Client Alert

October 2019

Shareholder Proposals: New SEC Staff Guidance on the "Ordinary Business" Exclusion and Other Rule 14a-8 Matters

On October 16, 2019, the staff of the Securities and Exchange Commission's (SEC) Division of Corporation Finance (the Division) issued Staff Legal Bulletin No. 14K (SLB 14K), providing guidance on the "ordinary business" exception under Rule 14a-8(i)(7). Additionally, SLB 14K addresses certain issues concerning proof of ownership letters. This client alert provides a brief summary of SLB 14K, explains how SLB 14K will affect no-action request letters and summarizes the bulletin's additional Rule 14a-8 guidance.

Highlights

- "Sufficiently significant" analysis in the context of the "ordinary business" exception should focus on the relationship between the policy issue presented in the shareholder proposal and the company.
- Companies should include a "robust" and detailed board analysis in their no-action requests, which may include a delta analysis and discussion of prior voting results.
- "Micromanaging" is more about the degree of prescriptiveness of a proposal, and less about the actual subject matter of the proposal.
- Companies should avoid an "overly technical" reading of proof of ownership letters.

Rule 14a-8 and the "Ordinary Business" Exception

Rule 14a-8(i)(7) allows a company to exclude a shareholder proposal that "deals with a matter relating to the company's ordinary business operations." The goal of this "ordinary business" exception is "to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting." When evaluating no-action requests from companies, the SEC staff considers: (1) the significance of the proposal's subject matter; and (2) the degree to which the proposal "micromanages" the board of directors or company management.

Significance of the Proposal's Subject Matter

Shareholder proposals that present a "sufficiently significant" policy issue do not fall within the scope of the "ordinary business" exception and may not be excluded under Rule 14a-8(i)(7). SLB 14K advises companies to determine whether a policy issue is "sufficiently significant" by focusing on the relationship between the issue and the company's business operations. The SEC staff notes that historically companies have focused on the general significance of the issue rather than whether the policy issue "transcends the company's ordinary business operations." SLB 14K clarifies that the Division evaluates whether a policy issue is "sufficiently significant" on a company-specific basis. A policy issue may be "sufficiently significant" for one company, but not "sufficiently significant" for another company.

In the past, the SEC staff has conducted its own analysis to determine whether it believes a shareholder proposal is "sufficiently significant." Two recent Staff Legal Bulletins, SLB 14I and SLB 14J, place more responsibility on boards and SLB 14K continues this trend.

As reported in our 2017 alert, the Division expressed its position in SLB 14I that "the board of directors is generally in a better position to determine" the "difficult judgment calls" of whether a shareholder proposal is "sufficiently significant." In SLB 14K, the SEC staff reemphasizes this point and notes that during the recent proxy season, no-action requests that provided a detailed discussion of the board's analysis were more helpful to the staff in determining whether the policy issue was "sufficiently significant." Board analyses should include the substantive factors the board considered when determining that the policy issue in the shareholder proposal was not "sufficiently significant." Further, the Division notes that the absence of a board analysis in a no-action request could be detrimental to the approval of the request, particularly if the factors for determining whether the issue is "sufficiently significant" are not obvious.

In SLB 14J released in 2018, the Division introduced a number of factors for companies to address in the board analysis included in their no-action requests. In SLB 14K, the Division reemphasizes (1) delta analysis and (2) prior voting results as key factors.

Delta Analysis

Delta analysis evaluates whether the company has already addressed the policy issue in the shareholder proposal, and the differences between the proposal's request and any actions the company has already taken on that same policy issue. If the company finds that it has already addressed a policy issue in a shareholder proposal, the Division advises that the board analysis should address whether the difference between the proposal's request and the company's prior actions is a significant policy issue for the company.

As an example, SLB 14K states that "if a shareholder proposal sought greater disclosure of a telecommunications company's customer information privacy policy, under appropriate circumstances, the company's board analysis could highlight, if it is the case, how its cybersecurity policy addresses the issues covered by the proposal and how the difference – or delta – between the two approaches would not raise a significant policy issue for the company." The Division notes that a delta analysis that clearly identifies the difference between the shareholder proposal's method of addressing the policy issue and how the company has already addressed the policy issue, and details why the difference does not represent a significant policy issue to the company, is the most helpful. Conversely, statements that fail to explain why the board of directors believes the policy issue presented in the shareholder proposal is not significant are less helpful.

