October 26, 2018

SEC Staff Issues New Guidance on Shareholder Proposals

On October 23, 2018, the SEC's Division of Corporation Finance (the Division) issued Staff Legal Bulletin No. 14J (SLB 14J) on shareholder proposals, providing helpful guidance to companies on some of the Division's expectations for the 2019 proxy season.

In SLB 14J, the Division clarifies its views on:

- board analyses provided in no-action requests that rely on the "economic relevance" (Rule 14a-8(i)(5)) or "ordinary business" (Rule 14a-8(i)(7)) exceptions to exclude shareholder proposals;
- the scope and application of micromanagement as a basis to exclude a proposal under Rule 14a-8(i)(7); and
- how Rule 14a-8(i)(7) applies to proposals that touch upon senior executive and/or director compensation matters.

Background

Last November, the Division issued Staff Legal Bulletin No. 14I (SLB 14I), which encouraged companies seeking no-action relief under Rules 14a-8(i)(5) or 14a-8(i)(7) to include board analyses of the particular policy issue raised by the shareholder proposal and its significance to the company. Our alert discussing SLB 14I may be accessed here. Although 24 no-action requests last year included a board analysis, we are aware of only one instance where the SEC staff concurred with the exclusion and cited the board's analysis of the proposal's significance to the company's business. *See Dunkin' Brands Group, Inc.* (avail. Feb. 22, 2018) (concurring with the exclusion under Rule 14a-8(i)(5) of a proposal requesting that the company's board issue a report assessing the environmental impacts of continuing to use K-Cup Pods brand packaging). For an analysis of the *Dunkin' Brands* no-action letter, see our previous alert here.

Staff Legal Bulletin No. 14J

Guidance on Board Analyses

Building upon its previous guidance, the Division reiterated its belief in SLB 14J that a "well-developed discussion" of the board's analysis of the significance of the particular policy issue raised by a proposal to the company or its business can assist the staff in evaluating a no-action request. Such a discussion would describe in sufficient detail the specific substantive factors the board considered in arriving at its conclusion, including:

- The extent to which the proposal relates to the company's core business activities.
- Quantitative data, including financial statement impact, related to the matter that illustrate whether or not a matter is significant to the company.
- Whether the company has already addressed the issue in some manner, including the differences – or the delta – between the proposal's specific request and the actions the company has already taken, and an analysis of whether the delta presents a significant policy issue for the company.
- The extent of shareholder engagement on the issue and the level of shareholder interest expressed through that engagement.
- Whether anyone other than the proponent has requested the type of action or information sought by the proposal.
- Whether the company's shareholders have previously voted on the matter and the board's views as to the related voting results.

For proposals on which there was a previous shareholder vote, the Division observed that any board discussion should address the voting results and, if the matter received "significant shareholder support," whether the company has taken any subsequent actions or whether other intervening events have occurred since the vote that may have mitigated the issue's significance to the company and how recently the vote occurred. Although SLB 14J does not specify at what specific percentage threshold the shareholder support would be deemed "significant," the lowest threshold that the staff referenced in a response denying a no-action request during the 2018 proxy season was 25%.

SLB 14J clarified that the above factors are not exclusive or exhaustive, nor is it necessary for a board analysis to address each one of the above factors. In addition, there are no presumptions either in favor of or against exclusion based on the presence or absence of a board analysis in a no-action request, and determinations as to whether the staff agrees that a proposal may be excluded will be made on a case-by-case basis. Finally, the staff confirmed that it will consider proponents' analyses of significance in considering the issue.

Guidance on Micromanagement Exceptions

The SEC has stated that the policy underlying the "ordinary business" exception rests on two central considerations: (i) the proposal's subject matter, and (ii) the degree to which the proposal "micromanages" the company "by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment." SLB 14J states that the Division will consider if a proposal "involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies" when evaluating whether a proposal micromanages a company. For example, a proposal calling for a report may be excludable if the substance of the report relates to the imposition or assumption of specific timeframes or methods for implementing complex policies. Thus, in SLB 14J, the Division is signaling that the more prescriptive a shareholder proposal, the more likely the staff will concur that it is excludable on the basis of micromanagement, even if the proposal relates to a significant policy issue.

Application of Rule 14a-8(i)(7) to Executive and/or Director Compensation Proposals

SLB 14J also provides additional guidance on proposals that implicate senior executive and/or director compensation.

With respect to proposals that raise both ordinary business and senior executive and/or director compensation matters, the staff will examine the **focus** of the proposal. Where the focus appears to be on the ordinary business matter, the proposal may be excludable under Rule 14a-8(i)(7). SLB 14J explains that this framework ensures that form is not elevated over substance, such that the mere inclusion of an aspect of senior executive or director compensation in a proposal that otherwise focuses on an ordinary business matter will not insulate a proposal from exclusion under Rule 14a-8(i)(7).

For proposals that address aspects of senior executive and/or director compensation that are also available or applicable to the general workforce, the Division will take the following approach:

- *Proposals where the focus is on aspects of compensation that are available or apply only to senior executive officers and/or directors.* Companies may generally not rely on Rule 14a-8(i)(7) to omit these proposals from their proxy materials.
- *Proposals where the focus is on aspects of compensation that are available or apply to senior executive officers, directors, and the general workforce.* Companies may generally rely on Rule 14a-8(i)(7) to omit the proposal from their proxy materials.

Importantly, and in a reversal of an existing position, SLB 14J states that the Division will apply its micromanagement guidance to senior executive and/or director compensation matters, explaining that, "[c]onsistent with the Division's treatment of shareholder proposals on other topics, therefore, the Division may agree that proposals addressing senior

executive and/or director compensation that seek intricate detail, or seek to impose specific timeframes or methods for implementing complex policies can be excluded under Rule14a-8(i)(7) on the basis of micromanagement." As an example, SLB 14J notes that a proposal detailing the eligible expenses covered under a company's relocation expense policy such as the type and duration of temporary living assistance, as well as the scope of eligible participants and amounts covered, could well be excludable on the basis of micromanagement. It is hard to generalize what this new position might mean in the 2019 proxy season, but it will provide companies with another argument to make against environmental and social policy proposals masquerading as executive compensation proposals.

Impact on the 2019 Proxy Season?

As in prior SLBs, this one probably did not go as far as companies might have liked and probably went too far for many proponents. As such, it strikes the right tone, although it is impossible to predict the impact it will have on the 2019 proxy season.

Please feel free to contact any member of Ropes & Gray's securities & public companies practice group or your usual Ropes & Gray contact with any questions about this Alert.