

SEC Staff Legal Bulletin No. 14J Provides Additional Shareholder Proposal Guidance

On October 23, 2018, the staff (Staff) of the Division of Corporation Finance of the US Securities and Exchange Commission (SEC) issued Staff Legal Bulletin No. 14J (SLB 14J) to provide further guidance on shareholder proposals submitted pursuant to Rule 14a-8 under the Securities Exchange Act of 1934.¹ SLB 14J addressed three topics:

- Board analyses provided in no-action requests that seek to rely on economic relevance (Rule 14a-8(i)(5)) or ordinary business (Rule 14a-8(i)(7)) as a basis to exclude shareholder proposals;
- The scope and application of micromanagement necessary to implement a proposal as a basis to exclude a proposal under Rule 14a-8(i)(7); and
- The scope and application of Rule 14a-8(i)(7) for proposals that touch upon senior executive and/or director compensation matters.

Rule 14a-8(i)(5) permits a company to exclude a shareholder proposal if it relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business. Rule 14a-8(i)(7) allows the exclusion of a shareholder proposal that deals with a matter relating to the company's ordinary business operations.

This is the 11th Staff Legal Bulletin providing guidance on shareholder proposals. The guidance provided by SLB 14J expands on developments from the 2018 proxy season. Companies that are, or may soon be, in the process of responding to shareholder proposals for the 2019 proxy season should consider the impact of these interpretations.

Board Analysis

In November 2017, the Staff issued Staff Legal Bulletin No. 14I (SLB 14I),² in which it indicated that an analysis by a company's board of directors could assist the Staff's review of a no-action request by explaining why it is appropriate for the company to exclude a particular shareholder proposal from its proxy statement under either Rule 14a-8(i)(7) or Rule 14a-8(i)(5). Specifically, the Staff requested board guidance on why a proposal is not sufficiently significant to transcend a company's ordinary business in the case of Rule 14a-8(i)(7) or why a proposal raises a policy issue that is not significantly related to the company's business in the case of Rule 14a-8(i)(5).³ As the Staff summarized in SLB 14J, these requests often raise "difficult judgment calls that the [Staff] believes are matters that the board of directors generally is well-situated to analyze."

SLB 14J evaluated the board analyses that the Staff received as part of no-action requests during the 2018 proxy season, stating that such board analyses were helpful even when the Staff

did not ultimately agree with the company's position. According to SLB 14J, the Staff found that the most helpful included a well-developed discussion of the specific substantive factors the board considered in arriving at its conclusion. The Staff indicated that discussions were less helpful when they only described the board's conclusions or process, without discussing the specific factors considered.

SLB 14J identified the following six factors as examples of the types of considerations that may be appropriate for inclusion in the board analysis discussion of a no-action request:

- 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 between the proposal's specific request and the actions the company has already taken, and an analysis of whether the differences present 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.

This list is not intended to be exclusive or exhaustive. In addition, it is not necessary for the board to address each one of these factors.

While clarifying that a board analysis is optional and that the absence of such discussion will not create a presumption against exclusion, SLB 14J warned that "without having the benefit of the board's views on the matters raised, the staff

may find it difficult in some instances to agree that a proposal may be excluded." According to SLB 14J, this is especially true if "the significance of a particular issue to a particular company and its shareholders may depend on factors that are not self-evident and that the board may be well-positioned to consider and evaluate."

SLB 14J reiterated that the Staff views substantive governance matters to be significantly related to almost all companies, so it is unlikely that the Staff would agree to exclude proposals that focus on such matters.

Micromanagement

SLB 14J also addressed the scope and application of micromanagement as a basis to exclude a proposal under Rule 14a-8(i)(7), explaining that the ordinary business exception has two components. The first involves the subject matter of the proposal, while the second relates to whether a proposal probes "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 made clear that the Staff applies this micromanagement framework to proposals that call for an intricately detailed report or study. In addition, SLB 14J specified that the Staff's concurrence with a micromanagement argument does not necessarily mean that the subject matter raised by the proposal is improper for shareholder consideration.

Senior Executive/Director Compensation

Proposals involving workforce management may be excludable as ordinary business matters under Rule 14a-8(i)(7), while proposals that focus on senior executive and/or director compensation generally cannot be excluded. SLB 14J provided guidance on how the Staff determines whether a proposal implicating senior executive/director compensation could be

excluded as involving ordinary business in three circumstances.

