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SEC Staff Publishes New Guidance for Shareholder Proposals

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Securities and Capital Markets

On November 1, 2017, the staff of the Division of Corporation Finance of the Securities and Exchange Commission (the "Staff") published Staff Legal Bulletin No. 14I ("SLB 14I"),[1] which includes important new guidance regarding the Staff's administration of the SEC's shareholder proposal rule. Specifically, the guidance relates to arguments under the "ordinary business" and "economic relevance" exclusions in Rule 14a-8(i)(7) and Rule 14a-8(i)(5), respectively, under the Securities Exchange Act of 1934. SLB 14I also includes new procedural guidance under Rule 14a-8(b) for agents of shareholder proponents and under Rule 14a-8(d) for the use of graphics and images in shareholder proposals. This advisory summarizes the Staff's new guidance.

The "Ordinary Business" Exclusion Under Rule 14a-8(i)(7)

Under Rule 14a-8(i)(7), a company may exclude from its proxy materials a shareholder proposal that "deals with a matter relating to the company's ordinary business operations." The Staff has historically allowed companies to rely on Rule 14a-8(i)(7) to exclude shareholder proposals that raise matters which 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." The Staff has not allowed the exclusion, however, for proposals that focus on significant social policy issues which transcend ordinary business matters.

In SLB 14I, the Staff describes the difficult judgement calls it must make in determining whether a shareholder proposal relates to ordinary business matters or raises significant social policy issues. In this regard, however, the Staff notes that a board of directors of a company would be better suited than the Staff to make these judgements due to its "knowledge of the company's business and the implications for a particular proposal on [a] company's business."

Accordingly, SLB 14I indicates that the Staff expects a company's Rule 14a-8(i)(7) no-action request to include the board of directors' "analysis of a particular policy issue raised and its significance," including in such analysis "the specific processes employed by the board to ensure that its conclusions are well-informed and well-reasoned." The Staff believes that such analysis will greatly assist its review of Rule 14a-8(i)(7) no-action requests.

[1] Staff Legal Bulletin No. 14I can be found at https://www.sec.gov/interps/legal/cfslb14i.htm.

For now, the impact of this guidance is uncertain. For example, it is not clear whether the Staff intends to break new ground with respect to the kinds of proposals that may be excluded under the ordinary business exclusion. It is equally unclear whether the new guidance will require additional steps for all requests to exclude proposals under the ordinary business exclusion, or simply for no-action requests relating to new shareholder proposal topics. At a minimum, the guidance suggests that the Staff will expect a new level of board involvement in some submissions involving arguments under the ordinary business exclusion. We expect the Staff may provide clarifications regarding questions like these in the coming weeks as companies and shareholders prepare for the 2018 proxy season.

The "Economic Relevance" Exclusion Under Rule 14a-8(i)(5)

Under Rule 14a-8(i)(5), a company may exclude a shareholder proposal from its proxy materials if the proposal (a) "relates to operations which account for less than five percent of the company's total assets at the end of its most recent fiscal year, and for less than five percent of its net earnings and gross sales for its most recent fiscal year" and (b) "is not otherwise significantly related to the company's business."

Over the last few decades, the Staff has only granted a handful of no-action requests under this exception. The relatively infrequent number of no-action grants under this exclusion is largely due to a Staff position adopted in the 1980s following a decision of a federal district court severely narrowing the application of the economic relevance exclusion.[2] Following that decision, the Staff concluded that a company could not rely on the economic relevance exclusion if the shareholder proposal was of any ethical or social significance, even if the proposal was well below the economic thresholds for significance included in Rule 14a-8(i)(5).

SLB 14I indicates that the Staff believes that its historical position has unduly limited the application of Rule 14a-8(i)(5) because it has not fully considered whether the proposal "deals with a matter that is not significantly related to the [company's] business and is therefore excludable." Accordingly, in SLB 14I the Staff says its analysis of Rule 14a-8(i)(5) no-action requests will focus on a shareholder proposal's significance to the company's business when it otherwise relates to operations that account for less than five percent of total assets, net earnings, and gross sales.

This significance, according to SLB 14I, will depend on the "particular circumstances of the company to which the proposal is submitted," which means that a proposal that is significant to one company may not be significant to another company. One exception to this approach appears to be substantive governance matters, which the Staff views to be significantly related to almost all companies. The Staff also says in SLB 14I that the proponent of the shareholder proposal will bear the burden of demonstrating that such proposal is "otherwise significantly related to the company's business" if the significance of a proposal is not apparent on its face.

