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SEC Staff Legal Bulletin Makes Exclusion of Certain Shareholder Proposals More Challenging

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On November 3, 2021, the Division of Corporation Finance of the Securities and Exchange Commission (SEC) issued **Staff Legal Bulletin 14L**, which outlines new guidance on shareholder proposals submitted to public companies pursuant to Rule 14a-8 under the Securities Exchange Act of 1934. SLB 14L rescinds three recent staff legal bulletins – SLB 14I, SLB 14J and SLB 14K – and:

- Reverses the earlier SLBs' company-specific approach to evaluating the significance of a policy issue that is the subject of a shareholder proposal for purposes of the ordinary business exclusion in Rule 14a-8(i)(7).
- Reverses the earlier SLBs' approach on micromanagement arguments for purposes of the "ordinary business" exclusion in Rule 14a-8(i)(7).
- Outlines the staff's view regarding application of the "economic relevance" exclusion in Rule 14a-8(i)(5).

This new guidance reverses four years of staff precedent and raises the burden for public companies seeking to exclude shareholder proposals, particularly those related to environmental and social issues.

Generally, SLB 14L presents its approach as a return to the standards that, as described below, historically prevailed before the issuance of the rescinded SLBs. SEC Chairman Gary Gensler **said** that the "bulletin will provide greater clarity to companies and shareholders on these matters, so they can better understand when exclusions may or may not apply. The updated staff legal bulletin, which replaces three previously issued bulletins, is consistent with the Commission's original intention." The replacement of the rescinded SLBs may well be part of a larger trend at the SEC under Gensler to reverse course on some of the work done under the previous administration and former Chairman Jay Clayton.

The new SLB also republishes previous guidance related to the use of graphics and images and to proof-of-ownership letters that was originally contained in rescinded SLBs 14I and 14K, with some minor technical changes. In addition, SLB 14L includes new guidance on the use of email for submission of proposals, delivery of notices of defects and responses to those notices.

Background

Rule 14a-8 provides a means by which shareholders can submit proposals for inclusion in a company's proxy statement to be presented for a shareholder vote, saving the shareholder the effort and expense of doing a separate proxy solicitation. In addition to setting forth the procedural and eligibility requirements for submitting shareholder proposals to a company, Rule 14a-8 identifies several substantive bases a company can rely on to exclude a shareholder proposal from its proxy statement. Typically, before excluding a shareholder proposal, a company will request assurance from the staff that it will not recommend an enforcement action if the company omits the proposal on the basis of one of the exclusions described in the no-action letter requesting relief.

Issued between 2017 and 2019 under Clayton, the rescinded SLBs provided guidance on the ordinary business exclusion under Rule 14a-8(i)(7) and the scope and application of the economic relevance exclusion under Rule 14a-8(i)(5).

‘Ordinary business’ exclusion

The “ordinary business” exclusion permits a company to omit a shareholder proposal that “deals with a matter relating to the company’s ordinary business operations.” The policy underlying the ordinary business exclusion is based on two considerations. The first is the “subject matter” of the proposal – that is, whether, as described in a **1998 SEC release**, it refers to 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,” with the rationale being that the resolution of these types of matters is considered to be more properly the province of management and the board of directors than of the shareholders. However, as noted in the 1998 release, proposals relating to these matters but focusing on significant social policy issues generally would not be excludable “because such issues typically fall outside the scope of management’s prerogative.” The second consideration is whether a proposal seeks to “micromanage” a company by probing too deeply into matters upon which shareholders would not be in a position to make an informed judgment.

Based on these considerations, the determination of whether a proposal may be excluded under the ordinary business exclusion turns on the answers to the following questions:

- Does the proposal relate to tasks so fundamental to management’s ability to run a company on a day-to-day basis they could not be subject to shareholder oversight?
- Does the proposal focus on a sufficiently significant social policy issue that transcends these day-to-day business matters?
- Does the proposal involve intricate detail or seek to impose specific time frames or methods for implementing complex policies?

