

October 21, 2019

New SEC Staff Guidance on Shareholder Proposals

Continues to Encourage Board of Director Involvement in the “Ordinary Business” Exclusion and Provides Guidance on Useful Factors and Analyses from 2019 Proxy Season

Discourages No-Action Requests Based on Overly Technical Readings of Shareholder Proof of Ownership Letter Requirements

SUMMARY

On October 16, 2019, the staff of the Division of Corporation Finance of the Securities and Exchange Commission issued [new guidance](#) on the shareholder proposal process:

- For the Rule 14a-8(i)(7) “ordinary business” exclusion, the guidance continues to encourage companies to include a description of the board’s analysis of the basis for the exclusion in no-action requests and provides additional guidance on using a “delta” analysis or addressing prior shareholder voting results.
- For the “ordinary business” exclusion, the guidance also reiterates and provides additional explanation on how an overly prescriptive proposal may be excluded because it seeks to “micromanage” the company, even if it deals with proper subject matter.
- The guidance clarifies that proof of ownership letters need not conform to the SEC staff’s proposed format and that the staff will not agree to exclude shareholder proposals based on drafting variances in a letter that is otherwise sufficient.

The new guidance does not discuss the staff’s September 6, 2019 announcement that, beginning with the 2019-2020 proxy season, the staff may respond orally instead of in writing to some no-action requests.

BACKGROUND

Exchange Act Rule 14a-8 addresses when a company must include a shareholder's proposal and supporting statement in its proxy statement. The Rule provides for both substantive and procedural bases for exclusion of a shareholder proposal.

- **“Ordinary Business” Exclusion.** Rule 14a-8(i)(7) permits the exclusion of a shareholder proposal if it “deals with a matter relating to the company’s ordinary business operations.” This exclusion is based on two central considerations:
 - Some matters are so fundamental to management’s ability to run the company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight. A proposal may not be excluded on this basis, however, if it focuses on policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a shareholder vote.
 - A shareholder proposal may not seek to “micromanage” the company.
- **Proof of Ownership Exclusion.** As a procedural basis for exclusion, Rule 14a-8(b)(2) requires a proponent of a shareholder proposal to offer proof that it “continuously held” the required number of securities of the company “for at least one year by the date” the proposal is submitted. Shareholder proposals that are not accompanied by proof of the requisite minimum ownership can be excluded.

This is the third consecutive year that the staff has issued guidance on shareholders proposals at this time of year. In guidance issued at this time last year ([SLB No. 14J](#)), the staff encouraged companies to include a discussion regarding the board’s analysis of the policy issue raised by a proposal and its significance to the company in no-action requests arguing either the “ordinary business” exclusion or the “economic relevance” exclusion under Rule 14a-8(i)(5), and also explained that proposals addressing executive and/or director compensation may be excluded on the basis of micromanagement, consistent with other types of proposals.

HIGHLIGHTS FROM THE SHAREHOLDER PROPOSAL GUIDANCE

Significance in Relation to the Company’s Business

In the new guidance, the SEC staff notes that proponents and companies have sometimes focused erroneously on the overall or universal significance of the issue featured in the shareholder proposal without reference to the company itself. Instead, the staff emphasizes its “company-specific approach to evaluating significance,” which is based on whether “the proposal deals with a matter relating to *that company’s* ordinary business operations or raises a policy issue that transcends *that company’s* ordinary business operations” (emphasis added). Accordingly, a company’s no-action request to exclude a shareholder proposal based on the ordinary business exclusion should focus on the significance of the issue *to the specific company*; no-action requests should not focus on the universal or overarching significance of the issue.

Board Analyses of Significance Pursuant to the Ordinary Business Exclusion

In the new guidance, the SEC staff continues to encourage companies to include their boards' analyses in no-action requests arguing "ordinary business" and reiterates the usefulness of the factors issued last year in SLB No. 14J as a means of demonstrating significance (or lack thereof), with a focus on two specific factors:

- **"Delta" Analyses.** One of the SLB No. 14J factors—whether the company has already addressed the issue in some manner, including the differences between the proposal and the actions the company has already taken, along with an analysis of whether such difference presents a significant policy issue for the company—was noted as useful for companies that have already addressed the policy issue in some manner but have not substantially implemented the proposal. Based on the staff's evaluation of no-action requests this past proxy season, delta analyses are most helpful if they identify the differences between the actions that the company has already taken to address the issue and the proposal's specific request and explain whether the difference between the company's actions and the proposal's request represents a significant policy issue to the company in itself.

For illustration, the staff explains that a shareholder proposal seeking greater disclosure of a telecommunications company's customer information privacy policy may be excludable where the company highlights in its analysis how its cybersecurity policy addresses the issues covered by the proposal and how the difference between the two approaches would not raise a significant policy issue for the company.

