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SEC Issues New Staff Guidance (SLB 14L) That Makes it Harder to Exclude Climate Change and Human Capital Management-Related Shareholder Proposals

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On November 3, 2021, the Staff of the SEC’s Division of Corporation Finance issued Staff Legal Bulletin No. 14L (SLB 14L), walking back previous Staff guidance issued in recent years addressing how the Staff would consider Rule 14a-8 no-action requests to exclude shareholder proposals raising a significant policy issue. Where prior guidance sought to define a “significant” policy issue as one that both transcends day-to-day management *and* is significant to the company’s business, under SLB 14L, the Staff will now no longer focus on the nexus prong – i.e., determining whether the policy issue raised is significant to the particular company. As a result, shareholder proposals that were previously viewed as excludable because they did not raise a policy issue of significance to the company will no longer be viewed as excludable. To that end, the Staff specifically called out as examples proposals that raise climate change and human capital management issues.

Additionally, SLB 14L rescinds prior Staff Legal Bulletin Nos. 14I, 14J and 14K (collectively, the “Prior SLBs”), all of which primarily discuss the Division’s views on excluding shareholder proposals pursuant to Rule 14a-8(i)(7), the ordinary business exception, and Rule 14a-8(i)(5), the economic relevance exception.

“Ordinary Business” Exclusion – Rule 14a-8(i)(7)

The “ordinary business” exception under Rule 14a-8(i)(7) was designed to exclude shareholder proposals dealing with “ordinary business” operations, which are in the domain of management and the board, unless the proposal raised a significant policy issue. Pursuant to the Staff’s traditional framework for evaluating no-action requests to exclude a proposal on ordinary business grounds, a “significant” policy was defined as one that (i) transcends day-to-day business matters *and* (ii) was significant to the company’s business. Recognizing the difficulty for the Staff to determine whether there was a sufficient nexus between the policy issued raised by the proposal and the particular company’s business, and that the board is generally in a better position to address the “difficult judgment calls” necessary to make this determination, the Prior SLBs added analytical layers to the 14a-8(i)(7) exclusion analysis that “invited” companies to provide the board’s view on whether the policy was sufficiently important to the company’s business as to warrant a shareholder vote.

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However, under SLB 14L, the Staff will not consider the connection between a policy issue and its importance to the specific company's business, and instead will focus on whether the proposal raises issues with such a broad societal impact that they transcend the ordinary business of the company. Under this new approach, proposals that the Staff previously viewed as excludable because they did not appear to raise a policy issue of significance for the specific company may no longer be viewed as excludable under Rule 14a-8(i)(7). SLB 14L specifically calls out "proposals squarely raising human capital management issues with a broad societal impact" as an example of the type of proposal that will no longer be subject to exclusion solely because the proponent does not demonstrate that the human capital management issue is significant to the company.

Micromanagement Exclusion – Rule 14a-8(i)(7)

In addition to providing further guidance on the company-specific "significance" of a policy issue in what is otherwise an "ordinary business" context, the Prior SLBs also elaborated on the scope and application of "micromanagement" prong of the (i)(7) exclusion analysis. Specifically, the Prior SLBs focused on whether the proposal sought intricate detail or imposed a specific strategy, method, action, outcome or timeline on management for addressing a significant issue in a way that supplanted the board and management's judgement in managing matters of a complex nature. However, the Staff has now concluded that application of the micromanagement concept, as outlined in the Prior SLBs, may have "expanded the concept of micromanagement beyond the Commission's policy directives" and "may have been taken to mean that any limit on company or board discretion constitutes micromanagement."

Under SLB 14L, proposals seeking detail or seeking to promote timeframes or methods are now no longer *per se* micromanagement. Instead, the Staff will 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. SLB 14L notes that the Staff expects the level of detail included in a shareholder proposal to be consistent with that needed to enable investors to assess an issuer's impacts, progress towards goals, risks or other strategic matters appropriate for shareholder input.

Further, pursuant to SLB 14L, in order to assess whether a proposal probes matters "too complex" for shareholders to make an informed judgment, the Staff may consider: the sophistication of investors generally on the matter; the availability of data; the robustness of public discussion and analysis on the topic; as well as "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." The Staff noted that many of the proposals addressed in the rescinded Prior SLBs requested companies adopt timeframes or targets to address climate change that the Staff concurred were excludable on micromanagement grounds. Going forward, the Staff will not concur on the exclusion of similar climate change proposals that suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals.

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

Rule 14a-8(i)(5) – the "economic relevance" exception -- permits a company to exclude a 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."

Prior guidance emphasized the second prong of the test – significantly related to the company's business – which the Staff then believed was not "fully considered" and, as a result, that the exception was "unduly limited" leading to the denial of no-action requests when a proposal raised social or ethical issues related to the company's business, no matter how small. The Prior SLBs also added a board analysis, under the belief that the board was better positioned to determine whether a matter was "not otherwise significantly related to the company's business." SLB 14L does away with that company-specific significance nexus. Now, 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 (i)(5) economic thresholds.

Takeaways

SLB 14L suggests that the Staff is now prioritizing shareholders' ability to be heard, through shareholder proposals, on issues deemed to have broad societal impact, even when such an issue may have little connection to the particular company's business. As a result, it will be significantly harder for companies to exclude on "ordinary business" or "economic relevance" grounds shareholder proposals that raise social or ethical issues, particularly those addressing climate change and human capital management issues. Moreover, it remains to be seen how the new guidance on the "micromanagement" of complex matters prong of the ordinary business exclusion – on which company's rarely succeeded – will be applied differently than the prior guidance, or what matters will now be considered "too complex" for shareholders to make an informed judgment under the criteria for consideration noted in SLB 14L (e.g., the internet contains readily-available data and robust discussion and analysis on a host of social topics). Whether the Staff's new guidance will likely embolden shareholders to submit more social and environmental-related shareholder proposals also remains to be seen. However, it seems clear that it will now be more difficult for companies to obtain no-action relief to exclude such proposals. Companies would do well to anticipate such proposals and begin to formulate their responses.

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