

# NOW & NEXT

## Securities Alert

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### SEC staff limits ability of public companies to exclude shareholder proposals

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We highlight the SEC Division of Corporation Finance's recent guidance on shareholder proposals and changes in its approach to evaluating requests to exclude these proposals from company proxy statements.



#### What's the Impact?

- / We anticipate that the guidance will lead to an increase in the submission of shareholder proposals relating to environmental and social policy issues
- / Going forward, it will become more difficult for companies to exclude such shareholder proposals
- / Shareholders must be aware of procedural and technical issues covered by the guidance relating to the proposal process

On November 3, 2021, the Division of Corporation Finance ("Staff") of the Securities and Exchange Commission ("SEC") published [Staff Legal Bulletin No. 14L](#) ("SLB 14L") to update Staff guidance on shareholder proposals submitted to publicly traded companies under Rule 14a-8 of

the Securities Exchange Act of 1934 and to clarify the Staff's current approach to evaluating requests to exclude such proposals from company proxy statements.

Rule 14a-8 addresses when a public company must include a shareholder's proposal in its proxy statement, as well as several bases for exclusion of such proposals. Companies often request assurance that the Staff will not recommend enforcement action if they omit a shareholder proposal based on one of these exclusions. SLB 14L rescinds previous Staff Legal Bulletin Nos. 14I, 14J, and 14K, issued in 2017, 2018, and 2019, respectively, and resets the Staff's views on certain bases for a company to exclude a shareholder's proposal from its proxy statement.

Specifically, SLB 14L (i) reverses the company-specific approach to evaluating the significance of a policy issue for purposes of excluding a shareholder proposal on the basis of the ordinary business exclusion provided by Rule 14a-8(i)(7); (ii) rescinds prior guidance in favor of a narrower "measured approach" to evaluating a company's micromanagement argument under the ordinary business exclusion; and (iii) reverses the company-specific approach to evaluating the economic relevance exclusion under Rule 14a-8(i)(5) with respect to the significance of proposals that raise issues of broad social or ethical concerns related to the company's business. SLB 14L also republishes prior guidance on the use of images in proposals and the Staff's approach to interpreting proof of ownership letters (with updating technical changes), and provides new guidance on the use of email for communications between companies and proponents of shareholder proposals.

### Ordinary business exclusion

Rule 14a-8(i)(7) permits exclusion of a shareholder proposal that "deals with a matter relating to the company's ordinary business operations." According to the SEC's [release](#) accompanying the 1998 amendments to Rule 14a-8, the term "ordinary business" refers to matters that are not necessarily "ordinary" in the common meaning of the word, but instead the term "is rooted in the corporate law concept providing management with flexibility in directing certain core matters involving the company's business and operations." The underlying policy of the ordinary business exclusion 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." This general policy reflects two central considerations: (i) "[c]ertain tasks 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" and (ii) the "degree to which the proposal seeks to 'micro-manage' 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."

### Significant social policy exception

The ordinary business exclusion is not generally available for proposals involving subjects that raise policy issues that transcend the day-to-day business matters of the company and are so significant that it would be appropriate to provide a shareholder vote (the "Significant Social Policy Exception"). The Staff in SLB 14L highlights that the Significant Social Policy Exception is "essential for preserving shareholders' right to bring important issues before other shareholders

by means of the company's proxy statement, while also recognizing the board's authority over most day-to-day business matters." SLB 14L rescinds the Staff's company-specific approach of recent years to the significance assessment of social policy issues, under which the significance of a policy issue was to be evaluated in the context of the particular company and its circumstances. SLB 14L provides a "realignment" of that approach and restores the Staff's historical standard for evaluating no-action requests under the Significant Social Policy Exception.

The Staff asserts in SLB 14L that the company-specific approach had placed an undue emphasis on evaluating the significance of a policy issue to a particular company at the expense of whether the proposal focuses on a social policy issue so significant that it would be appropriate for shareholder voting. Under the approach articulated in SLB 14L, the Staff will no longer focus on determining the nexus between the policy issue underlying the proposal and the company, but will instead focus its evaluation on whether a shareholder proposal raises issues of such broad societal impact that they transcend the ordinary business of the company. Under this new approach, previously excludable proposals may not be viewed as excludable under Rule 14a-8(i)(7) solely because the proposal does not demonstrate that a policy issue is significant to the company. One proposal topic specifically referenced in SLB 14L as having broad societal impact—and therefore potentially not excludable under this realigned standard—is proposals raising human capital management issues. In light of this change in approach, the Staff will no longer expect companies requesting no-action relief under the ordinary business exclusion to provide a board analysis assessing whether the particular policy issue raised by the proposal was sufficiently significant to the company.

### *Micromanagement*

A common argument in support of exclusion of a shareholder proposal under the ordinary business exclusion is that the proposal constitutes shareholder micromanagement of the company by "probing too deeply into matters of a complex nature" better left to management or board discretion ("micromanagement"). SLB 14L rescinds prior guidance on micromanagement claims given in Staff Legal Bulletin Numbers 14J and 14K, which the Staff indicates may have been understood to mean that any limit on a company's or board's direction constitutes micromanagement, thereby expanding the concept of micromanagement beyond its originally intended bounds. In SLB 14L, the Staff reverts to a narrower "measured approach" to the concept of micromanagement and arguments justifying exclusion on that basis.

