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Heads up for the 2020 Proxy Season: The SEC Weighs in on Rule 14a-8 No-Action Requests

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As the 2020 proxy season looms on the near horizon, recent pronouncements on Rule 14a-8 no-action requests by the SEC's Division of Corporation Finance (Division or Staff) may have significant implications for the shareholder proposal no-action letter process. Last week, the Division published Staff Legal Bulletin (SLB) No. 14K, which provides guidance and observations, based on the Staff's experience during the 2019 proxy season, regarding the application of Rule 14a-8(i)(7)'s "ordinary business" exclusion in two key areas: (1) the nature and scope of the "significance" analysis needed to support a company's (i)(7) no-action request, and the importance to the Staff of knowing what the board of directors thinks in situations where a shareholder proponent argues that a policy issue raised in his or her proposal transcends ordinary business; and (2) the contours of the "micromanagement" prong of the ordinary business exclusion analysis. SLB No. 14K also re-emphasizes the Division's "substance-over-form" approach to dealing with technical proponent proof-of-ownership deficiencies. As such, SLB No. 14K builds on previous post-season Division guidance set forth in SLB Nos. 14I, 14J and 14F.

Another recent development that may affect the upcoming proxy season – but which is not mentioned in SLB No. 14K – is the Division's announcement in early September of certain changes in the Staff's processing of company Rule 14a-8 no-action requests. According to this announcement, the Division plans to issue oral responses to some no-action letters, and decline to state a view under some as yet unidentified circumstances. Despite assurances of full transparency given by senior Division officials during the mid-September meeting of the ABA Business Law Section, corporate and shareholder constituencies alike remain somewhat skeptical that this new approach will improve the shareholder proposal process.

We discuss these developments below, and offer some suggestions to companies on how to apply the Division guidance just published in SLB No. 14K. Tips on how best to navigate the new Division no-action process will have to await further action by the Staff as the 2019-2020 shareholder proposal season begins to unfold over the next few weeks.

Staff Legal Bulletin No. 14K

The "ordinary business" exception codified in Rule 14a-8(i)(7) permits a company to exclude a shareholder proposal that "deals with a matter relating to the company's ordinary business operations," unless that proposal raises a significant policy issue. What this means is that, even where a proposal relates to the day-to-day management of a company's business, that proposal cannot be omitted from the company's proxy statement and form of proxy in reliance upon Rule 14a-8(i)(7) where the proposal raises a policy issue that "would transcend the day-to-day business matters and … [is] so significant that it would be appropriate for a shareholder vote." SLB No. 14K clarifies and builds on previously published Division guidance on the parameters of the required "significance" analysis and the importance of the board of director's views in that analysis, and amplifies the Staff's position on the "micromanagement prong" of the (i)(7) exclusion analysis. Finally, this SLB addresses a technical eligibility issue involving the proponent's proof of ownership of the company's voting stock. We briefly address each topic below.

What Does "Significance" Mean, and Do the Board's Views Matter?

As the Division points out in SLB No. 14K, proponents and companies have often focused on the overall or global significance of a policy issue raised by a shareholder proposal in considering excludability under Rule 14a-8(i)(7), rather than on what ***really*** matters to the SEC and its Staff: whether that policy issue both transcends, and is significant to, a particular company's ordinary business operations. The distinction drawn by the Division in SLB No. 14K is not new – as we discussed in an earlier post available here, SLB No. 14I added an analytical layer in late 2017 to the arguments the Staff suggested companies should make in support of a no-action request on "ordinary business" grounds – a description of the board's views on the significance of a policy issue to the particular company. Approximately one year later, in SLB No. 14J, the Division observed that, while the inclusion or absence of a board analysis would not be dispositive in connection with the Staff's evaluation of a company's request, the absence of board input may make it more difficult for the Staff to grant relief under Rule 14a-8(i)(7).

To address a continuing misunderstanding of the requisite "significance" analysis that became apparent during the 2019 proxy season, the Division reiterated in SLB No. 14K that the guiding analytical principle in the "transcends ordinary business" determination is the "significance" of a particular policy issue or issues to the company requesting a favorable no-action response. The Division also observed that those no-action letters that included a robust board analysis were more helpful to the Staff in determining whether a proposal involved a policy issue or issues deemed significant to the company's business. Conversely, the SLB points out that there were a number of instances in which the Staff was unable to agree with a company's argument for exclusion where a board analysis was not provided, and the significance of a relevant policy issue to a particular company's business operations may depend on factors that are not self-evident.

The Division made clear that if "a request where significance is at issue *does not* include a robust board analysis substantiating the board's determination that the policy issue raised . . . is not significant to the company, [the Division's] analysis and ability to state a view regarding exclusion may be impacted." In other words, the board's analysis and ultimate opinion on the policy issue will carry weight with the Division if properly focused on the company's business operations. At the end of the day, "[w]hile we [the Staff] do not necessarily expect the board, or a board committee, to prepare the significance analysis . . . we do believe it is important that the appropriate body with fiduciary duties to shareholders give due consideration as to whether the policy issue presented by a proposal is of significance to the company."

