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BLOG

SEC Grants No-Action Relief to Companies Seeking to Exclude Director Resignation Bylaw Proposals on State-Law Grounds

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A version of this blog has been published in Law360.

In connection with the 2024 proxy season, pension funds associated with the United Brotherhood of Carpenters and Joiners of America (the Carpenter Funds) have submitted a director resignation bylaw proposal (the Proposed Bylaw or Proposal) to at least 30 companies for inclusion in the companies' 2024 proxy statements and to be voted on at the companies' 2024 annual meetings of stockholders pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the Exchange Act). On March 15, 2024, the Securities and Exchange Commission (the SEC or the Commission) granted no-action relief to Verizon Communications Inc. (Verizon) on the grounds that the Proposed Bylaw, if implemented, would cause the company to violate Delaware law. Since granting relief to Verizon, the SEC has been swiftly releasing analogous responses to outstanding requests for relief on the same grounds and is expected to do so until each requesting company has received relief. The Carpenter Funds have seemingly begun withdrawing some of their proposals following the issuance of the Verizon letter, as noted in the SEC's recent response to CVS Health Corporation.

OVERVIEW OF RULE 14A-8

Rule 14a-8 under the Exchange Act provides the framework for certain stockholders of a public company to request that the company include in its proxy statement a proposal to be voted on at a company's annual meeting of stockholders. Such proposals are subject to certain procedural and eligibility requirements. Proponents who have met the procedural and eligibility requirements of Rule 14a-8 may nonetheless see their proposals excluded based on one or more of the 13 substantive grounds for exclusion described in Rule 14a-8(i).

Before excluding a stockholder proposal under procedural, eligibility, or substantive grounds, companies typically send a letter to the SEC requesting confirmation that the Commission's staff will not recommend enforcement action against such company for excluding the proposal from its proxy statement (a No-Action Request). The SEC will then issue a response stating its informal, nonbinding response to the request by concurring or failing to concur with the exclusionary grounds set forth by the requesting company (a No-Action Response).

Incoming No-Action Requests are publicly available here, and No-Action Responses are publicly available here.

EXCLUDING THE PROPOSED BYLAW

As of the date of this post, 29 companies have submitted No-Action Requests to exclude the Proposal from their proxy statements. While several of these companies were granted no-action relief on eligibility or procedural grounds, many, like Verizon, relied on the substantive argument under Rule 14a-8(i)(2) that the Proposed Bylaw, if implemented, would cause the company to violate Delaware law.

Through the Proposed Bylaw, the Carpenter Funds sought to change the director resignation policies and standards by which Boards of Directors (Boards) may reject the resignation of a director who has failed to receive the requisite number of votes for his or her reelection in an uncontested election by requiring the Board to articulate a "compelling reason" to reject the resignation. Additionally, the Proposed Bylaw sought to require that the resignation of a director be automatically effective 30 days after the certification of an election vote in which said director failed, for a second year in a row, to receive the requisite number of votes for his or her reelection, leaving no discretion to the Board to accept or reject the resignation.

Companies relying on Delaware-law grounds to exclude the Proposal based their argument on Section 141(a) of the Delaware General Corporation Law (the DGCL), which reserves to a company's Board the full power and authority to manage the business and affairs of the company. In carrying out this authority, directors owe fiduciary duties of care and loyalty to the corporation and its stockholders. These fiduciary duties require each director to base his or her decisions on what he or she reasonably believes is in the best interests of the corporation and its stockholders. Delaware courts have routinely held that a bylaw that purports to mandate a substantive decision on the Board without regard to the application of directors' fiduciary duties violates Section 141(a).

Many companies also argued that the Proposed Bylaw's requirement that a holdover director's resignation be automatically accepted if they fail a second time to receive the requisite number of votes violates Section 141(k) of the DGCL, which requires the vote of holders of a majority of shares then entitled to vote at an election of directors to remove a director. Because many of the affected companies require a majority of votes cast to elect directors in an uncontested election, which is a lesser standard than a majority of shares then entitled to vote, implementing the Proposed Bylaw would require such companies to violate Section 141(k).

BUCKING THE TREND

The favorable No-Action Response comes as a surprise after the SEC has shown hesitation toward granting relief to companies relying on substantive grounds for exclusion in recent years. In 2021, the SEC released new guidance in Staff Legal Bulletin No. 14L, which rescinded the expansion of companies' ability to exclude proposals on substantive grounds, and in 2022, the SEC proposed an amendment to narrow certain substantive bases for exclusion.

The Verizon letter is, however, consistent with recent case law. On February 23, 2024, the Delaware Court of Chancery issued an opinion in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, invalidating certain governance arrangements not contained in the company's charter as inconsistent with Delaware's board-centric model of corporate governance because they deprived the company's Board of a significant portion of its authority in contravention of Section 141(a). In light of the SEC's recent trend in denying No-Action Requests on substantive grounds, this decision suggests that the SEC is more likely to favor arguments for exclusion based on state-law grounds than arguments based on substantial implementation (Rule 14a-8(i)(10)) or management functions (Rule 14a-8(i)(7)), two previously popular grounds for relief.

We expect the SEC to continue to issue favorable No-Action Responses to the remaining companies that have requested relief on the grounds that the Proposed Bylaw would violate the DGCL.

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