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Impact of SEC Guidance on Shareholder Proposals in the 2018 Proxy Season

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In the period leading up to the 2018 proxy season, the staff of the Division of Corporation Finance (Staff) of the Securities and Exchange Commission (SEC) published Staff Legal Bulletin No. 14I (SLB 14I), which provided new guidance concerning companies' ability to exclude shareholder proposals from their proxy statements under the "ordinary business" or "relevance" grounds of Rule 14a-8. Although some viewed the guidance as a significant shift that would increase the likelihood of excluding shareholder proposals from proxy statements, to date that has not been the case.

This lack of early company success, coupled with the need to use limited board or board committee resources to utilize the guidance, may create the impression that SLB 14I represents a dead-end street to be avoided. Lessons learned from this first year, however, suggest the Staff's guidance may yet represent a viable and worthwhile avenue to exclude certain shareholder proposals.

Background

The Ordinary Business Exclusion. Rule 14a-8(i)(7) allows companies to exclude shareholder proposals that deal with matters relating to a company's "ordinary business operations." The SEC has stated that the policy underlying this rule rests on two central considerations: the proposal's subject matter and the degree to which the proposal "micromanages" the company. Under the first consideration, the Staff recognizes that certain matters 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." These proposals generally may be excluded from proxy statements unless they raise certain policy issues that the Staff determines are sufficiently significant and related to the company's business that they transcend otherwise ordinary business matters. SLB 14I acknowledged that such determinations raise difficult judgments and that a company's board generally is in a better position than the Staff to analyze these issues. Accordingly, SLB 14I invited companies to assist the Staff's review by including in no-action requests a discussion of the board's analysis of the policy issue raised and its significance to the company. SLB 14I did not address the micromanagement consideration of Rule 14a-8(i)(7).

The Economic Relevance Exclusion. Rule 14a-8(i)(5) allows companies to exclude shareholder proposals that relate to operations accounting for less than 5 percent of the company's total assets, net earnings and gross sales, and that are not "otherwise significantly related" to the company's business. This basis for exclusion has been of limited utility in recent years, as the Staff took a broad view that social or ethical concerns were nearly always significantly related to a company's business. Like with Rule 14a-8(i)(7), SLB 14I acknowledged that a company's board of directors generally is in a better position than the Staff to determine whether a proposal topic is "otherwise significantly related" to the company's business and invited company no-action requests to provide a discussion of the board's analysis regarding a proposal's lack of significance to the company's business.

SLB 14I in the 2018 Proxy Season: Speed Bumps, Wrong Turns and Cautionary Signs

Although a number of companies attempted to utilize the guidance in SLB 14I by including some discussion of the board's analysis in their no-action requests, to date there has been only one instance where a no-action request containing a board analysis received relief under Rule 14a-8(i)(5) and no instance where a board analysis resulted in a grant of no-action relief under Rule 14a-8(i)(7).

One Narrow Instance of Success. The one successful use of SLB 14I this season appeared in a no-action letter granted to Dunkin' Brands Group, Inc. Upon close inspection, however, the board analysis, while potentially helpful, may not have been critical to the outcome. As a result, the Dunkin' Brands letter may prove to be of limited help for companies seeking to exclude other proposals.

In the Dunkin' Brands letter, the company successfully argued that a proposal requesting a report on the environmental impact of using certain branded packaging, including an assessment of reputational, financial and operational risks associated with that packaging, was not relevant to the company's business under Rule 14a-8(i)(5). Specifically, the company argued that the proposal was not significantly related to its business because the company did not make the products at issue but instead licensed its brand to a third party who manufactured the products. The no-action request explained that the proposal was reviewed by the company's nominating and corporate governance committee, whose recommendations were submitted to the board, and took into consideration that the proposal's topic did not address the company's primary business operations but focused instead on packaging used in products manufactured by a third-party licensee. In addition, the board committee noted that a substantially identical proposal was submitted for inclusion in the company's 2017 proxy materials and received less than 14 percent of votes cast, and it was not a topic raised by shareholders in the course of the company's robust shareholder engagement program. The company also asserted that the proponent provided no support demonstrating the significance of the proposal to the company's business.

Although the Staff's response letter indicated that it took the board's analysis into account, the letter also stated that the proposal's significance to the company's business was "not apparent on its face" and that the proponent had "not demonstrated that it [was] otherwise significantly related to the Company's business." Thus, while SLB 14I affirmed that the "mere possibility of reputational or economic harm" will not preclude no-action relief, the Staff's decision appears to have rested on the proponent's failure to carry its burden rather than on the description of the

board analysis. The proponent's failure, together with the unique fact pattern relating to a third-party licensee's packaging, may limit the precedential value of the Dunkin' Brands letter.