What Substantive Factors Are Relevant to the Board's Significance Analysis?

SLB No. 14K provides further guidance on two substantive factors that a board's significance analysis could cover, both of which had been discussed in previous SLBs: (a) whether the company has already addressed the policy issue in some manner and, if so, whether the board has considered the differences – or the delta – between the proposal's specific request and the actions the company has already taken in making a judgment on whether the delta presents a significant policy issue for the company; and (b) whether the company's shareholders have previously voted on the matter and the board's views as to the implications of the voting results.

With respect to the "delta analysis," SLB No.14K notes that, in reviewing this past season's no-action requests, the Staff has found this analysis to be most helpful when it clearly identifies differences between the manner in which the company has addressed an issue and the manner in which a proposal seeks to address the issue, and explains whether such differences themselves represent a significant policy issue to the company. By contrast, the Division found unhelpful "conclusory" statements by the board about the differences in question that failed to explain why the board found that the issue is no longer significant to the company once certain measures were taken. To illustrate, the Staff offered the following example:

> *Delta Analysis Example*: In response to a shareholder proposal seeking greater disclosure of a telecommunications company's customer information privacy policy, a board analysis could highlight how its cybersecurity policy addresses the issues covered by the proposal and how the difference – the delta – between the two approaches would not raise a significant policy issue for the company.

Turning to the relevance to the board's significance analysis of prior voting results as an expression of current shareholder views, the Division re-emphasized its statement (last outlined in SLB No. 14J) that when a company's shareholders have previously voted on a matter involving a potentially significant policy issue, the Division expects that the message sent by shareholders via the vote will be considered by the board in assessing current significance, and that any description of the board's belief or conclusion that the issue that has been raised in a pending shareholder proposal does not rise to the requisite level of significance warranting inclusion of such proposal in the company's proxy materials. According to the Division, unpersuasive arguments asserted during this past shareholder proposal season were as follows:

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

Moreover, the Division indicates that the board's analysis may be more helpful if it includes "a robust discussion that explains how the company's subsequent actions, intervening events or other objective indicia of shareholder engagement on the issue bear on the significance of the underlying issue to the company." Here is an example of what the Staff expects to see in a no-action request under (i)(7) involving a "significance" issue, if pertinent:

> *Prior Voting Results Example*: If after a proposal receiving significant support, a company engages with its shareholders to better understand the level of support, the board analysis should include a discussion that describes how its view on significance is informed by those engagements as well as any actions the company may have taken to address concerns expressed in the proposal.

Micromanagement

In addition to further guidance on board analyses on company-specific "significance" of a policy issue in what is otherwise an "ordinary business" context, SLB No. 14K also elaborates on the scope and application of "micromanagement" as a basis to exclude proposals under Rule14a-8(i)(7). Here, the Division discusses how the level of prescriptiveness of a proposal may be outcome-determinative in an (i)(7) no-action context, expanding upon previous guidance provided in SLB No. 14I.

If a proposal seeks intricate detail or imposes a specific strategy, method, action, outcome or timeline (e.g., prescribing specific timeframes) for addressing an issue, thereby supplanting the judgment of management and the board, such proposal may be excludable on micromanagement grounds. The Staff gave this example:

Example of Micromanaging: A proposal seeking annual reporting on "short-, medium- and long-term greenhouse gas targets aligned with the greenhouse gas reduction goals established by the Paris Climate Agreement to keep the increase in global average temperature to well below 2 degrees Celsius and to pursue efforts to limit the increase to 1.5 degrees Celsius"[1] was, in the Division's view, excludable on the basis of micromanagement.

In contrast, a proposal that is framed as a request that the company "consider, discuss the feasibility of, or evaluate the potential for a particular issue" generally would not be viewed as micromanaging complex matters, assuming that the subject-matter is otherwise appropriate under Rule 14a-8(i)(7). Therefore, according to the Division, a proposal that defers to management's discretion to consider if and how the company plans to implement the particular goal or objective of a proposal will likely not be deemed to constitute micromanagement warranting exclusion, as demonstrated by this fact pattern taken from a Staff denial of no-action relief:

Example of not Micromanaging: 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's goal of maintaining global temperatures well below 2 degrees Celsius []"[2] was not excludable because the proposal transcended ordinary business matters and did not seek to micromanage the company by using prescriptive measures, such as timeframes or specific methods or actions. As mentioned above, the proposal left it to management's discretion to consider if and how the company plans to reduce its carbon footprint and asked the company to consider relative benefits and drawbacks of several actions.

