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SEC Issues New Guidance on Several Exclusions under Rule 14a-8

On November 1, 2017, the SEC's Division of Corporation Finance (the Division) issued Staff Legal Bulletin No. 14I (the SLB) on shareholder proposals. The SLB provides guidance on: (i) the application of Rule 14a-8(i)(7), the "ordinary business" exception, (ii) the scope of Rule 14a-8(i)(5), the "economic relevance" exception, (iii) documentation requirements for shareholders submitting proposals by proxy, and (iv) the treatment of graphs and images under the 500-word limitation of Rule 14a-8(d).

Staff Legal Bulletin No. 14I

Ordinary Business. Rule 14a-8(i)(7) permits a company to exclude a proposal that deals with a matter relating to its "ordinary business" operations. The SLB explains that under this exclusion a company may exclude a proposal that raises matters that are "so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight," unless it focuses on policy issues that are sufficiently significant that they transcend ordinary business. The staff has historically determined whether policy issues are significant by looking to external sources while also determining that there was a nexus between the issue the proposal raised and the company's business. The SLB notes that whether a proposal focuses on a significant policy issue "often raise[s] difficult judgment calls that the Division believes are in the first instance matters that the board of directors is generally in a better position to determine." As a result, to support a company's significance argument, the SLB indicates that the company should include in its no-action request the board's analysis of the relevant policy issue and the issue's significance to the company, which will "greatly assist" the staff with its review.

We do not believe that this board analysis must be included in all no-action requests. It does not, for example, affect the objection that a proposal "micromanages" the company. For matters that the staff has in the past concluded are significant policy issues, however, the guidance appears to allow companies to argue, based on the board's conclusion as fiduciaries, that the policy issue is not significant to their company. We believe that this analysis could be undertaken and presented by a properly constituted committee of the board.

Economic Relevance. Rule 14a-8(i)(5) permits a company to exclude a proposal that relates to operations that account for less than 5% of its total assets, net earnings and gross sales, and is not otherwise significantly related to the company's business. Under the staff's historical application, the "otherwise significantly related" clause swallowed the exclusion. Any proposal that raised social or ethical issues involving a matter that related to business the company conducted, no matter how small, could not be excluded. The SLB states that for proposals that are below the quantitative thresholds, the Division's analysis, going forward, will focus on a proposal's significance to the company's business. In other words, "otherwise significantly related" will assess whether the matter has a significant impact on the company's business. Under the SLB's revised analysis, when the subject matter of the proposal is below the quantitative thresholds, and the "proposal's significance to a company's business is not apparent on its face," the burden shifts to the proponent to demonstrate that it is "otherwise significantly related to the company's business." A proponent can still raise social or ethical issues in its arguments, but it must tie them to a significant effect on the company's business and the "mere possibility of reputational or economic harm will not preclude no-action relief."

As in the “ordinary business” exclusion, the SLB also acknowledges that the board of directors is generally in a better position than the SEC staff to determine whether a shareholder proposal is “otherwise significantly related to the company’s business.” Thus, a company seeking no-action relief under Rule 14a-8(i)(5) will want to include in its no-action request its board’s analysis of why the subject matter of the proposal does not have a significant effect on the company.

Proposal by Proxy. The SLB addresses concerns about the authorizations obtained by some proponents that submit proposals by proxy. Going forward, the Division will now require those who submit a proposal by proxy to provide documentation that is signed and dated by the shareholder and identifies:

- the shareholder-proponent and the person or entity selected as proxy;
- the company to which the proposal is directed;
- the annual or special meeting for which the proposal is submitted; and
- the specific proposal to be submitted.

Where this documentation is not provided, there may be a basis to exclude the proposal by proxy under Rule 14a-8(b).

Use of Graphics or Images. The SLB reaffirms the Division’s position taken in no-action letters to General Electric that Rule 14a-8(d)’s 500-word limitation does not prohibit the use of graphs or images in shareholder proposals. Any words used in the graphics themselves, however, do count towards the 500-word limit. The SLB also notes that Rule 14a-8(i)(3) provides other bases to potentially exclude proposals that use graphics or images that make the proposals materially false or misleading.

Impact on the 2018 Proxy Season?

It is too early to predict the impact of the SLB on the upcoming proxy season. Focusing the decision to exclude a proposal based on the impact of a significant policy issue on the particular company, and giving deference to the board’s assessment of that impact, has the potential to increase the number of proposals excluded on ordinary business grounds. Applying that same analysis to the economic relevance exclusion has the potential to make that provision viable once again. Yet dire predictions in the proponent community that boards may run roughshod over the process are surely overblown. Responsible boards of directors will attend to their analyses with the care that they bring to their duties as fiduciaries. The result of their work will be very public and they risk reputational and shareholder relations damage with analyses that are less than convincing. The SLB restores some balance to the give and take between companies and proponents and in that sense will hopefully make the process better for all shareholders.

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