

## **SEC Staff Provides Further Guidance On Management Response to Shareholder Proposals**

### **I. Overview**

On October 16, 2019, the staff of the Division of Corporation Finance (the “Staff”) of the Securities and Exchange Commission (the “SEC”) issued a Staff Legal Bulletin (“SLB 14K”)<sup>1</sup> providing further guidance on when, under Securities Exchange Act Rule 14a-8, a company may exclude a shareholder proposal under the “ordinary business” exception.<sup>2</sup> In particular, the bulletin discusses (i) the proposal’s subject matter and micromanagement of the company as bases for excluding a shareholder proposal under Rule 14a-8(i)(7)’s “ordinary business” exception and (ii) the Staff’s expectations regarding the interpretation of shareholders’ proof of ownership letters.<sup>3</sup>

### **II. Rule 14a-8(i)(7)’s “Ordinary Business” Exception**

Under Rule 14a-8(i)(7), a company may exclude a shareholder proposal that “deals with a matter relating to the company’s ordinary business operations.”<sup>4</sup> The SEC has stated that this exception’s purpose 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.”<sup>5</sup> The SEC has also noted that there are two considerations central to the policy underlying the “ordinary business” exception: the proposal’s subject matter and the degree to which the proposal “micromanages” the company.<sup>6</sup>

#### **A. Subject Matter of the Proposal**

Proposals raising matters that relate to a company’s “ordinary business operations” are those 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.”<sup>7</sup> However, proposals focusing on significant policy issues are not excludable “because the proposals would transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote.”<sup>8</sup>

SLB 14K clarifies that if a proposal appears to raise a significant policy issue, a company’s no-action request to exclude the proposal should focus on the significance of the issue to that company.<sup>9</sup> The Staff explained that it avoids any consideration of whether particular issues are universally “significant,” stating that a policy issue

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<sup>1</sup> See SEC, Staff Legal Bulletin No. 14K (Oct. 16, 2019), available at <https://www.sec.gov/corpfin/Staff-legal-bulletin-14k-shareholder-proposals>.

<sup>2</sup> See 17 C.F.R. § 240.14a-8.

<sup>3</sup> SEC, Staff Legal Bulletin No. 14K (Oct. 16, 2019).

<sup>4</sup> 17 C.F.R. § 240.14a-8(i)(7).

<sup>5</sup> Release No. 34-40018 (May 21, 1998).

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> SEC, Staff Legal Bulletin No. 14K (Oct. 16, 2019).

that is significant to one company may not be significant to another.<sup>10</sup>

In order to assess the significance to the company, the Staff asks that the company provide a “well-developed discussion of the board’s analysis” of whether the proposal’s particular policy issue is “sufficiently significant in relation to the company.”<sup>11</sup> As noted in a previous Staff Legal Bulletin (“SLB 14J”), this kind of analysis will describe in “sufficient detail the specific substantive factors the board considered in arriving at its conclusion” and may include a non-exclusive list of certain factors.<sup>12</sup> In SLB 14K, the Staff notes that, during the most recent proxy season, it did not agree with certain requests for exclusion where the significance of a particular issue to a particular company and its shareholders was not self-evident and the company failed to provide a board analysis.<sup>13</sup> Thus, if a company wishes to exclude the shareholder proposal from its proxy statement, the Staff recommends that the board, which is the body with fiduciary duties to shareholders, give due consideration to whether the proposal raises significant policy issues for the company.<sup>14</sup>

For instance, as previously explained in SLB 14J, a board analysis may indicate whether the company has already addressed the proposal’s policy issues by identifying the differences (the “delta”) between the proposal’s specific request and the actions already taken by the company.<sup>15</sup> SLB 14K further elaborates that the Staff finds it helpful when the board’s analysis explains whether the delta represents a significant policy issue to the company.<sup>16</sup> By contrast, conclusory statements failing to explain why the delta does not present a significant policy issue are less helpful to the Staff’s evaluation.<sup>17</sup>

In addition, as previously noted in SLB 14J, a board analysis may include whether the company’s shareholders have formerly voted on the matter and the board’s views on the voting results.<sup>18</sup> SLB 14K notes further that this analysis is more helpful if the company includes “a robust discussion that explains how the company’s 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.”<sup>19</sup> By contrast, unsuccessful arguments include:<sup>20</sup>

- The voting results were not significant given that a majority of shareholders voted against the prior proposal.
- The significance of the prior voting results was mitigated by the impact of proxy advisory firms’ recommendations.

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<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> SEC, Staff Legal Bulletin No. 14J (Oct. 23, 2018), available at <https://www.sec.gov/corpfin/Staff-legal-bulletin-14j-shareholder-proposals>.

<sup>13</sup> See SEC, Staff Legal Bulletin No. 14K (Oct. 16, 2019).

<sup>14</sup> See *id.*

<sup>15</sup> See SEC, Staff Legal Bulletin No. 14J (Oct. 23, 2018).

<sup>16</sup> See SEC, Staff Legal Bulletin No. 14K (Oct. 16, 2019).

<sup>17</sup> *Id.*

<sup>18</sup> SEC, Staff Legal Bulletin No. 14J (Oct. 23, 2018).

