevating the evidentiary standard imposed on issuers. Use of the exclusion declined as did the right to revise. Staff involvement in the application of the provision also fell.

Nonetheless, the Staff's tendency to interpret the exclusion broadly may be returning. Issuers have objected to the imposition of the burden to establish false or misleading disclosure.[95] Moreover, the Staff's recent

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91. *Id*. ("The Division recognizes the potential for abuse in this area. The Division believes, however, that these potential abuses can be addressed through other provisions of Rule 14a-8").

92. *Id*. "For example, exclusion of graphs and/or images would be appropriate under Rule 14a-8(i)(3) where they: make the proposal materially false or misleading; . . . are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which he or she is being asked to vote.").

93. *Id*.

94. *See SEC Releases Pro-Issuer Guidance on Shareholder Proposals*, STINSON LEONARD STREET, (Nov. 3, 2017), *available at* https://www.stinson.com/Resources/Alerts/2017_Alerts/SEC_Releases_Pro-Issuer_Guidance_on_Shareholder_Proposals.aspx ("The U.S. Securities and Exchange Commission staff's release of Staff Legal Bulletin No. 14I ahead of the upcoming proxy season appears to reflect several issuer-friendly modifications to the staff's processing of no-action letters seeking exclusion of shareholder proposals under Rule 14a-8 of the Exchange Act.")

95. *See generally* CENTER FOR CAPITAL MARKETS COMPETITIVENESS, SHAREHOLDER PROPOSAL REFORM (2017) at 6 ("In practice, however, SEC staff has eroded the viability of this

guidance on the use of images in shareholder proposals apparently altered the 2004 standard. For example, the 2004 standard required that the company *"demonstrates objectively* that a factual statement is materially false or misleading."[96] In contrast, the 2018 guidance permits exclusion when images "make the proposal materially false or misleading."[97] Moreover, the 2004 standard requires that "*substantial portions* of the supporting statement [be] irrelevant," while the recent guidance simply requires an abstract showing of irrelevance.[98]

The recent guidance raises concerns. A return to a broad, subjective approach to the false or misleading exclusion will not benefit the proxy process. Before 2004, the Staff's subjective administration of Rule 14a-8(i)(3) created uncertainty and added cost to the proxy process. A recent lack of cohesion between the objective standard and the recent guidance on images could result in a degree of uncertainty which incentivizes opportunistic issuers. Absent adherence to an objective standard, overuse of the exclusion and the concomitant tax on Commission resources will likely recur.

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exemption by placing the burden on issuers to prove that a statement made by a proponent is materially false or misleading.").

96. *See SLB 14B* at *4 ("Specifically, reliance on rule 14a-8(i)(3) to exclude or modify a statement may be appropriate where . . . the company demonstrates objectively that a factual statement is materially false or misleading.").

97. *See SLB 14I* at *6 ("For example, exclusion of graphs and/or images would be appropriate under Rule 14a-8(i)(3) where they: make the proposal materially false or misleading.").

98. *Compare* Staff Legal Bulletin No. 14B, 2004 WL 3711971 at *4 ("Specifically, reliance on rule 14a-8(i)(3) to exclude or modify a statement may be appropriate where: . . . substantial portions of the supporting statement are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which she is being asked to vote."), *with SLB 14I* at *6 ("For example, exclusion of graphs and/or images would be appropriate under Rule 14a-8(i)(3) where they: . . . are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which he or she is being asked to vote.").

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