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New SEC Staff Guidance on Shareholder Proposals

Continues to Encourage Board of Director Involvement in the “Ordinary Business” and “Economic Relevance” Exclusions and Provides Examples of Useful Factors from 2018 Proxy Season

Opens Door for “Ordinary Business” and “Micromanagement” Exclusions for Proposals Addressing Executive Compensation

SUMMARY

On Tuesday, 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)(5) and Rule 14a-8(i)(7) “economic relevance” and “ordinary business” exclusions, 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 summarizes the substantive factors the SEC staff found most helpful in the most recent proxy season.
- For the “ordinary business” exclusion, the guidance reiterates that a proposal may be excluded because it seeks to “micromanage” the company and explains that a proposal dealing with proper subject matter may be independently excluded on micromanagement grounds.
- The guidance clarifies that proposals that touch upon executive and/or director compensation but are focused on ordinary business matters may be excluded under the “ordinary business” exclusion, as may proposals where the primary aspect of the targeted compensation is not specific to executives or directors but rather broadly available to employees.
- In a change from prior practice, the guidance also states that proposals addressing executive and/or director compensation may be excluded on the basis of micromanagement, just like other types of proposals.

BACKGROUND

Exchange Act Rule 14a-8 addresses when a company must include a shareholder's proposal and supporting statement in its proxy statement. In addition to certain procedural bases for exclusion of a shareholder proposal, the Rule provides 13 substantive bases for exclusion, including the following two exclusions:

- **“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:
 - certain 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; and
 - the shareholder proposal may not seek to “micromanage” the company.

A proposal may not be excluded, however, if it focuses on policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a shareholder vote. Whether the significant policy exception applies depends, in part, on the connection between the significant policy issue and the company’s business operations.

- **“Economic Relevance” Exclusion:** Rule 14a-8(i)(5) permits the exclusion of a shareholder proposal that “relates to operations which account for less than 5 percent of the company’s total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company’s business.” Because Rule 14a-8(i)(5) only allows exclusion when the matter is not otherwise significantly related to the company, the SEC staff views the analysis as dependent on the particular circumstances of the company to which the proposal is submitted (i.e., a matter significant to one company may not be significant to another).

In guidance issued at this time last year ([SLB No. 141](#)), the Division 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” or the “economic relevance” exclusion.

HIGHLIGHTS FROM THE SHAREHOLDER PROPOSAL GUIDANCE

Factors Relevant to the Ordinary Business and Economic Relevance Exclusions

In the new guidance, the Division continues to encourage companies to include their boards’ analyses in no-action requests arguing “ordinary business” or “economic relevance”. The new guidance explains that the most helpful analyses from the 2018 proxy season focused on the specific substantive factors the board considered to arrive at its conclusion that an issue is not otherwise significantly related to its business (in the case of “ordinary business”) or not sufficiently significant in relation to the company (in the case of “economic relevance”). The SEC staff found descriptions of conclusions or process without a discussion of the factors less helpful.

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The new guidance provides an illustrative list of substantive factors that may be relevant to a board's analysis, which include:

- The extent to which the proposal relates to the company's core business activities.
- Quantitative data, such as financial statement impact, related to the matter illustrating whether or not a matter is significant to the company.
- 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.
- The extent of shareholder engagement on the issue and the level of shareholder interest expressed through that engagement.
- Whether anyone in addition to the proponent has requested the type of action or information proposed.
- Whether the company's shareholders have previously voted on the matter and the board's views as to the related voting results.

The guidance notes that the existence or absence of a discussion of the board's analysis will not create a presumption either against or for exclusion. However, the Division stated that the SEC staff may "find it difficult" in some instances to agree that a proposal may be excluded in cases where the board's analysis is not included and the significance of a particular issue may "depend on factors that are not self-evident and that the board may be well-positioned to consider and evaluate."

Micromanagement

Rule 14a-8(i)(7), the "ordinary business" exception, permits a company to exclude a proposal that "deals with a matter relating to the company's ordinary business operations." The Division has previously explained that the underlying exception rests on two central considerations: the proposal's subject matter and 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." The guidance explains that a proposal may probe too deeply if it "involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies." Examples of micromanaging as a basis for exclusion include:

- A proposal to generate a plan to reach net-zero greenhouse gas emissions by the year 2030, which sought to impose specific timeframes or methods for implementing complex policies.
- A proposal that seeks an intricately detailed study or report relating to the imposition or assumption of specific timeframes or methods for implementing complex policies.

The guidance notes that this framework is consistent with existing guidance, and that the SEC staff will continue to apply it in evaluating whether a proposal micromanages a company. The new guidance notes that the staff's concurrence with a company's micromanagement argument does not necessarily mean that the subject matter raised by the proposal is improper for shareholder consideration but can mean that the manner in which the proposal seeks to address the subject matter micromanages the company.

Senior executive and/or director compensation

In evaluating the application of the “ordinary business” exclusion to compensation-related proposals, the Division has previously concluded that proposals involving the management of the workforce generally are excludable as relating to ordinary business matters. However, proposals focusing on significant aspects of senior executive and/or director compensation generally are not excludable because they are appropriate for shareholder oversight.

The new guidance clarifies that proposals styled as addressing senior executive and/or director compensation but have as their underlying concern ordinary business matters may be excludable. In evaluating proposals that raise both ordinary business and senior executive and/or director compensation matters, the guidance explains that the staff will examine the focus of the proposal. Where the focus of the proposal is the ordinary business matter, the proposal may be excludable. As an example, the guidance pointed to the staff’s concurrence in the exclusion of a proposal requesting that the board prohibit payment of incentive compensation to executive officers unless the company first adopted a process to fund the retirement accounts of retired employees as an example of a proposal where the focus was on the ordinary business matter of employee benefits, rather than executive compensation matters.

The guidance clarifies that proposals addressing senior executive and/or director compensation also may be excludable if a primary aspect of the targeted compensation is broadly available or applicable to a company’s general workforce. In such case, the company should demonstrate that the executives’ or directors’ eligibility to receive the compensation does not implicate significant compensation matters. If a proposal addresses elements of compensation generally available to employees, even if framed in terms of executives and directors, then the proposal is likely excludable under the new guidance as relating to a company’s ordinary business.

The new guidance also changes the SEC staff’s prior policy of not allowing the exclusion of proposals addressing senior executive and/or director compensation on the basis of micromanagement. Instead, the new guidance concludes that there is no basis for treating compensation proposals differently than other types of proposals with respect to micromanagement. As with proposals on other topics, the staff will now concur in the exclusion of proposals addressing senior executive and/or director compensation on the basis of micromanagement where they seek intricate detail or seek to impose specific timeframes or methods for implementing complex policies.

IMPLICATIONS

The new guidance is continuing evidence of the Division’s focus on reform of the shareholder proposal process. The guidance on bases to exclude shareholder proposals regarding executive and director compensation may increase the ability of companies to exclude such proposals in the upcoming proxy

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season. The SEC has announced that its staff will host a roundtable on November 15, 2018 on the proxy process and rules, including shareholder proposals.

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