October 21, 2019

# SEC Staff Issues Additional Guidance on Shareholder Proposals

In what has become an annual rite of fall, on October 16, 2019, the SEC's Division of Corporation Finance (the Division) issued Staff Legal Bulletin No. 14K (SLB 14K) on shareholder proposals, providing additional guidance on the "ordinary business" exception that permits the exclusion of proposals.

In SLB 14K, the Division discusses:

- the analytical framework of Rule 14a-8(i)(7);
- board analyses provided in no-action requests to demonstrate that the policy issue raised by the proposal is not significant to the company;
- the scope and application of micromanagement as a basis to exclude a proposal under Rule 14a-8(i)(7); and
- proof of ownership letters.

## Background

In 2017, in Staff Legal Bulletin No. 14I (SLB 14I), the Division encouraged companies seeking no-action relief under Rules 14a-8(i)(5) or 14a-8(i)(7) to include board analyses of the significance to the company of the particular policy issue the shareholder proposal raised (see our prior Alert on SLB 14I here). Last year, Staff Legal Bulletin No. 14J (SLB 14J) provided furtherguidance on board analyses, the micromanagement exception, and the application of Rule 14a-8(i)(7) to executive and/or director compensation proposals (see our prior Alert on SLB 14J here).

While many recent no-action requests have included board analyses, we are aware of only two instances where the Division concurred with the exclusions and cited the companies' board analyses of each proposal's significance to the respective companies' businesses. *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) (see our prior Alert here) and *Reliance Steel & Aluminum Co.* (avail. Apr. 2, 2019) (concurring with the exclusion under Rule 14a-8(i)(5) of a proposal requesting that the company provide a report on political contributions and expenditures).

## Staff Legal Bulletin No. 14K

### *"Significant" Policy Exception*

SLB 14K confirms that the Division takes a company-specific approach in evaluating significance, rather than recognizing particular issues or categories of issues as "universally significant." SLB 14K cites, as an example, that a climate change proposal submitted to an energy company may raise significant policy issues for that company, but it might not if submitted to a software development company. Thus, when companies seek to rely on the "ordinary business" exclusion, the Division advises companies to focus their no-action requests on the significance of the issue to the company. If the company fails to meet the burden of establishing the issue is not significant to it, then the Division believes that the proposal may not be excluded under Rule 14a-8(i)(7).



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***Additional Guidance on Board Analyses***

Building upon its previous guidance, the Division confirms in SLB 14K that it continues to believe that a "well-developed discussion" of the board's analysis of whether the particular policy issue raised by a proposal is sufficiently significant to the company can assist the Staff in evaluating a no-action request. The Division observes that there has been an "improvement in the board analyses" in the most recent proxy season due to more detailed discussions of the specific substantive factors (set forth in SLB 14J) that the board considered in determining whether an issue was significant to the company's business.

**Delta analysis.** SLB 14K cites with approval the inclusion of a delta analysis, which identifies the differences between a proposal's specific request and the actions the company has already taken, and provides an analysis of whether that gap – the difference between what a company has done and what the proposal requests – represents a significant policy issue for the company. Based on its evaluation of no-action requests during the past proxy season, the Division observed that such an analysis is most helpful where it clearly identifies the differences between the manner in which the company has addressed an issue and the manner in which a proposal seeks to address the issue and explains in detail why those differences do not represent a significant policy issue to the company. On the other hand, the Division found "conclusory statements," which offer little explanation as to why the board believes an issue is no longer significant, to be less helpful.

**Prior voting results.** SLB 14K notes that, during the last proxy season, SEC Staff was unable to agree with exclusion in cases where a board's discussion of a prior shareholder vote on the matter raised by the proposal was unpersuasive in demonstrating that the policy issue was no longer significant to the company. Rather than pointing to the fact that a similar proposal failed to garner majority support or attempting to diminish the significance of the prior voting results because of proxy advisory firms' recommendations or comparing the percentage of support against total outstanding shares versus votes cast, SLB 14K encourages companies to include a "robust discussion" that explains how the company's shareholder engagement activities on the issue, as well as any actions the company may have taken to address the concerns raised by the prior proposal, "bear on the significance of the underlying issue to the company."