Similar to questions under Rule 14a-8(i)(7) discussed above, determinations of whether a proposal is "otherwise significantly related to the company's business" require difficult judgement calls that the Staff believes a company's board of directors is better positioned to

[2] See *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554 (D.D.C. 1985).

make than the Staff in the first instance. Accordingly, the Staff will expect a company's Rule 14a-8(i)(5) no-action request to include the board of directors' analysis of the proposal's significance to the company, including in such analysis the specific processes employed by the board.

Lastly, SLB 14I notes that the Staff's analysis of whether a proposal is "otherwise significantly related to the company's business" has historically been informed by its analysis under the "ordinary business" exception in Rule 14a-8(i)(7). SLB 14I makes it clear that the Staff "will no longer look to its analysis under Rule 14a-8(i)(7) when evaluating arguments under Rule 14a-8(i)(5)." This reflects the Staff's view that application of separate analytical frameworks for each exclusion will ensure that each basis for exclusion serves its intended purpose.

The Staff's new guidance on the economic relevance exclusion raises some of the same questions raised by its new approach to the ordinary business exclusion, including whether the guidance will require a new level of board involvement in at least some submissions involving relevance arguments. Unlike the guidance regarding the ordinary business exclusion, however, the guidance regarding the economic relevance exclusion is likely to pave the way for new lines of no-action letters regarding proposal topics. For example, we expect that shareholder proposals concerning broad social and environmental topics will raise new issues for the Staff to evaluate—particularly where the topics relate to issues of little economic or social significance to the company.

As with its guidance regarding the ordinary business exclusion, we expect the Staff to provide clarifications regarding these questions in the coming weeks.

Proposals by Proxy and Rule 14a-8(b)

Over the last several decades, there have been steady increases in the number of shareholder proposals that are submitted by individuals on behalf of multiple shareholders for the same annual meeting. This practice, which the Staff refers to as "proposals by proxy," is not covered in Rule 14a-8.

In SLB 14I, however, the Staff notes that a proposal by proxy can in fact raise numerous questions under Rule 14a-8, including whether the proof of ownership requirements of Rule 14a-8(b) are satisfied and whether shareholders are aware that proposals are being submitted on their behalf. To address these issues and to help the Staff and companies better evaluate whether the eligibility requirements of Rule 14a-8(b) have been satisfied, the Staff will start looking to whether the shareholder submitting a proposal by proxy provides documentation describing the shareholder's delegation of authority to the proxy. This documentation should provide the following information:

- the name of the shareholder-proponent and the person or entity selected as proxy;
- the company to which the proposal has been submitted;
- the specific annual or special meeting for which the proposal has been submitted;
- the shareholder proposal which has been submitted (*e.g.*, proposal to lower the threshold for calling a special meeting from 25% to 10%); and
- a dated signature by the shareholder-proponent.

SLB 14I provides that the absence of such documentation could be a basis for excluding a shareholder proposal under Rule 14a-8(b). A company that seeks to exclude a shareholder proposal based on the failure to provide some or all of this information must notify the shareholder of the specific defect within 14 calendar days of receiving the proposal so that the shareholder can cure the defect.

Graphics and Images in Shareholder Proposals and Rule 14a-8(d)

Rule 14a-8(d) imposes a 500-word limitation on a shareholder proposal and any accompanying supporting statement. In recent years, companies have challenged the inclusion of graphics in shareholder proposals under Rule 14a-8(d). These arguments generally have been unsuccessful. SLB 14I indicates that the Staff, consistent with these no-action decisions, is of the view that Rule 14a-8(d) does not preclude a shareholder from including graphics or images in a shareholder proposal.

In SLB 14I, the Staff recognizes that the inclusion of graphics or images in shareholder proposals could allow shareholders to abuse Rule 14a-8, but notes that these graphics or images may be excluded through other provisions of Rule 14a-8. Specifically, the Staff indicates that a company may exclude graphs and/or images included in a shareholder proposal under Rule 14a-8(i)(3) where they:

- make the proposal materially false or misleading;
- render the proposal so inherently vague or indefinite that neither the stockholders voting on the proposal, nor the company in implementing it, would be able to determine with any reasonable certainty exactly what actions or measures the proposal requires;
- directly or indirectly impugn character, integrity, or personal reputation, or directly or indirectly make charges concerning improper, illegal, or immoral conduct or association, without factual foundation; or
- are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which he or she is being asked to vote.

In addition, SLB 14I provides that graphics and/or images may be excluded from a shareholder proposal under Rule 14a-8(d) “if the total number of words in [such] proposal, including words in the graphics, exceeds 500.”

SLB 14I also notes that a company may not “minimize or otherwise diminish the appearance” of a graphic in a shareholder proposal and that it must give such graphic similar prominence to its own graphics in its proxy statement. SLB 14I clarifies that if a company’s proxy statement is in black and white, the shareholder proposal and accompanying graphics may also appear in black and white.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Securities and Capital Markets practice:

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