<sup>19</sup> SEC, Staff Legal Bulletin No. 14K (Oct. 16, 2019).

<sup>20</sup> *Id.*

- When considering the voting results based on shares outstanding, instead of votes cast, the voting results were not significant.

## **B. Whether the Proposal Micromanages**

According to SLB 14K, a proposal may be excluded under the “ordinary business” exception if it “micromanages” the company.<sup>21</sup> Here, the Staff focuses on the manner in which the proposal seeks to address the raised subject matter.<sup>22</sup> It evaluates the level of prescriptiveness of the proposal—whether it “imposes a specific strategy, method, action, outcome or timeline for addressing an issue, thereby supplanting the judgment of management and the board.”<sup>23</sup> Thus, a proposal that “prescribes specific timeframes or methods for implementing complex policies” may be excluded on the basis of micromanagement.<sup>24</sup> On the other hand, a proposal would not be viewed as micromanaging matters if it is “framed as a request that the company consider, discuss the feasibility of, or evaluate the potential for a particular issue.”<sup>25</sup> A company seeking to exclude a proposal because of its micromanaging characteristics should state in its analysis how the “proposal may unduly limit the ability of management and the board to manage complex matters with a level of flexibility necessary to fulfill their fiduciary duties to shareholders.”<sup>26</sup>

For example, a proposal seeking a report “describing if, and how, [a company] plans to reduce its total contribution to climate change and align its operations and investments with the Paris [Climate] Agreement’s goal” is not micromanaging because it defers to management’s discretion as to how to reduce the company’s carbon footprint.<sup>27</sup> By contrast, a proposal seeking annual reporting on “short-, medium- and long-term greenhouse gas targets aligned with the greenhouse gas reduction goals established by the Paris Climate Agreement” is micromanaging because it is prescribing the company’s method for reducing greenhouse gas emissions through the use of time-bound targets (short, medium, long-term).<sup>28</sup>

## **III. Shareholder Eligibility To Submit Proposals: Proof of Ownership Letters**

Under Rule 14a-8(b), the proponent of a shareholder proposal must prove eligibility to submit a proposal by offering written proof that it “continuously held” the required amount of securities “for at least one year by the date” the proposal is submitted (a “proof of ownership letter”).<sup>29</sup> In a previous Staff Legal Bulletin (“SLB 14F”), the Staff suggested a format for shareholders and their brokers or banks to follow when supplying required verification of ownership to avoid the several common errors made in attempts to satisfy Rule 14a-(b)(2).<sup>30</sup> SLB

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<sup>21</sup> *Id.*

<sup>22</sup> *See id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> 17 C.F.R. § 240.14a-8(b).

<sup>30</sup> *See* SEC, Staff Legal Bulletin No. 14F (Oct. 18, 2011), available at <https://www.sec.gov/interps/legal/cfslb14f.htm>.

14K now states that brokers and banks are not required to follow that format.<sup>31</sup>

Furthermore, in SLB 14K, the Staff takes a plain meaning approach to interpreting the text of the proof of ownership letter, and expects companies to adopt a similar approach in their review.<sup>32</sup> According to the Staff, a company's argument to exclude a proposal is generally not persuasive if the company applies an overly technical reading of proof of ownership letters.<sup>33</sup> For example, the Staff recently disagreed with excluding a proposal under Rule 14a-8(b) on the basis that the ownership letter deviated from the format in SLB 14F when documentary support sufficiently evidencing the required minimum ownership requirements for the one-year period was provided.<sup>34</sup> Thus, in SLB 14K, companies are advised to not exclude a proposal on the basis of a technical reading of proof of ownership letters.

## IV. Conclusion

SLB 14K offers practical guidance on the circumstances under which companies may exclude shareholder proposals from their proxy statements. In particular, the Staff underscores the importance of a board analysis offering detailed explanations for excluding a proposal, especially how a proposal relates to a company's "ordinary business" and why issues raised by the proposal are not significant policy matters for the company. Finally, this bulletin notes that companies should not exclude a proposal based on a technical interpretation of the required elements in a proof of ownership letter, advising them instead to take a plain meaning approach.

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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 in it, please do not hesitate to call or email Helene Banks at 212.701.3439 or [hbanks@cahill.com](mailto:hbanks@cahill.com); Bradley J. Bondi at 202.862.8910 or [bbondi@cahill.com](mailto:bbondi@cahill.com); Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Elai Katz at 212.701.3039 or [ekatz@cahill.com](mailto:ekatz@cahill.com); Geoffrey E. Liebmann at 212.701.3313 or [gliebmann@cahill.com](mailto:gliebmann@cahill.com); Ross Sturman at 212.701.3831 or [rsturman@cahill.com](mailto:rsturman@cahill.com); Bruna M. Amaral at 212.701.3389 or [bamaral@cahill.com](mailto:bamaral@cahill.com); or Changlan L. Xu at 212.701.3998 or [cxu@cahill.com](mailto:cxu@cahill.com).

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<sup>31</sup> SEC, Staff Legal Bulletin No. 14K (Oct. 16, 2019).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*