Under the Staff's measured approach to evaluating micromanagement arguments, as described in SLB 14L, proposals suggesting targets or seeking specific details, timeframes, or methods do not *per se* constitute micromanagement. Going forward, the Staff will focus on "the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management." To assess whether a proposal is "too complex" for shareholder consideration, the Staff may consider the sophistication of investors generally on the matter, the availability of data, the robustness of public discussion and analysis on the topic, and references to well-established national or international frameworks when assessing proposals related to disclosure, target setting, and timeframes. The Staff in SLB 14L specifically cited

proposals relating to climate change as no longer being excludable on micromanagement grounds simply because the proponent requests that the company adopt timeframes or targets to address climate change, so long as the proposal leaves with company management the discretion to determine how to achieve such goals.

## Economic relevance exclusion

Rule 14a-8(i)(5) permits a company to exclude a proposal that “relates to operations which account for less than 5% of the company’s total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company’s business.” Previous guidance under Staff Legal Bulletin No. 14I provided a basis for exclusion of a proposal relating to operations which fell below the numeric thresholds if the proposal was not “significantly related” to the company’s business. To support the argument that the proposal topic was not “significantly related” to the company’s business, companies requesting no-action relief on this basis were encouraged to submit a board analysis addressing the relevance of the topic to the specific company.

Going forward, this company-specific approach to examining relevance will not be applied in the context of shareholder proposals that raise issues of broad social or ethical concern related to the company’s business, even if the relevant business falls below the economic thresholds under Rule 14a-8(i)(5). SLB 14L does not indicate that the relationship must be “significant” to require inclusion in the context of proposals addressing such issues. As a result of this change in approach, the Staff will no longer expect a board analysis for the Staff’s consideration for no-action requests under Rule 14a-8(i)(5).

## Procedural and technical items

In addition to addressing the new Staff approaches to exclusion of shareholder proposals on these substantive bases, SLB 14L addresses various procedural and technical issues relating to the shareholder proposal process, as noted below.

### *Images in shareholder proposals*

SLB 14L reissues prior Staff guidance from the rescinded Staff Legal Bulletins, with technical updates, on uses of images in shareholder proposals. The Staff continues to believe that Rule 14a-8(d) does not preclude shareholders from using graphics or images to convey information about their proposal, so long as the total number of words in the proposal, including words in the graphics, does not exceed 500. Recognizing the potential for abuse in this area, the Staff reaffirms its view that it would be appropriate to exclude such graphics/images under Rule 14a-8(i)(3), when they (i) make the proposal materially false or misleading; (ii) render the proposal too vague or indefinite; (iii) impugn character, integrity, or personal reputation, or make charges concerning improper, illegal, or immoral conduct or association, without factual foundation; or (iv) are irrelevant to a consideration of the proposal’s subject matter.

### *Proof of ownership letters*

Rule 14a-8(b) provides that, when making a shareholder proposal, a shareholder must offer proof that it continuously held the requisite amount of securities for the required amount of time. SLB 14L provides an updated sample format for shareholders and their brokers to use in the proof of ownership letters. The Staff rejects an overly technical approach to interpreting the contents of a proof of ownership letters, emphasizing that the suggested format is neither mandatory nor the exclusive means of demonstrating ownership. Companies are instead encouraged to take a plain meaning approach to evaluating such letters. SLB 14L also provides that companies should identify any specific defects in the proof of ownership letter, even if the company previously sent a deficiency notice prior to receiving proof of ownership if such deficiency notice did not identify the specific defect(s).

### *Use of email*

The Staff recognizes that shareholders and companies have increasingly relied on the use of email to submit proposals and exchange related communications. SLB 14L suggests that the shareholders obtain the correct email address from the company and that the companies provide such email addresses upon request. SLB 14L also encourages senders to seek confirmation of receipt from the recipient and recipients to provide such confirmation when using emails for communications of shareholder proposal matters.

### **Takeaways**

SLB 14L limits the availability of the ordinary business and economic relevance bases to exclude shareholder proposals raising social and environmental issues through no-action requests. Going forward, it will become more difficult for companies to exclude such shareholder proposals. This is a positive development for shareholders that plan to submit proposals for the next proxy season.

In light of the guidance set forth in SLB 14L, we note the following takeaways for public companies and shareholders:

#### *Public companies*

- / It will be much harder to exclude a shareholder proposal from the proxy statement based on arguments of ordinary business, micromanagement or economic relevance, particularly in the case of proposals addressing significant social policy or environmental issues. The “substantial implementation” argument under Rule 14a-8(i)(10) will become a more important basis to exclude shareholder proposals.
- / It will also be harder to exclude shareholder proposals based on the proponent’s failure to satisfy procedural requirements. Companies now should send a second deficiency letter if the previous deficiency letter does not identify the specific defect(s) in the proof of ownership letter.
- / When communicating via email on shareholder proposal matters, companies should provide a correct email address upon request and seek confirmation of receipt from the

shareholders.

- / SLB 14L is likely to lead to an increase in the submission of shareholder proposals relating to environmental and social policy issues.

### *Shareholders*

- / Shareholder proposals relating to environmental and social matters will more likely not be excludable on the basis of the ordinary business exclusion or the economic relevance exclusion.
- / When delivering shareholder proposals via email, shareholders should obtain the correct email address of the company recipient and seek confirmation of receipt and/or use read receipts.
- / When using graphics or images in proposals, the words in such graphics/images will count toward the 500-word limit and such graphics or images may be excludable under Rule 14a-8(i)(3).

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