‘Significant social policy’ exception

The “significant social policy” exception precludes exclusion of the proposal if the proposal “would transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote.” Historically, proponents and companies have often focused on “the overall significance of the policy issue raised by the proposal.” Before the guidance in the rescinded SLBs noted above, under this exception, proposals that raised “significant policy considerations” or that were “the subject of widespread public debate” were considered “beyond the realm of an issuer’s ordinary business operations” and therefore not subject to exclusion under Rule 14a-8(i)(7). In rescinded SLB 14K, however, the staff took a different approach and advised that the significance discussion should be company-specific – “whether the proposal raises a policy issue that transcends the particular company’s ordinary business operations” – rather than discussing whether the particular issue is of general significance. Given the company-specific nature of this analysis, SLB 14K encouraged companies to submit a board analysis in no-action requests to demonstrate that the policy issue raised by the proposal is not significant to the company.

In SLB 14L, the staff indicates that the guidance in SLB 14K resulted in “undue emphasis [being] placed 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[.]” In support of its position, the staff asserts that these company-specific analyses “did not yield consistent, predictable results.”

Under SLB 14L, the staff advises that it will “realign its approach” with the standard originally expressed in 1976, and reaffirmed in 1998, which simply looked at whether the proposal raised significant social policy issues. Accordingly, 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 making this determination, the staff will consider whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company.” The elimination of the need to discuss the company-specific significance of policy issues also means that the staff “will no longer expect a board analysis as described in the rescinded SLBs as part of demonstrating that the proposal is excludable under the ordinary business exclusion.”

For example, under its revised approach, SLB 14L states that "proposals 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." The staff identifies proposals related to employment discrimination as "but one example of the workforce management proposals that may rise to the level of transcending the company's ordinary business operations."

'Micromanagement' consideration

The application of the "micromanagement" consideration under Rule 14a-8(i)(7), as described in the 1998 release, involves an analysis of whether the proposal seeks to "micromanage" 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." When reviewing no-action requests arguing exclusion under the micromanagement prong of Rule 14a-8(i)(7), the staff does not look at the subject matter, but rather only at the manner in which a proposal seeks to address the subject matter (i.e., how prescriptive the proposal is).

Companies frequently relied on the interpretation of the micromanagement prong under Rule 14a-8(i)(7) in rescinded SLB 14K to exclude proposals related to climate, which often included requests for companies to provide specific time frames and targets. For example, in SLB 14K, the staff illustrated the type of proposal that it viewed as micromanaging a company and thus excludable: a proposal that sought "annual reporting on 'short-, medium- and long-term greenhouse gas targets aligned with the greenhouse gas reduction goals established by the Paris Climate Agreement to keep the increase in global average temperature to well below 2 degrees Celsius and to pursue efforts to limit the increase to 1.5 degrees Celsius." The staff's rationale at the time was that the proposal "prescribed the method for addressing reduction of greenhouse gas emissions[,] effectively requiring the adoption of time-bound targets (short, medium and long) that the company would measure itself against and changes in operations to meet those goals, thereby imposing a specific method for implementing a complex policy." "Going forward," the staff indicates in SLB 14L, "we would not concur in the exclusion of similar proposals that suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals."

In SLB 14L, the staff indicates that, after further consideration, it has determined that its application of the micromanagement argument in the rescinded SLBs expanded the concept of micromanagement too far, potentially stretching "to mean that any limit on company or board discretion constitutes micromanagement." In support of the staff's revised position, SLB 14L highlights the clarification in the 1998 release that "specific methods, timelines, or detail do not necessarily amount to micromanagement and are not dispositive of excludability." The concept of micromanagement should not be read, the 1998 release explained, to "imply that all proposals seeking detail, or seeking to promote time-frames or methods, necessarily amount to 'ordinary business.'" Rather, the 1998 release explained, questions of timing "could involve significant policy where large differences are at stake, and proposals may seek a reasonable level of detail without running afoul of these considerations."

As described in SLB 14L, the staff "will take 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." The staff will instead "focus on the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management."

In addition, the staff signals in SLB 14L that it may expand the analysis to "assess whether a proposal probes matters 'too complex' for shareholders, as a group, to make an informed judgment." These factors might include "the sophistication of investors generally on the matter, the availability of data, and the robustness of public discussion and analysis on the topic." In addition, the staff advises that it may "consider references to well-established national or international frameworks when assessing proposals related to disclosure, target setting, and timeframes as indicative of topics that shareholders are well-equipped to evaluate."

