

SEC Signals Company-Friendly Approach in New Shareholder Proposal Guidance

November 9, 2017

Just as companies are starting to gear up for the 2018 proxy season, on November 1, 2017, the staff (the “Staff”) of the Division of Corporation Finance of the Securities and Exchange Commission (“SEC”) released new guidance on shareholder proposals that seems to indicate the Staff will be taking a more company-friendly approach in its review of no-action letter requests.

Specifically, Staff Legal Bulletin No. 14I (“SLB 14I”) clarifies the scope and application of two grounds for excluding a shareholder proposal from a company’s proxy statement – the “ordinary business” exception (Rule 14a-8(i)(7)) and the “economic relevance” exception (Rule 14a-8(i)(5)) – and provides guidance on proposals submitted on behalf of shareholders (“proposals by proxy”) and the use of graphs and images in proposals. The following is a summary of the guidance:

- **The “ordinary business” exception.** Rule 14a-8(i)(7) permits a company to exclude a shareholder proposal if it “deals with a matter relating to the company’s ordinary business operations” – matters that are seen as best left to management rather than subject to direct shareholder oversight. The SEC has set forth two factors for identifying a matter relating to “ordinary business operations”: the extent to which the proposal would “micromanage” the company and the extent to which the matter is fundamental to management’s ability to run the company on a day-to-day basis. However, if the proposal implicates significant social policy issues that “transcend ordinary business,” the proposal may not be excluded. The success of a no-action letter request for exclusion of a proposal on this basis typically turns on the assessment of the connection between a significant policy issue and the company’s ordinary business operations.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or any of our partners and counsel listed under [Capital Markets](#), [Corporate Governance](#) or [Executive Compensation and ERISA](#) in the “Our Practice” section of our website.

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999



In SLB 14I, the Staff indicates that a company's board of directors, as a steward for shareholders with concomitant fiduciary duties and an informational advantage, is well-situated to determine whether a particular policy issue is sufficiently significant to the company. Accordingly, any no-action requests based on the "ordinary business" exception should discuss the board's analysis and assessment of the significance of the policy issue implicated by the shareholder proposal, detailing the specific processes the board used "to ensure that its conclusions are well-informed and well-reasoned." This guidance seems to signal that the Staff will afford greater deference to a company's assessment of a proposal as implicating an "ordinary business" matter, as long as the company makes that determination at the board level.

- **The "economic relevance" exception.** Rule 14a-8(i)(5) permits a company to exclude a shareholder proposal if the proposal relates to operations constituting less than 5% of the company's total assets, net earnings and gross sales for its most recent fiscal year and is "otherwise not significantly related to the company's business." In practice, this exception was rarely a successful basis for exclusion because, as the Staff acknowledges in SLB 14I, this exception has generally been subsumed under the "ordinary business" exception, with the Staff generally rejecting these no-action requests if the proposal related to an issue of broad social and ethical concern and the company conducted any business relating to the issue, even if under the 5% threshold.

In SLB 14I, the Staff indicates it will consider both prongs of the rule going forward, including the 5% threshold. The Staff will continue to consider whether the matter is "significantly related to the company," but will no longer look to the "ordinary business" exception analysis for that determination. In evaluating significance, the Staff will consider the "total mix" of information about

the company, noting that a matter significant to one company may not be significant to another. However, the Staff states that it would generally view "substantive governance matters" as significantly related to almost all companies.

Notably, the Staff indicates that if a proposal's significance to a company's business is not apparent on its face, the *proponent* bears the burden of demonstrating that it is "significantly related" – for example, that it may have a significant impact on other segments of the company's business or subject the company to significant contingent liabilities. Also, as with the "ordinary business" exception, the Staff indicates its belief that a company's board of directors is well-positioned to determine the significance of a proposal in the first instance, again signaling the possibility of greater Staff deference to the company's assessment. Again, no-action requests should include a discussion of the board's analysis.

- **Proposal by proxy.** Companies have expressed considerable concerns about submissions of shareholder proposals by proxy. Historically, the Staff has uniformly rejected no-action requests related to these concerns. In SLB 14I, the Staff reiterates its view that proposals by proxy are consistent with Rule 14a-8. However, the Staff also acknowledges the validity of companies' concerns in this area – for example, whether the eligibility requirements of Rule 14a-8(b) have been met and whether shareholders are aware that proposals are being submitted on their behalf. Accordingly, SLB 14I sets forth additional documentation about a shareholder's delegation of authority to a proxy that should be provided to the company when submitting the proposal (and lack of this documentation may be a basis for exclusion of the proposal, after giving the proponent an opportunity to cure defects). This documentation should be signed and dated by the shareholder and identify:
 - the shareholder-proponent and the person or entity selected as proxy;

- the company to which the proposal is directed;
- the annual or special meeting for which the proposal is submitted; and
- the specific proposal to be submitted.

These requirements only apply to proposals submitted after November 1, 2017.

- **Use of images in shareholder proposals.** SLB 14I confirms the Staff’s longstanding position that Rule 14a-8(d) does not prohibit shareholders from including graphs or images in proposals. However, in response to company concerns, the Staff notes that other bases of exclusion may apply to graphs and images and should be sufficient to address any potential abuses in this area. For example, proposals containing graphs and images may be excludable under Rule 14a-8(i)(3) if they make the proposal materially false or misleading; impugn character, integrity or personal reputation; make charges regarding improper, illegal or immoral conduct or association, without factual foundation; render the proposal vague or indefinite; or are irrelevant to the subject matter of the proposal. In addition, the Staff clarifies that the words in a graph or image count towards the 500 word limit under Rule 14a-8(d). The Staff also includes a caution to companies that they should not minimize or otherwise diminish the appearance of a shareholder’s graphic, and should give it similar prominence to their own graphics in the proxy statement. If the proxy statement is in black and white, however, a company may include the shareholder’s proposal and graphics in black and white as well.

In light of this new guidance and in particular the focus on the role of the board, we recommend that companies begin formalizing a process for assessing the significance of matters addressed in shareholder proposals by the board or a relevant committee so they can be described in no-action requests as outlined in SLB 14I. The specific considerations the Staff seems to contemplate in SLB 14I go beyond the typical board involvement in dealing with a shareholder proposal, although the nominating and governance committee generally is aware of proposals received and the company’s planned approach. Expanding that committee’s role in the shareholder proposal process may be the easiest way to address the Staff’s guidance, although considerations of the significance of an issue covered by a proposal may involve the company’s overall business operations and strategy, which may be best addressed by the full board. The often tight timelines required in the shareholder proposal process may pose challenges for a board or committee process, so it may be helpful to identify in advance issues expected to be included in shareholder proposals to allow an effective board process.

Overall, while the Staff’s approach to no-action requests in practice and the impact on the 2018 proxy season remains to be seen, SLB 14I seems to signal a more company-friendly approach by the Staff, with greater deference potentially being afforded to a company’s assessment of the relevance of shareholder proposals to its business.

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