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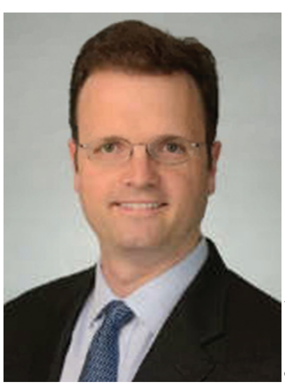
MoloLamken Suit Claims New SEC Rule 'Guts' Shareholder Proposals

"It does have some pretty significant impacts on the ability to bring these proposals," said plaintiff counsel Robert Kry.

BY ANDREW GOUDSWARD

Attorneys from MoloLamken are challenging a new U.S. Securities and Exchange Commission rule limiting shareholder proposals included in company proxy materials, which it claims would stifle the voice of smaller investors in corporate governance.

The firm filed suit Tuesday on behalf of shareholder advocates seeking to invalidate changes enacted by the SEC last September, which require investors to invest more money over a longer period of time to be eligible to submit proposals and restrict the use of shareholder representatives to present recommendations on behalf of investors.



Courtesy photo

Robert Kry of Mololamken.

The complaint argues shareholder proposals are "an important engine of corporate democracy" that have allowed investors to raise concerns about issues like climate change and racial and ethnic diversity. Many prompt action from management, and

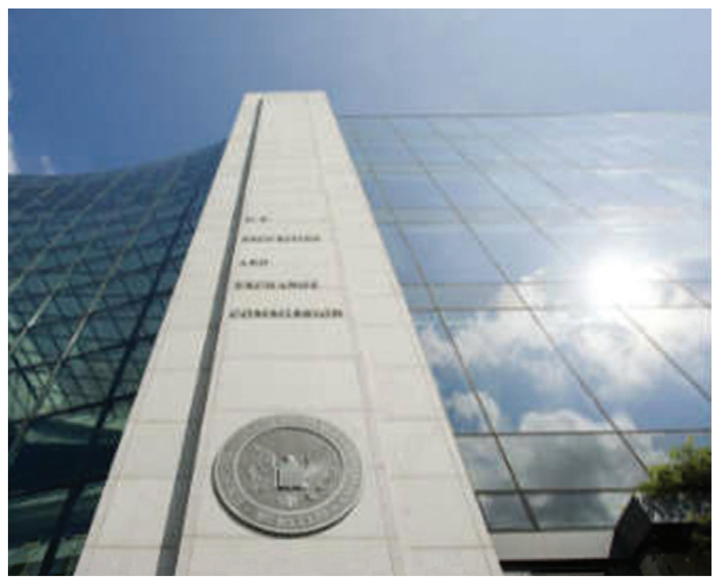


Photo: Diego M. Radzinschi/ALM

Headquarters of the U.S. Securities and Exchange Commission in Washington, D.C.

flag problems that threaten the long-term value of the company, the suit claims.

"The commission's sharp restrictions on shareholder rights undermine efforts in the investor community to ensure greater management responsiveness to the shareholders whose interests they supposedly represent," the complaint states. "The commission's new rule guts the shareholder proposal process in exchange for minuscule and largely hypothetical cost savings."

MoloLamken attorneys Robert Kry, Sarah Newman and Eric Posner filed the suit in U.S. District Court for the District of Columbia on behalf of the Interfaith Center on Corporate Responsibility, a coalition of institutional investors, including faith groups, unions and asset managers, along with shareholder advocates James McRitchie and the group As You Sow.

The rule change requires shareholders to own at least $25,000 in company stock for one year before submitting a proposal, $15,000 for two years and $2,000 for three years.

The former rule required only a $2,000 ownership stake for one year to submit a resolution. The SEC also raised the share of support a recommendation needs, before shareholders can resubmit it on a proxy statement in subsequent years.

“It does have some pretty significant impacts on the ability to bring these proposals. Over the past several decades there have been a lot of governance changes and reforms that have been prompted by these proposals,” Kry said. “So restricting that mechanism for change is a significant concern for my clients.”

The agency limited representatives—on whom investors often rely to submit proposals because of their familiarity with the process—from acting for more than one shareholder during any given meeting. The rule also mandates that investors meet with company managers themselves to discuss proposals, rather than rely on representatives.

The SEC said the rule changes would ensure shareholders have a meaningful economic stake or investment interest in the company before advancing a proposal on a proxy statement and reduce company costs associated with processing the requests.

The agency also contended the ownership thresholds, which hadn’t been updated since 1998, were outdated and did not reflect changes on Wall Street that have altered shareholder-company engagement in recent years.

An SEC spokesperson declined to comment on the lawsuit, citing a policy not to speak on pending litigation.

But the suit alleges the changes “will have a disproportionate impact on Main Street investors, for whom the proposal process is a critical mechanism for raising concerns.”

The plaintiffs planned to file resolutions on issues like food waste, human rights and allowing shareholders to nominate their own director candidates. The plaintiffs hold stock in companies like Zoom and General Motors and the restaurant chain owner Dine Brands, but the suit alleges the new rules on ownership and representation will prevent them from filing their proposals.

The complaint alleges the SEC completed a flawed cost-benefit analysis in enacting the rule change, by ignoring the value of the proposals in raising issues important to the long-term health of the company and by refusing to use data that showed the new rules would drastically reduce the number of shareholder proposals.

The SEC claimed the data was unreliable because it showed investment accounts, rather than individual shareholders.

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