Updates
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# SEC Staff Provides Additional Guidance on Shareholder Proposals

The U.S. Securities and Exchange Commission (SEC) has issued several important recent updates regarding shareholder proposals and the related no-action request process for companies to consider ahead of the 2019-2020 proxy season.

On October 16, the SEC's Division of Corporation Finance staff issued Staff Legal Bulletin No. 14K (SLB 14K), providing additional guidance for companies submitting no-action requests to exclude shareholder proposals from proxy statements. SLB 14K expands on prior staff guidance by articulating the following:

- Clarifying that whether a proposal relates to a "significant policy issue" in the context of the "ordinary business" exception under Rule 14a-8(i)(7) is a question of the significance of the issue to the particular company, rather than whether the issue is of universal significance
- Stressing the importance of board analyses provided in no-action requests to demonstrate that the policy issue raised by the proposal is not significant to the company
- Reminding companies that a no-action request concerning a proposal that the company's board believes is not significant is most helpful if it includes a detailed analysis substantiating the significance determination, which may include a delta analysis or results of prior shareholder votes
- Illustrating that a key inquiry in considering an argument for exclusion based on "micromanagement" is whether the proposal imposes a specific strategy, method, action, outcome or timeline, thereby supplanting the judgment of management and the board
- Advising companies to refrain from an overly technical reading of proof of ownership letters

SLB 14K was released on the heels of the staff's September 2019 memorandum (memorandum) announcing two significant procedural changes to the Rule 14a-8 no-action letter process. The following are the changes taking effect for the 2019-2020 shareholder proposal season:

- The staff now may *respond orally rather than in writing*, to some no-action requests where it does not believe that a written response would provide value. The staff intends to continue to issue written responses where it believes the response will provide more broadly applicable guidance about complying with Rule 14a-8.
- The staff may now more frequently *decline to state a view* with respect to the company's asserted basis for exclusion. The staff noted that when it declines to take a view on a request, the company may still have a valid basis to exclude the proposal, and the parties may seek formal, binding adjudication on the merits in court.

The memorandum also noted that the staff continues to believe that when a company seeks to exclude a shareholder proposal from its proxy materials under the economic relevance exclusion under Rule 14a-8(i)(5) or the ordinary business exclusion under Rule 14a-8(i)(7), "an analysis by the company's board of directors is often useful."

In addition, on November 5 the SEC approved proposed amendments to shareholder proposal resubmission and eligibility requirements. The amendments address several issues that companies have been asking the SEC to modernize for years, including significantly increasing the eligibility threshold for shareholders who have owned company stock for less than three years, and increasing prior shareholder vote thresholds for proposals that are

substantially the same as proposals included in a company's proxy statement within the preceding five years. Currently, those thresholds are 3%, 6% and 10% for proposals voted on once, twice and three or more times in the past five years, respectively. The proposed amendments would increase those thresholds to 5%, 15% and 25%, respectively. These proposed amendments are subject to a 60-day notice and comment period, and may be revised before final adoption.

**SLB 14K Guidance**

**Ordinary Business Exclusion**

Rule 14(a)-8(i)(7) permits a company to exclude a proposal that "deals with a matter relating to the company's ordinary business operations." Proposals may be excluded if they "raise matters that 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.'" However, proposals focused on policy issues that are so significant that "they transcend ordinary business and would be appropriate for a shareholder vote" may not be excluded.

SLB 14K advises that the staff takes a company-specific approach to evaluating the significance of a proposed policy to a company's ordinary business operations. Under this approach, an issue that is significant to one company may not be significant to all. For example, the staff raises the possibility of distinguishing between a climate change proposal submitted to an energy company, which could raise significant policy issues, and a climate change proposal submitted to a software development company, which, in the staff's view, potentially may not raise significant policy issues for that company.

**Board Analysis**

In SLB 14K, the staff reminds companies that no-action requests arguing that a policy is not significant to a company's business are most helpful to its decision-making when they include a board analysis, as first requested by the staff in Staff Legal Bulletin No. 14I (SLB 14I). The staff further notes that board analysis is especially important in cases where the significance of the issue to the company and shareholders is not self-evident. SLB 14K provides specific advice regarding two types of board analysis: delta analysis and prior voting results.

*Delta Analysis*. SLB 14K expands on Staff Legal Bulletin No. 14J (SLB 14J), which included "[w]hether the company has already addressed the issue in some manner, including the differences—or the delta—between the proposal's specific request and the actions the company has already taken, and an analysis of whether the delta presents a significant policy issue for the company" as one of six factors a "well-developed" board analysis could include. SLB 14K clarifies that a delta analysis is distinct from the analysis required for a "substantial implementation" argument under Rule 14a-8(i)(10). In SLB 14K, the staff observes that a delta analysis could be useful for companies that have addressed the policy issue, but in a way that may not amount to substantial implementation of the proposal.