To sum up the Division's micromanagement guidance applicable to (i)(7) no-action requests that is set forth in SLB No. 14K, the Staff will analyze a proposal on the level of its prescriptiveness, rather than whether the proposal presents issues that are too complex for shareholders to understand. A proposal that prescribes specific actions without affording management or the board sufficient flexibility or discretion in addressing a complex matter would be excludable under the micromanagement prong. Accordingly, when a company asserts micromanagement as a reason to exclude a proposal, its analysis should include an explanation of how the proposal, if implemented, may unduly limit the ability of management and the board to manage complex matters with the degree of flexibility and judgment necessary to fulfill their fiduciary duties.

Proof of Ownership Guidance

Rule 14a-8(b) provides that a proponent must establish his or her (or its) eligibility to submit a proposal by offering proof that he, she or it "continuously held" the required amount of voting securities "for at least one year by the date" the proposal is submitted. Where a proponent beneficially owns stock in street-name, via a bank, broker-dealer or other financial institution serving as custodian, he or she (or it) is required to provide, as part of a shareholder proposal submission, a letter verifying continuous one-year ownership of a minimum amount of company voting stock of the particular company.

In SLB No. 14F, issued in late 2011, the Division identified common errors shareholders make when submitting proof of ownership for proposals and offered proponents a suggested, non-exclusive model to help proponents avoid these errors. At the same time, the Division urged companies to avoid elevating form over substance in considering whether to challenge a proponent's proof of ownership on technical deficiency grounds under Rule 14a-8(b).

Because the Staff observed in 2019 that some companies continued to apply an overly technical reading of Rule 14a-8(b)'s ownership eligibility standard as a means to exclude a proposal via the no-action process, the Division took the opportunity in SLB No. 14K to remind companies that they should not seek to exclude a shareholder proposal based on drafting variances in the proof of ownership letter if the language used is otherwise clear and sufficient to establish that the proponent satisfies the requisite minimum ownership requirements.

No-Action Request Procedural Changes

The Division announced in early September that, beginning with the 2019-2020 shareholder proposal season, the SEC Staff may opt to respond orally to some Rule 14a-8 no-action requests seeking to exclude shareholder proposals, in lieu of issuing a written response. In addition, the Staff might decline to respond to a particular no-action request in certain situations; such a declination should not be interpreted as a signal that the company must include the underlying shareholder proposal in its proxy materials. The announcement further stated that the Staff would continue to monitor correspondence relating to the exclusion of shareholder proposals and provide informal guidance to companies and proponents, and would inform the company and the proponent of the Division's position on the company's arguments for exclusion. A written response will be more likely in situations where the Staff "believes doing so would provide value, such as more broadly applicable guidance about complying with Rule 14a-8."

Just what this all means in the application remains unclear, although senior Division officials Director William Hinman and Chief Counsel/Associate Director David Frederickson provided some additional insights during a panel discussion at the mid-September meeting of the ABA's Business Law Section held in Washington, D.C. Mr. Frederickson explained that the procedural changes outlined in the early September announcement were motivated by the Staff's desire to alter expectations of companies and shareholder proponents in the 14a-8 no action process, make the Staff's responses more meaningful, and enable the Staff to devote more time and resources to analysis of the more complex issues raised by some no-action requests by dispensing with detailed written responses to all such requests. According to Mr. Frederickson, the Staff might conclude that a disagreement between the company and the proponent on topics relating to the management of company's business operations is better resolved by the parties, in which case the Staff might decline to express a view. He added that any such declination should not be regarded as a signal that the company must include the proposal in its proxy statement and card. Both Mr. Hinman and Mr. Frederickson indicated that the Staff was working through how best to publish information on the substance of its positions and/or responses, whether communicated orally or in writing. One approach under consideration is a chart or other graphical depiction that could be posted on the Division's web page.

Considerations for the Upcoming Proxy Season

Through SLB No. 14K, the Division has clarified what is, and what is not, regarded as helpful to the Staff's substantive "ordinary business" analysis when presented with a request for no-action relief under Rule 14a-8(i)(7). In any ordinary business context in which a proposal raises a potentially significant policy issue, a company considering an (i)(7) no-action request should carefully weigh the benefits and costs of including a focused, company-specific description of the views of the board (or relevant committee) on significance, which should include the analytical underpinnings. As the Division observed, the inclusion of a meaningful board assessment is important and may even be "outcome determinative." With respect to the analytical underpinnings of the board's views, the board (or responsible committee) should consider, if relevant, the utility of a delta analysis and/or the implications of prior shareholder voting results. Where a particular proposal relating to the business operations of the company appears overly prescriptive or attempts to cabin the exercise of judgment by members of management and/or the board in furtherance of their respective fiduciary duties, the company should heed the Staff's guidance on crafting effective (i)(7) micromanagement arguments. Finally, the company should take a flexible, reasoned approach to dealing with technical deficiencies in proponent proof of ownership letters; in many situations, these deficiencies can be corrected via constructive communication between and/or among company representatives, the proponent and custodial institutions.

ENDNOTES

[1] SLB No. 14K cited, for this proposition, the Staff response to a no-action request from Devon Energy Corp. (Mar. 4, 2019), available here.

[2] Anadarko Petroleum Corp. (Mar. 4, 2019), available here.

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