

Legal Update

SEC Staff Issues Legal Bulletin Announcing Shift in Shareholder Proposal Review Process Ahead of 2022 Proxy Season

On November 3, 2021, the staff of the Division of Corporation Finance (Staff) of the US Securities and Exchange Commission (Commission) issued Staff Legal Bulletin No. 14L (SLB 14L), providing information regarding the Staff's review process for companies seeking to exclude shareholder proposals submitted for inclusion in company proxy statements pursuant to Rule 14a-8 under the Securities Exchange Act of 1934.¹ SLB 14L rescinds Staff Legal Bulletins Nos. 14I, 14J and 14K (Rescinded Bulletins), reversing course on positions taken since 2017 with respect to the ordinary business grounds for exclusion of shareholder proposals contained in Rule 14a-8(i)(7) and the economic relevance grounds for exclusion contained in Rule 14a-8(i)(5).

SLB 14L also addresses the use of emails in the shareholder proposal process and republishes guidance that had been contained in the Rescinded Bulletins, with some changes that are primarily technical and conforming in nature.

Significant Policy Exception to Ordinary Business Exclusion

Rule 14a-8(i)(7) permits a shareholder proposal to be excluded from a company's proxy statement when it involves ordinary business operations. For this purpose, a matter involves "ordinary business" if it is so fundamental to management's ability to run the company on a day-to-day basis that it could not as a practical matter be subject to direct shareholder oversight. The Commission recognizes an exception, however, for proposals that focus on policy issues that are sufficiently significant to transcend ordinary business. In 2009, Staff Legal Bulletin 14E specified that a sufficient nexus must exist between the nature of the proposal and the company in order for the significant policy exception to apply. SLB 14L asserts that the Rescinded Bulletins placed "undue emphasis" "on evaluating the significance of a policy issue to a particular company at the expense of whether the proposal focuses on a significant social policy." SLB 14L indicates that, going forward, the Staff "will no longer focus on determining the nexus between a policy issue and the company, but will instead focus on the social policy significance of the issue that is the subject of the shareholder proposal." In a departure from longstanding policy, the Staff "will

consider whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company.” As a result, proposals that the Staff “previously viewed as excludable because they did not appear to raise a policy issue of significance for the company may no longer be viewed as excludable under Rule 14a-8(i)(7).” The Staff provides an example of how the public should expect them to implement this new policy: “[P]roposals squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company.”

Micromanagement

According to SLB 14L, the Rescinded Bulletins expanded the micromanagement analysis of the ordinary business exclusion beyond the Commission’s policy directives in a manner that could be construed as meaning that any limit on company or board discretion constitutes micromanagement. Under SLB 14L, the Staff will now apply a “measured approach to evaluating companies’ micromanagement arguments – recognizing that proposals seeking detail or seeking to promote timeframes or methods do not per se constitute micromanagement,” focusing “on the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management.” While observing that its analysis applies to any subject matter, SLB 14L expressly advises that the Staff would not concur in the exclusion of climate change proposals that “suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals.”

As an example of its new approach to micromanagement, SLB 14L refers to a recent no-action letter where the Staff concluded that a proposal requesting that the company set greenhouse gas emission reduction targets without imposing a specific method for doing so did not constitute micromanagement. In addition, SLB 14L indicates the Staff “may consider the sophistication of investors generally on the matter, the availability of data, and the robustness of public discussion and analysis on the topic” when assessing whether a proposal is “‘too complex’ for shareholders, as a group, to make an informed judgment.” The Staff may also consider references to well-established frameworks “related to disclosure, target setting, and timeframes as indicative of topics that shareholders are well-equipped to evaluate.”

Economic Relevance

Rule 14a-8(i)(5) permits a shareholder proposal to be excluded from a company’s proxy statement 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.” However, for this basis for exclusion to apply, the proposal must not otherwise be “significantly related to the company’s business.” The Rescinded Bulletins had interpreted the “significantly related to the company” test as dependent on the particular circumstances of the company to which the proposal is submitted. SLB 14L rejects this approach, stating that “proposals that raise issues of broad social or ethical concern related to the company’s business may not be excluded, even if the relevant business falls below the economic thresholds” specified by Rule 14a-8(i)(5).