Prior Voting Results

SLB 14K reaffirms the Division's view that if the company's shareholders have previously voted on the matter proposed, the board analyses should include a discussion of the voting results. The Division advises that a robust discussion should explain how, since the prior vote, the company's subsequent actions, intervening events or other objective indications of shareholder engagement on the issue demonstrate the lack of significance of the underlying issue to the company.

As an example, the Division notes that if a company engages with its shareholders to understand the level of support for a proposal that received significant support, the board's analysis should include a discussion describing how its view on significance was informed by such shareholder engagement and any actions the company may have taken since the vote to address concerns expressed in the proposal.

Micromanaging

The SEC staff reviews the degree to which a proposal "micromanages" the company in determining whether it may properly be excluded under the "ordinary business" exception. In its analysis, the SEC staff evaluates the manner of the proposal, the prescriptiveness of the proposal, whether the proposal provides the board with flexibility on the implementation of the proposal and whether the proposal is excessive. Micromanaging is about the manner in which the proposal seeks to address the subject matter of the

proposal, and how much flexibility the proposal gives the board to implement the proposal. SLB 14K provides a few general examples of micromanaging:

- Proposals that prescribe specific timeframes or methods for implementing complex policies[1]
- Proposals that are overly prescriptive as to the method or strategy for implementing the action requested by the proposal
- Proposals that limit the judgment and discretion of the board

As an example, the SEC staff agreed that a shareholder proposal was "micromanaging" because it requested 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." The SEC notes that this proposal was too prescriptive and required the "adoption of time-bound targets." Conversely, the Division found that a proposal that requested that a company provide a plan for reducing its carbon footprint and consider the pros and cons of different options, but deferred to the management's discretion was not "micromanaging." SLB 14K explains that when evaluating a proposal for micromanagement, the Division examines the proposal in its entirety so that if a supporting statement requires a certain action to achieve the proposal, then that could be micromanaging.

Proof of Ownership Letters

Shareholders wishing to submit a shareholder proposal for inclusion in proxy materials must prove that the shareholder "continuously held" the amount of securities prescribed by Rule 14a-8 "for at least one year by the date" the shareholder submits the proposal. The SEC provided a suggested format for shareholders to prove their ownership in SLB14F; however, SLB 14K clarifies that the suggested format is not required. In this bulletin, the Division advises companies to avoid "overly technical" approaches when evaluating proof of ownership as a basis for excluding a shareholder proposal. The SEC staff suggests a plain meaning approach to reading proof of ownership letters. If the evidence of ownership is sufficiently clear and meets the eligibility requirements under Rule 14a-8, then the company should not exclude the proposal just because the ownership letter does not conform to the SEC's format.

Interaction Between SLB 14K and Oral Advice Policy

As described in a previous client alert, on September 6, 2019, the Division announced that the staff may respond orally rather than in writing to no-action requests. Furthermore, the SEC staff may decline to take a position on the merits of certain requests, and leave the decision of whether to exclude the shareholder proposal to the company. Companies must still submit a no-action letter, and should provide the Division with detailed arguments in support of their no-action request. This oral advice policy and SLB 14K evidence the SEC staff's latest attempts to disentangle themselves from proposal disputes, give more responsibility to companies for policing their own shareholder proposals and encourage greater engagement between shareholders and companies.

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[1] Perhaps foreshadowing SLB 14K, on March 13, 2019, SEC staff issued a no-action letter to MGE Energy permitting it to exclude a shareholder proposal that requested a report "describing how [the company] can provide a secure, low-cost energy future for their customers and shareholders by eliminating coal and moving to 100% renewable energy by 2050 or sooner." MGE sought to exclude the proposal under Rule 14a-8(i)(7) because it related to the company's ordinary business operations. The staff agreed, finding that "the Proposal seeks to micromanage the Company by seeking to impose specific methods of implementing complex policies in place of management as overseen by its board of directors." Reliance on the board's analysis also seemed to be a critical component of the staff analysis.

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