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Memorandum

SEC Issues Staff Legal Bulletin No. 14K Providing New Guidance Regarding Shareholder Proposals Submitted Under Rule 14a-8

October 21, 2019

On October 16, 2019, the Division of Corporation Finance (the Staff) of the Securities and Exchange Commission (the SEC) issued new Staff Legal Bulletin 14K (SLB No. 14K), the latest in a series of similar bulletins that the Staff has released providing clarifications and updates to guidance on issues that arise in connection with respect to shareholder proposals submitted pursuant to Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the Exchange Act).

This bulletin follows the Staff's announcement on September 6, 2019, which discussed changes to the Staff's role in administering the Rule 14a-8 no-action relief process. In its September announcement, the Staff indicated that, starting with the 2019-2020 shareholder proposal season, it may respond orally instead of in writing to some no-action requests. According to this earlier announcement, written responses will be provided only when the Staff believes that doing so would provide value, such as more broadly applicable guidance about complying with Rule 14a-8. In addition, the Staff may now decline to state a view with respect to a company's asserted basis for exclusion of the shareholder proposal.

While the earlier announcement may have signaled that the Staff was attempting to extricate itself from the Rule 14a-8 no-action relief process, the newest bulletin suggests that the Staff continues to be focused on the content of Rule 14a-8 no-action submissions. In particular, the newest bulletin addresses the Staff's views on:

- the significance analysis under the "ordinary business" exception, which permits a company to exclude a proposal that "deals with a matter relating to the company's ordinary business operations";
- board analyses provided in no-action requests to demonstrate that the policy issue raised by the proposal is not significant to the company;
- the scope and application of micromanagement as a basis to exclude a proposal under the "ordinary business" exception; and
- overly technical readings of proof of ownership letters.

"Ordinary Business" Exception—Significance Analysis Must Be Tailored

Under previously issued guidance, shareholder proposals that relate to ordinary business matters but that focus on "sufficiently significant social policy issues … would not be considered to be excludable because the proposals would transcend the day-to-day business matters" pursuant to Rule 14a-8(i)(7) of the Exchange Act. Whether the significant policy exception applies depends, in part, on the connection between the significant policy issue and the company's business operations. As such, a policy issue that is significant to one company may not be significant to another.

In SLB No. 14K, the Staff takes issue with arguments that have focused on the overall significance of a policy issue, "instead of whether the proposal raises a policy issue that transcends the particular company's ordinary business operations." According to the Staff, the focus of an argument for exclusion under the "ordinary business" exception should be on whether the proposal deals with a matter relating to that particular company's ordinary business operations or raises a policy issue that transcends that particular company's ordinary business operations. When a proposal raises a policy issue that appears to be significant, SLB No. 14K provides that a company's no-action request should focus on the significance of the issue to that particular company. According to the Staff, if a company fails to meet this burden, the matter may not be excluded under this exception.

Additional Guidance on Board Analyses in Support of the Significance Determination

In its 2017 and 2018 bulletins, the Staff indicated that, in evaluating a company's no-action request to exclude a proposal based on the "ordinary business" exception or the "economic relevance" exception, a well-developed discussion of the board's analysis of the particular policy issue raised by the proposal and its significance in relation to the company can be helpful to the Staff in its evaluation of the request.

In SLB No. 14K, the Staff reiterates its belief regarding the usefulness of board analyses and provides additional insight into what types of discussions are most helpful. According to the Staff, these discussions were more helpful during the 2018-2019 proxy season than in the previous season because companies focused on the substantive factors described in the Staff's prior 2018 bulletin, even in instances where no-action relief was granted but the Staff did not explicitly reference the board's analysis in its response letter. In particular, SLB No. 14K addresses two substantive factors, as follows:

- Delta Analysis. A delta analysis consists of a discussion of whether the company has already addressed in some manner the policy issue raised by the proposal, 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 specific manner in which the proposal addresses the issue presents a significant policy issue for the company. SLB No. 14K notes that a delta analysis will be most helpful where such analysis clearly identifies the differences between the manner in which the company has addressed an issue and the manner in which the proposal seeks to address the issue and explains in detail why those differences do not represent a significant policy issue to the company.

- Prior Voting Results. Where a company's shareholders have previously voted on the matter covered by the proposal, the Staff expects the voting results to be addressed as part of the board's analysis. The Staff indicates in SLB No. 14K that many arguments based on this analysis were not persuasive during the 2018-2019 proxy season. That said, SLB No. 14K suggests that a board's analysis may be more helpful if it includes, for example, 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. According to the Staff, a helpful discussion would describe how a company's view on significance was informed by shareholder engagements after the prior vote, as well as any actions the company may have taken to address concerns expressed in the proposal.

Interestingly, although the Staff's bulletins do not make board analyses mandatory, the Staff suggests that, in a number of instances, it was unable to agree with exclusion where a board analysis was not provided, which was especially likely where the significance of a particular issue to a particular company and its shareholders may have depended on factors that were not self-evident. Although the Staff asserts that it does not expect a board to prepare the significance analysis that is included in the company's no-action request, the Staff believes that "it is important that 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."

Micromanagement as a Basis to Exclude Under "Ordinary Business" Exception

The SEC's policy underlying the "ordinary business" exception rests on two central considerations. The first relates to the proposal's subject matter; the second, the degree to which the proposal "micromanages" the company "by probing 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." In SLB No. 14K, the Staff reiterates its belief that it is the manner in which a proposal seeks to address an issue that results in exclusion on micromanagement grounds.

According to SLB No. 14K, when a proposal prescribes specific actions that the company's management or the board must undertake without affording them sufficient flexibility or discretion in addressing the complex matter presented by the proposal, the proposal may micromanage the company to such a degree that exclusion of the proposal would be warranted. The bulletin notes, for example, that a proposal urging the board to adopt a policy prohibiting the adjustment of financial performance metrics to exclude compliance costs when determining executive compensation would be excludable on the grounds of micromanagement because such proposal prohibits any such adjustments without regard to specific circumstances or the possibility of reasonable exceptions. The bulletin also addresses two variations of climate change proposals in this context, explaining its rationale for permitting overly prescriptive climate change proposals on micromanagement grounds.

In this context, interestingly, SLB No. 14K indicates that, when analyzing a proposal to determine its underlying concern or central purpose, the Staff looks not only to the resolved clause but to the proposal in its entirety. As such, if a supporting statement modifies or re-focuses the intent of the resolved clause, or effectively requires

some action in order to achieve the proposal's central purpose as set forth in the resolved clause, the Staff will take that into account in determining whether the proposal seeks to micromanage the company.

Proof of Ownership Letters

In SLB No. 14K, the Staff further expresses concern with respect to overly technical readings by companies of proof of ownership letters as a means to exclude a proposal. The bulletin indicates that the SEC takes a plain meaning approach to interpreting the text of the proof of ownership letter, and it expects companies to apply a similar approach. Importantly, the bulletin points out that the sample proof of ownership language provided in SLB No. 14F is neither mandatory nor the exclusive means of demonstrating the ownership requirements of Rule 14a-8, and that failure to use this form language is not a valid basis for exclusion.

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