- **Prior Shareholder Voting Results.** Another of the SLB No. 14J factors—whether the company's shareholders have previously voted on the matter and the board's views as to the related voting results—is also highlighted in the new guidance. Based on an evaluation of recent no-action requests, the staff endorses including a robust discussion that explains how the company's actions following the prior shareholder vote, intervening events or other objective indicia of shareholder engagement on the issue bear on the significance of the underlying issue to the company.

The staff notes three examples, however, where a company's discussion of the prior shareholder vote was not persuasive, and therefore the proposal was not excludable. In these examples, the companies argued unsuccessfully that:

- the voting results were not significant given that a majority of shareholders voted against the proposal;
- the significance of the prior voting results was mitigated by the impact of proxy advisory firms' recommendations; and
- when considering the voting results based on shares outstanding, instead of votes cast, the voting results were not significant.

In the new guidance, the staff emphasizes that board analyses discussing substantive factors, including the SLB No. 14J factors, were deemed the most helpful during the most recent proxy season, even in instances where the staff granted relief under Rule 14a-8(i)(7) but did not explicitly reference the board's analysis in the response letter. The staff also notes that it was unable to agree with exclusion in a number of instances during the last proxy season where a board analysis was not provided, which was especially likely where the significance of an issue to a particular company and its shareholders may depend on factors that are not self-evident. The new guidance clarifies that the board analysis need not be prepared by the board or a committee but that it is important that the appropriate body with fiduciary duties to shareholders gives due consideration to whether the policy issue presented by the proposal is significant.

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Micromanagement

Under the ordinary business exclusion, a shareholder proposal may be excludable under Rule 14a-8(i)(7) if it “micromanages” the company regardless of whether the proposal deals with otherwise “significant” subject matter.

The new guidance reiterates that the micromanagement analysis focuses on *the manner* in which a shareholder proposal seeks to address the subject matter raised (as opposed to the subject matter itself). As a result, two proposals focusing on the same subject matter may receive different SEC staff determinations on excludability based solely on differing levels of prescriptiveness.

- For example, the staff states that it found that a proposal seeking annual reporting on whether “short-, medium- and long-term greenhouse gas targets aligned with the Paris Climate Agreement” was excludable because it required time-bound targets that the company would measure itself against, and therefore, imposed a specific method for implementing policy that constituted micromanagement.
- On the other hand, the staff states that it did not find 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 excludable because the proposal “deferred to management’s discretion” and “asked the company to consider the relative benefits and drawbacks of several actions.”

Under the micromanagement prong, the staff states that it “looks to whether the proposal seeks intricate detail or imposes a specific strategy, method, action, outcome or timeline for addressing an issue.” The new guidance states that the staff expects a company seeking to assert micromanagement as a reason to exclude a shareholder proposal to include in its analysis “how the proposal may unduly limit the ability of management and the board to manage complex matters” with the flexibility necessary to fulfill their fiduciary duties. As an example, the new guidance provides that a proposal urging the board to adopt a policy prohibiting adjusting financial performance metrics to exclude compliance costs when determining executive compensation would be excludable on micromanagement grounds because such proposal “prohibits any such adjustments without regard to specific circumstances or the possibility of reasonable exceptions.”

Consistent with prior guidance, the new guidance states that a proposal will be evaluated based on the underlying concern or central purpose of the proposal and that the staff will consider whether supporting statements modify the intent of the “resolved” clause to reveal a different central purpose or require overly prescriptive action to achieve such purpose.

Exclusions Based on Proof of Ownership Letter Deficiencies

The guidance also discusses the approach of some companies seeking to exclude shareholder proposals based on drafting variances in the shareholder proof of ownership letter. In [SLB No. 14F](#) issued in 2011, the SEC staff set forth a suggested format for proponents to use to verify ownership but provided that this format is not required. During the last proxy season, the staff did not concur in certain cases where companies sought to exclude shareholder proposals based on an “overly technical reading” of the

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applicable proof of ownership letter that deviated from the suggested format but the language used in the letter was clear and sufficiently evidenced the requisite minimum ownership requirements. The new guidance notes that shareholders are not required to follow the form in SLB No. 14F to satisfy the proof of ownership requirements in Rule 14a-8(b) and that companies should take a plain meaning approach to interpreting such letters based on whether the shareholder has supplied sufficient documentary support evidencing the requisite minimum ownership.

IMPLICATIONS

The new guidance is continuing evidence of the SEC staff's focus on reform of the shareholder proposal process, with a particular focus on the use of the "ordinary business" exclusion. The guidance regarding the staff's expectations for board analyses to be included in no-action letters may increase the ability of companies to properly frame such analyses in the upcoming proxy season.

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