'Economic relevance' exclusion

Rule 14a-8(i)(5), the "economic relevance" exclusion, permits a company to exclude a proposal that "relates to operations which account for less than 5% of the company's total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business." The rescinded SLB 14I addressed the second prong of the rule – the proposal's significance to the company's business – indicating that the staff's analysis would be focused on a proposal's significance to the company's business when it otherwise related to operations that accounted for less than 5% of total assets, net earnings and gross sales. The rescinded SLB 14I explained that the burden was on the proponent to show that a proposal was "otherwise significantly related to the company's business." That is, if the "proposal's significance to a company's business is not apparent on its face," it "may be excludable unless the proponent demonstrates that it is 'otherwise significantly related to the company's business.'" As with the "ordinary business" exclusion in Rule 14a-8(i)(7), the staff had advised that it would expect a company's no-action request that included an "economic relevance" argument to include a discussion that reflects the board's analysis of the proposal's significance to the company, again detailing "the specific processes employed by the board to ensure that its conclusions are well-informed and well-reasoned."

In SLB 14L, the staff advises that it is returning to its approach, in effect prior to SLB 14I, of analyzing Rule 14a-8(i)(5) consistent with a decision of the federal district court in a 1985 case, *Lovenheim v. Iroquois Brands*, in which the court interpreted the words "otherwise significantly related to the company's business" in Rule 14a-8(i)(5) to not permit omission of a shareholder proposal that has "ethical or social significance" merely because the proposal was not economically significant. As a result, SLB 14L continues, "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 of Rule 14a-8(i)(5). In light of this approach, the staff will no longer expect a board analysis for its consideration of a no-action request under Rule 14a-8(i)(5)."

Rule 14a-8(d)

Rule 14a-8(d) provides a basis for exclusion of a shareholder proposal if it, including any accompanying supporting statement, exceeds 500 words. The discussion of this rule, which relates to the use of images in shareholder proposals, originally appeared in rescinded SLB 14I. To retain the guidance, the staff republished the discussion in SLB 14L with only minor, conforming changes. While the staff believes that Rule 14a-8(d) does not prohibit the inclusion of graphs and/or images in proposals, it does, however, recognize the potential for abuse in this area and provides examples of other provisions of Rule 14a-8 under which exclusion of graphs and/or images would be appropriate. For example, images or graphs that "make the proposal materially false or misleading," or that make charges concerning illegal conduct without any factual foundation, would be excludable. In addition, SLB 14L notes that "[e]xclusion would also be appropriate under Rule 14a-8(d) if the total number of words in a proposal, including words in the graphics, exceeds 500."

Proof-of-ownership letters

Rule 14a-8(b) provides that a shareholder must prove eligibility to submit a proposal by offering proof that it "continuously held" the required amount of securities for the required amount of time under Rule 14a-8. The staff's guidance on proof-of-ownership letters previously appeared in the rescinded SLB 14K. The guidance, which is republished in SLB 14L with minor, conforming changes, addressed companies' application of an "overly technical" approach in trying to exclude proposals on the basis of proof-of-ownership letters for purposes of Rule 14a-8(b). The staff notes that it will take a "plain meaning" approach to interpreting the text of the proof-of-ownership letter and that it expects companies to apply a similar approach in their review of these letters.

In addition, the staff provides some additional guidance related to how brokers or banks fulfill their roles when providing proof of ownership. In the staff's view, brokers or banks "may continue to provide confirmation as to how many shares the proponent held continuously and need not separately calculate the share valuation, which may instead be done by the proponent and presented to the receiving issuer consistent with the Commission's 2020 rulemaking." Notably, the staff also indicates that, should a company receive a deficient proof-of-ownership letter after it has already sent a deficiency letter to the shareholder proponent, the company should send a follow-up deficiency letter identifying specific defects in the proof-of-ownership letter, seemingly increasing the procedural burdens on companies.

Use of email

The use of email has increased, especially during the COVID-19 pandemic, to submit proposals and make other communications. However, unlike regular mail, there is no standard proof of delivery, and methods for confirmation of email may differ. Accordingly, the staff advises that parties should keep in mind that "[e]mail delivery confirmations and company server logs may not be sufficient to prove receipt of emails as they only serve to prove that emails were sent. In addition, spam filters or incorrect email addresses can prevent an email from being delivered to the appropriate recipient. The staff therefore suggests that, to prove delivery of an email for purposes of Rule 14a-8, the sender should seek a reply e-mail from the recipient in which the recipient acknowledges receipt of the e-mail. The staff also encourages both companies and shareholder proponents to acknowledge receipt of emails when requested. Email read receipts, if received by the sender, may also help to establish that emails were received."

