

SEC Staff Issues Further Guidance on Shareholder Proposals

I. Overview

On October 23, 2018, the Division of Corporation Finance (the “Staff”) of the Securities and Exchange Commission (the “SEC”) issued Staff Legal Bulletin No. 14J.¹ The purpose of the bulletin is to provide further guidance on Securities Exchange Act Rule 14a-8, which addresses when a company must include a shareholder proposal in its annual proxy statement and the circumstances when a company is permitted to exclude such a proposal.² The bulletin discusses (i) board analyses provided in no-action requests that seek to rely on Rule 14a-8(i)(5) or Rule 14a-8(i)(7) as a basis to exclude shareholder proposals, (ii) the scope and application of “micromanagement” as a basis to exclude a proposal under Rule 14a-8(i)(7) and (iii) the scope and application of Rule 14a-8(i)(7) for proposals that touch upon senior executive and/or director compensation matters.

II. Discussion of Board Analysis

Prior Staff guidance addressed the scope and application of Rule 14a-8(i)(5), “the economic relevance” exception, and Rule 14a-8(i)(7), the “ordinary business” exception.³ Specifically, the Staff stated that determining whether such exceptions are applicable can raise difficult judgment calls that, in the Staff’s view, company boards are well-equipped to analyze. To aid the SEC in its review of related no-action requests, the Staff invited companies to include a discussion of the board’s analysis of the particular policy issue raised by the proposal and its significance in relation to the company. During the most recent proxy season, in reviewing such no-action requests, the Staff found these discussions most helpful when they focused on the board’s analysis and the specific substantive factors the board considered, rather than merely stating the board’s conclusions. The Staff identified the following as factors to consider including in the discussion:

- The extent to which the proposal relates to the company’s core business activities.
- Quantitative data that illustrate whether a matter is significant to the company.
- Whether the company has already addressed the issue, 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.
- Whether anyone else 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 voting results.

¹ See SEC, Staff Legal Bulletin No. 14J (Oct. 23, 2018), available at <https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals>.

² See 17 C.F.R. § 240.14a-8.

³ See SEC, Staff Legal Bulletin No. 14I (Nov. 1, 2017), available at <https://www.sec.gov/interps/legal/cfs1b14i.htm>. The “economic relevance” exception permits a company to exclude a shareholder proposal if it relates to operations which account for less than 5% of the company’s total asset and less than 5% of its net earnings and gross sales, and is “not otherwise significantly related to the company’s business.” 17 C.F.R. § 240.14a-8(a)(i)(5). The “ordinary business” exception permits a company to exclude a shareholder proposal if it relates “to the company’s ordinary business operations.” 17 C.F.R. § 240.14a-8(a)(i)(7).

The Staff cautioned that the factors listed above are not exclusive or exhaustive, and it is not necessary for a board analysis to address each of them. Moreover, the submission of a board analysis is entirely voluntary, and the inclusion or absence of an analysis will not be dispositive in the Staff's decision regarding the no-action request. No-action requests on these issues will be assessed based on the unique facts and circumstances of each request. The Staff explained that a finding that a certain proposal is excludable for one company will not be dispositive as to whether it is excludable for another company. However, the Staff reminded that it generally views substantive governance matters to be significantly related to a company's business and will be unlikely to agree with exclusion of proposals on such matters.⁴

III. Micromanagement

The "ordinary business" exception contained in Rule 14a-8(i)(7) is rooted in the principle that management and the board are in a better position to handle the company's ordinary business problems, as it is impracticable for shareholders to do so at an annual meeting.⁵ The SEC has stated that there are two primary considerations for the application of the exception. While the first consideration looks to a proposal's subject matter, the second looks only to the degree to which a proposal seeks to micromanage. Therefore, a proposal that is not clearly excludable based on its subject matter still may be excludable if it seeks to micromanage. The Staff explained that it applies this framework when considering whether a proposal should be excluded on the basis of "micromanagement." The Staff may deem a proposal to constitute micromanagement when it (i) involves intricate detail or seeks to impose specific time-frames or methods for implementing complex policies or (ii) calls for a detailed study or report.

IV. Senior Executive or Director Compensation Matters

The SEC has found shareholder proposals related to general employee compensation and benefits – such as hiring, promotion and termination – excludable under Rule 14a-8(i)(7) as they relate to ordinary business matters.⁶ However, proposals centered on senior executive and/or director compensation are not considered to be excludable.⁷ Staff Legal Bulletin No. 14J clarifies the Staff's views with respect to the latter.

Although proposals focused on senior executive and/or director compensation are not excludable, proposals styled as such nevertheless are excludable if the underlying concern is an ordinary business matter. For example, the Staff deemed excludable a proposal to prohibit payment of incentive compensation to executive officers unless the company first adopted a process to fund the retirement accounts of certain retired employees.⁸ As this proposal is focused on employee benefits, an ordinary business matter, the fact that it touches upon senior executive and/or director compensation did not insulate the proposal from exclusion.

Furthermore, proposals that address aspects of compensation that are available to senior executives and/or directors, as well as the general workforce, are generally excludable. For example, a proposal that seeks to limit the availability of golden parachutes to senior executives may be excludable if the company's golden parachute

⁴ See SEC, Staff Legal Bulletin No. 14I (Nov. 1, 2017).

⁵ Release No. 34-40018 (May 21, 1998).

⁶ See Release No. 34-40018; *see also* Staff Legal Bulletin No. 14A (Jul. 12, 2002).

⁷ See Battle Mountain Gold Co., Fed. Sec. L. Rep. P 76,107 (S.E.C. No - Action Letter Feb. 13, 1992); *see also* Release No.34-30851.

⁸ See Delta Air Lines, Inc., 2011 WL 7297159, at *1 (S.E.C. No - Action Letter Mar. 27, 2012).

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policy also applies to a significant portion of its general workforce. Proposals related to compensation broadly available to the general workforce do not transcend ordinary business such that they are insulated from exclusion.

The Staff further explained that while proposals that focus on aspects of compensation applicable only to senior executives and/or directors are generally not excludable under Rule 14a-8(i)(7), it has reconsidered its historical view that such proposals cannot rely on “micromanagement” for exclusion. The Staff now believes that executive compensation proposals should not be treated differently than other types of proposals when they constitute micromanagement and on that basis can be excluded under Rule 14a-8(i)(7), as discussed in Section III above. For example, a proposal delineating eligible expenses covered under a company’s relocation expense policy is likely to be excludable on the basis of micromanagement.

V. Conclusion

Staff Legal Bulletin No. 14J provides practical guidance regarding the factors that determine the appropriateness of the exclusion of shareholder proposals from annual proxy statements. The bulletin underscores the importance of the board’s analysis of what constitutes “ordinary business,” and it more precisely defines the limits on the ability of shareholders to micromanage ordinary business matters and involve themselves in matters of general workforce compensation.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Kimberly Petillo-Décossard at 212.701.3265 or kpetillo-decossard@cahill.com; or David A. Rand at 212.701.3189 or drand@cahill.com.