***Micromanagement Exception***

A shareholder proposal that raises a significant policy issue may still be excluded under the "ordinary business" exception if it "micromanages" the company. This prong of the Rule 14a-8(i)(7) analysis rests on an evaluation of the manner in which a proposal seeks to address the subject matter raised, rather than the subject matter itself.

SLB 14K emphasizes that the Division's evaluation of the applicability of the "micromanagement" exception to a proposal will depend on how prescriptive the proposal is. In SLB 14K, the Division describes how two climate change-related proposals warranted different outcomes based solely on the level of prescriptiveness with which the proposals approached the same subject matter. In the first case, the Division concurred with the exclusion, on the basis of micromanagement, of a proposal seeking annual reporting on short-, medium- and long-term greenhouse gas targets aligned with the greenhouse gas reduction goals established by the Paris Climate Agreement to keep the increase in global average temperature to well below 2 degrees Celsius and to pursue efforts to limit the increase to 1.5 degrees Celsius. In the second case, the Division did not concur with the exclusion, on the basis of micromanagement, of a proposal seeking a report describing if, and how, a company plans to reduce its total contribution to climate change and align its operations and investments with the Paris Climate Agreement's goal of maintaining global temperatures well below 2 degrees Celsius. The Division viewed the first proposal as imposing a specific method of implementing a complex policy, whereas it viewed the second proposal as providing the company's management with more discretion to consider if and how the company plans to reduce its carbon footprint.



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SLB 14K states that when a proposal prescribes specific actions that the company's management or the board must undertake without affording them sufficient flexibility or discretion in addressing the complex matter presented by the proposal, the proposal may micromanage the company to such a degree that exclusion of the proposal would be warranted. Accordingly, the Division would expect a company's no-action request, when a company asserts micromanagement as the basis for exclusion, to include an analysis of how the proposal "may unduly limit the ability of management and the board to manage complex matters with a level of flexibility necessary to fulfill their fiduciary duties to shareholders."

***Proof of Ownership Letters***

Rule 14a-8(b) provides that a proponent must prove eligibility to submit a proposal by offering proof that it continuously held the required amount of securities for at least one year by the date the proposal is submitted. SLB 14K explains that the sample language provided in Staff Legal Bulletin No. 14F is neither mandatory nor the exclusive means of demonstrating the ownership requirements of Rule 14a-8(b). Accordingly, SLB 14K advises that companies should not seek to exclude a shareholder proposal based on drafting variances in the proof of ownership letter if the language used in such letter is clear and sufficiently evidences the requisite minimum ownership requirements.

## Impact on the 2020 Proxy Season?

Although the inclusion of board analyses in no-action requests was met with some initial enthusiasm from the issuer community, SLB14I and SLB14J have thus far not produced the hoped-for results for issuers. It remains to be seen whether the third time is the charm. For micromanagement, the proponent community has bridled at the SEC Staff's recent re-discovery of this basis for exclusion. SLB 14K provides proponents with a roadmap for avoiding exclusion, although the price may be that companies can satisfy a proposal that passes with a report that provides less detail than the proponents are seeking. In any event, the new guidance on micromanagement may change perceptions about the parties' relative bargaining power when companies seek to negotiate a withdrawal.

Interestingly, SLB 14K is silent on anything related to the Division's recent announcement that it would not necessarily respond to all Rule 14a-8 no-action requests (see our prior Alert here). Many unanswered questions remain – e.g., how decisions are communicated, transparency of correspondence – that will need to be clarified before next year's proxy season.

If you have any questions about this Alert, please contact your usual legal advisor at Ropes & Gray.



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