Submission of proposals

Under Rule 14a-8(e)(1) "shareholders should submit their proposals by means, including electronic means, that permit them to prove the date of delivery." Proponents "risk exclusion of their proposals if they do not receive a confirmation of receipt from the company in order to prove timely delivery with email submissions." The staff advises that, in the absence of an email address in the proxy statement for proposal submission, proponents should contact the company to obtain the correct email address, and companies should provide it on request.

Delivery of notices of defects and responses

The same applies with regard to a company's delivery by email of deficiency notices to proponents and proponents' responses: Companies and proponents should seek a confirmation of receipt to prove timely delivery. Under Rule 14a-8(f)(1), companies must notify the shareholder of any defects within 14 calendar days of receipt of the proposal, and the company has the burden to prove timely delivery of the notice. Under Rule 14a-8(f)(1), the shareholder's response must be postmarked, or transmitted electronically, within 14 days of the date of receipt of the company's notification of a deficiency. If a shareholder uses email to respond, the burden is on the shareholder or representative to use an appropriate email address (e.g., an email address provided by the company, or the email address of the counsel who sent the deficiency notice).

Observations and commentary

Environmental and social policy issues proposals

In recent years, the number of shareholder proposals relating to environmental and social policy issues has increased. By eliminating the need to show a nexus between the "significant social policy" reflected in the shareholder proposal and the subject company, SLB 14L increases the challenge for companies seeking to exclude these types of proposals under Rule 14a-8(i)(7). The effect of SLB 14L is to provide the staff with additional flexibility to consider paramount the "broad societal impact" of a policy issue, especially where the particular policy issue is a significant element of public discourse. That has been the case in recent years with climate and diversity issues that have been championed by many major institutional investors and other investor groups, along with nongovernmental organizations, independent nonprofits, unions and even, in some cases, stock exchanges and state governments.

In light of the prominence of these social policy issues, the staff makes clear in SLB 14L that it is disinclined to permit exclusion of certain ESG-related proposals, such as those regarding climate and human capital, consistent with the SEC's recent prioritization of those issues under Gensler. What's less clear, however, is how the staff will treat proposals about other issues of social policy, such as political spending or the social impact of certain technologies. How much discussion in the public spotlight will be necessary for a significant policy issue to be viewed to have a "broad societal impact" that "transcends day-to-day business matters"? What other factors will the staff consider in assessing broad social impact? It remains to be seen whether the staff will generally view these other issues as comparable in significance to issues specifically identified in SLB 14L.

Micromanagement arguments

Under the revamped approach to the micromanagement concept under Rule 14a-8(i)(7), we expect that companies may find it more difficult to exclude a shareholder proposal under Rule 14a-8(i)(7) based on a micromanagement argument if the proposal makes clear that it does not limit the discretion of the board of directors or management as to how to implement the proposal, even if the proposal requests that the company adopt time frames or specific goals.

Impact of economic relevance exclusion

Even under the rescinded SLBs, the economic relevance exclusion under Rule 14a-8(i)(5) rarely served as the basis for excluding a shareholder proposal. Therefore, while narrowing the economic relevance exclusion under SLB 14L will further limit its availability, we do not expect it to have a significant overall impact on the ability of companies to exclude proposals under Rule 14a-8(i)(5).

Part of a larger trend?

The rescission of SLBs 14I, 14J and 14K and issuance of SLB 14L may well be part of a larger trend at the SEC under Gensler to reverse course on some of the work done under the previous administration and Clayton. In a **statement**, SEC Commissioners Hester Peirce and Elad Roisman were critical of SLB 14L, asserting that the new "[b]ulletin furthers the recent trend of erasing previous Commissions' and staffs' work and replacing it with the current Commission's flavor-of-the-day regulatory approach." The two Commissioners even went so far as to suggest that the SEC "relieve the staff of this burden," and "either take on consideration of these proposals itself" or amend the rule to remove the SEC and its staff from a process governed by state corporate law and involving areas outside of the SEC's expertise. To be sure, the SEC has indicated on its **most recent agenda** that it may revisit recently adopted SEC guidance and rules related to human capital disclosure, eligibility criteria for submission and resubmission of shareholder proposals, proxy voting advice by proxy advisory firms, disclosure of payments by resource extraction issuers, the whistleblower program rules, and the accredited investor definition and the integration framework for exempt offerings.

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