Board Analysis

As a result of the changed interpretations of “significant policy” issues for the purposes of the exception to the ordinary business exclusion of Rule 14a-8(i)(7) and “significantly related to the company’s business” for the purposes of Rule 14a-8(i)(5), SLB 14L indicates that the Staff is no longer seeking board analyses as part of the submission of no-action requests on either of those grounds.

Emails

SLB 14L also provides new guidance on the use of email for submission of shareholder proposals, delivery of notice of defects, and responses to those notices. The Staff encourages senders to seek a reply email from the recipient that acknowledges receipt of the email and encourages recipients to acknowledge receipt of emails when requested. According to SLB 14L, shareholders choosing to respond to a company’s deficiency notice by email have the burden to use an appropriate email address, such as an email address provided by the company or the email address of the counsel who sent the deficiency notice. Similarly, companies using email to send notice of defects in the shareholder proposal have the burden to prove timely delivery.

Technical Republication of Some Prior Guidance

SLB 14L republishes the guidance from the Rescinded Bulletins relating to proof of ownership letters and use of images in shareholder proposals. In the ownership letters context, SLB 14L updates the suggested format to reflect recent changes to the ownership thresholds resulting from amendments to Rule 14a-8 and also advises that the Staff does not “interpret the recent amendments to Rule 14a-8(b) to contemplate a change in how brokers or banks fulfill their role” in providing confirmation of ownership of shares. While there are some primarily technical and conforming changes in the ownership letters and images guidance, the guidance in those areas has not substantially changed.

Practical Considerations

The shareholder proposal process is a popular means for shareholders (and other interested parties acting as shareholder representatives) to present environmental, social and governance (ESG) topics to company management as well as to shareholders. The policies in SLB 14L will make it more difficult for companies to exclude ESG proposals from their proxy statements. As a result, the Staff’s new approach will likely result in the inclusion of more ESG-focused shareholder proposals in companies’ 2022 proxy statements, especially proposals involving climate change or human capital management, two areas that were highlighted in SLB 14L.

Because SLB 14L changes the Staff’s approach to the ordinary business and economic relevance grounds for exclusion, no-action precedents from prior years may no longer be applicable for proposals that raise ESG issues that the Staff considers to be focused on a significant social policy issue.

Because the Commission has not amended the applicable rules, ordinary business and economic relevance remain grounds for exclusion. And micromanagement is still an available basis for exclusion, although it may be less likely that the Staff will concur with such an argument. Companies submitting no-action requests seeking exclusions on these grounds will need to frame their arguments within the scope of the interpretive approach of SLB 14L.

Although it may be more challenging to receive the Staff's concurrence for exclusion of a proposal by presenting ordinary business or economic relevance arguments when a significant social policy issue is raised, other grounds for exclusion may be available even for a proposal that may involve a significant social policy issue. Therefore, companies receiving a shareholder proposal should analyze it carefully to consider all possible grounds for exclusion that might be available. For example, there also may be facts that support a no-action request setting forth an argument for exclusion on the grounds of substantial implementation pursuant to Rule 14a-8(i)(10). And, as with any shareholder proposal, companies should promptly determine if there are any procedural grounds for exclusion and if so, whether the company needs to send the proposal's proponent a deficiency notice.

Companies receiving proposals that raise social policy issues may also find it productive to negotiate with the proponents to see if they can reach a mutually agreeable approach that could lead to the withdrawal of the proposal. The procedural amendments to Rule 14a-8 that go into effect for this proxy season require that the shareholder proponent be available to engage with the company.

Finally, companies should pay attention to the guidance provided with respect to emails by seeking delivery receipts, or otherwise seeking acknowledgement of emails, to establish the delivery date of documents such as emailed notices of defects. Given that the Staff is encouraging recipients to acknowledge receipt of emails, companies should consider adopting the practice with respect to shareholder proposals.

For more information about the topics raised in this Legal Update, please contact the author of this Legal Update, Laura D. Richman, at +1 312 701 7304, any of the following lawyers or any other member of our Corporate & Securities practice.

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Endnote

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

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