A delta analysis is most useful where it identifies differences between the proposal's specific request and the actions the company has already taken, as well as explaining whether the *differences* represent a significant policy issue to the company. For example, if a proposal requests disclosure of a customer information privacy policy and the company's cybersecurity policy addresses some of those issues, a delta analysis could identify the differences between the proposal and the existing company policy and explain why those differences would not raise a significant policy issue for the company. The staff cautions that the use of "conclusory statements about the differences that fail to explain why the board believes that the issue is no longer significant are less helpful."

*Prior voting results*. The staff also elaborated on what type of analysis it finds persuasive with regard to prior voting results. In SLB 14J, the staff noted that "where a company's shareholders have previously voted on the matter [it] would expect the voting results to be addressed as part of the board's analysis." In the 2019 proxy season, the staff was unable to agree with exclusion in some instances where a board's analysis was provided because that analysis was not persuasive in showing that the policy was no longer significant to the company. The unsuccessful arguments included challenges to the significance of the voting results where a majority of shareholders voted against the prior proposal or the voting results were affected by proxy advisory firm recommendations, and assertions that the voting results were not significant if considered in the context of shares outstanding instead of votes cast. In SLB 14K, the staff clarified that a more persuasive argument would instead discuss how "subsequent actions, intervening events or other objective indicia of shareholder engagement on the issue bear on the significance of the underlying issue to the company."

*Expectations for Board Analysis*. The staff in SLB 14K clarified that while it does not necessarily expect the board or a board committee to prepare the significance analysis, it believes that "it is important the appropriate body with fiduciary duties to shareholders give due consideration as to whether the policy issue presented by a proposal is of significance to the company." The staff also warned that in a request where significance is at issue, the staff's "analysis and ability to state a view regarding exclusion may be impacted" if the company's no-action request "does not include a robust analysis substantiating the board's determination that the policy issue raised by the proposal is not significant to the company."

**Micromanagement Exclusion**

A proposal may be excludable under the ordinary business exclusion if it seeks to micromanage the company. As the staff noted last year in SLB 14J and reiterates in SLB 14K, the micromanagement exclusion may apply even if the subject matter raised would otherwise be proper for shareholder consideration. In SLB 14K, the staff highlights that its focus in considering arguments for exclusion based on micromanagement is on whether the method or strategy for implementing the proposal is overly prescriptive. If the proposal, including taking into account requirements of the proposal stated in the proponent's supporting statement, unduly limits the ability of the board and management to manage complex matters with an appropriate level of flexibility, the proposal may improperly micromanage the company. The staff also notes that it is not the complexity of the issues addressed by a proposal that drive a decision on whether the proposal micromanages, but instead the level of prescriptiveness.

**Proof-of-Ownership Letters**

SLB 14K also provides a warning to companies not to be overly technical in reviewing proponents' proof-of-ownership letters. In Staff Legal Bulletin No. 14F (SLB 14F), the staff attempted to assist shareholder proponents by providing form language that could be used to demonstrate satisfaction of ownership requirements. SLB 14K confirms that the format of proof of ownership letters contained in SLB 14F is not mandatory, and states that companies should refrain from an "overly technical" reading of proof-of-ownership letters, so long as the language used is clear and sufficiently evidences the ownership requirements.

**Practical Considerations**

Companies that are responding to shareholder proposals in the upcoming proxy season should take into account the guidance in SLB 14K and the procedural changes announced in the memorandum.

- **Include a Board Analysis.** In SLB 14I, SLB 14J and SLB 14K, the staff has provided specific guidance on what it needs in reviewing no-action requests arguing for exclusion because a proposal lacks economic relevance under Rule 14a-8(i)(5) or is not a significant policy issue to the company and is therefore ordinary business under Rule 14a-8(i)(7). This guidance, together with the memorandum, indicates that the staff expects to see a robust board analysis, and suggests that requests without such an analysis may be more likely to receive a "decline to state a view" response from the staff.
- **Provide Details of Factors Considered.** SLB 14K offers suggestions for the details a board analysis should provide, including a "delta" analysis and attention to prior voting results. This guidance, together with the six-factor analysis set forth in SLB 14J, can provide companies with a roadmap for preparing a well-developed board analysis.
- **Consider How to Handle a "Decline to Take a View" Decision.** Following the memorandum, companies may need to be prepared to react to a staff decision to decline to take a view. As the staff noted in SLB 14K, in such a situation the company may have a valid legal basis to exclude the proposal. But a company would need to weigh its concerns about including a proposal that it believes to be excludable against risks of negative shareholder reactions, adverse publicity, responses from proxy advisory firms and litigation risk inherent in excluding the proposal.

Companies that have questions or require further clarification on these updates should seek guidance from trusted counsel.



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