First, if a proposal raises both ordinary business and senior executive and/or director compensation matters, the Staff will evaluate whether the proposal's focus is on an ordinary business matter or on aspects of senior executive and/or director compensation. If the Staff determines the focus to be on the ordinary business matter, the proposal may be excludable under Rule 14a-8(i)(7) even though it involves senior executive and/or director compensation matters.

Also, if a primary aspect of compensation targeted by a proposal is broadly available or applicable to a company's general workforce, it may be excludable under Rule 14a-8(i)(7), even if the proposal addresses senior executive and/or director compensation, if the company demonstrates that the executives' or directors' eligibility to receive the compensation does not implicate significant compensation matters.

Finally, proposals addressing senior executive and/or director compensation can be excluded under Rule 14a-8(i)(7) on the basis of micromanagement if they "seek intricate detail, or seek to impose specific timeframes or methods for implementing complex policies." As an example, SLB 14J indicated that a proposal detailing the eligible expenses covered under a company's relocation expense policy "could well be excludable" as micromanagement. SLB 14J emphasized that micromanagement addresses the manner in which a proposal raises an issue. If the focus of the proposal is on significant executive and/or director compensation matters without micromanagement, the proposal will not be excludable under Rule 14a-8(i)(7).

Practical Considerations

As noted above, while a board analysis is not essential, it can be helpful to the Staff's evaluation of a company's no-action request for exclusion of a shareholder proposal under

Rule 14a-8(i)(7) or (i)(5) where the significance of the proposal is at issue. Because a board of directors has many competing demands on its time, management needs to assess whether to suggest to directors that they analyze a proposal to determine if it raises an issue that is sufficiently significant to transcend the company's ordinary business or that is significantly related to the company's business.

In light of a board's other time commitments, it may not be worthwhile to ask directors to analyze the significance of a proposal for the purposes of a no-action request, for example, if there are strong arguments for exclusion on technical grounds, such as a deficient proof of ownership. Similarly, a board analysis might not be necessary if there is strong no-action letter precedent suggesting that the Staff is likely to grant a no-action letter on ordinary business grounds, as may be the case if the proposal involves micromanagement. And if a significant number of shareholders voted in favor of a proposal on a similar topic in prior years, a board analysis may not be productive unless there are mitigating developments on the issue for the board to discuss, such as subsequent actions taken by the company or other intervening events.

On the other hand, the Staff has indicated that it generally considers board analyses to be helpful. A board analysis is another tool that companies can use when seeking to exclude a shareholder proposal from their proxy statements under Rule 14a-8(i)(7) or (i)(5) where significance is being debated. A board analysis can bring helpful facts to the Staff's attention and give the Staff the benefit of the board's perspective. The analysis also demonstrates that the board has prioritized the exclusion request by taking the time to consider the issues involved.

While a board analysis does not always need to be included in a no-action request, companies should consider the facts and circumstances of shareholder proposals in these areas carefully—as well as the board's other time commitments—

to assess whether a board analysis will help further the arguments made in support of a no-action request. If a company chooses to provide a board analysis, it is important to submit one that is “well-developed,” taking into account some of the factors provided as examples in SLB 14J as described above.

SLB 14J’s emphasis on micromanagement as a basis for exclusion under Rule 14a-8(i)(7), including with respect to studies, reports and senior executive and/or director compensation, signals that the Staff is receptive to considering such arguments. Therefore, when a shareholder proposal is received, it is worthwhile to evaluate whether implementation of the proposal can be appropriately characterized as micromanagement. Companies, however, should recognize that the Staff’s determinations on micromanagement as a basis for agreement with a no-action request will be made on a case-by-case basis. SLB 14J explained the Staff’s views on the scope and application of micromanagement exclusions under Rule 14a-8(i)(7) but did not imply that the Staff will agree with all no-action requests raising micromanagement as an issue.

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¹ Available at <https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals>

² Available at <https://www.sec.gov/interps/legal/cfs14i.htm>

³ For a further discussion of SLB 14I, see our Legal Update, “SEC Staff Issues Legal Bulletin on Shareholder Proposals,” dated November 7, 2017, available at <https://www.mayerbrown.com/SEC-Staff-Issues-Legal-Bulletin-on-Shareholder-Proposals-11-07-2017/>

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