Not All Ordinary Business Arguments Need a Board Analysis. The Staff's traditional framework for evaluating no-action requests to exclude proposals on ordinary business grounds has not changed as a result of SLB 14I. Accordingly, the Staff continued to permit exclusion of proposals that focused on ordinary business matters and did not raise significant policy issues. The board analysis described in SLB 14I, intended to assist the Staff in evaluating whether a policy issue contained in a proposal has a sufficient connection to a particular company's business, is not implicated when no policy issue is presented.

Consistent with this approach, where proposals during the 2018 proxy season raised topics that, based on precedent, were clearly ordinary business matters and did not implicate significant policy issues, the Staff granted relief even if there was no description of a board analysis in the no-action request. For example, the Staff granted relief under Rule 14a-8(i)(7) for a proposal requesting that a company adopt a policy to "tell the truth" in its news operations where the company argued that the proposal related to an ordinary business matter without providing a discussion of any board analysis. Similarly, the Staff granted relief under Rule 14a-8(i)(7) for a proposal relating to a company's process for selecting aircraft production sites where the company argued that the proposal related to ordinary business matters and that there was no significant policy issue for the board to analyze.

A Board Analysis Should Contain Sufficient Detail About the Significance of the Proposal to the Company's Operations. As described in SLB 14I, the Staff is looking for a description of the board's analysis of whether the particular policy issue raised in a proposal is significant to the company's business operations. Informally, the Staff has indicated that it is looking for more analysis than companies have provided thus far and that a description of the board's substantive analysis is more helpful than a detailed description of the procedural steps taken to arrive at the board's determination. In some instances this season, the Staff denied relief and noted that the information presented in the no-action request did not include "quantitative or other analysis that may be helpful in determining whether this particular proposal is significant to the Company's business operations." In other cases, the Staff denied relief and stated that "[a]lthough your discussion of the board's analysis sets forth several factors the board considered in evaluating the Proposal, it does not provide a sufficient level of detail to reach a determination that exclusion of the Proposal is appropriate." In addition, where proposals implicated previously recognized significant policy issues and the letter omitted any description of a board analysis, the Staff noted this omission in its response letter. These responses indicate that the Staff is looking for letters that provide a sufficient level of detail regarding the board's quantitative and qualitative analyses to allow the Staff to comfortably conclude that a significant policy issue raised by a proposal is not significant to the company in question.

A Board Analysis Should Discuss Prior Shareholder Support for the Proposal. To date, the Staff has not shown any inclination to rely on a board analysis where the proposal topic previously has been submitted to a shareholder vote (except in the Dunkin' Brands letter, discussed above). Specifically, the Staff denied relief in several instances where proponents highlighted past shareholder support, evidenced by prior votes ranging from 25 percent to more than 40 percent of votes cast, even where the company's description of the board analysis

otherwise appeared fulsome. In most of these cases, the Staff said the companies failed to meet their burden of adequately arguing for relief.

While the Staff confirmed through informal guidance that it remains receptive to a board's analysis as to why a proposal with similar levels of prior shareholder support is not significant to a company's business, it remains to be seen what type of argument would be sufficient to overcome what appears to be a presumption against no-action relief in such cases.

Micromanagement Arguments Have New Vitality. As noted above, SLB 14I did not address the "micromanagement" prong of the ordinary business exclusion analytical framework. Nevertheless, in a noteworthy turn of events, in 2018 the Staff granted an increased number of no-action requests based on micromanagement than in previous years: at least 11 no-action requests granted on this basis, compared to only four during the 2017 season and none during the 2016 or 2015 seasons.

The standard for relief under micromanagement derives from SEC releases and remains unchanged—whether a proposal "involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies." The increase in successful arguments this season appears to represent a fresh look at this basis by the Staff. For example, the Staff permitted a company to exclude a shareholder proposal requesting a report on the feasibility of achieving "net zero" greenhouse gas emissions by 2030 on the basis of micromanagement, even though the Staff rejected a micromanagement argument by the same company to exclude a nearly identical proposal in 2017.

Looking Forward

Whether inclusion of a board analysis invited by SLB 14I ultimately will result in exclusion of a shareholder proposal remains to be seen. The hoped-for deference to company boards did not materialize, and the path forward is not entirely clear. Nevertheless, lessons from 2018 can inform a more targeted and perhaps productive use of the guidance going forward. Additional obstacles can be expected, but the road to success under SLB 14I may yet be paved.

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