

# The Impact of SEC Staff Guidance on Shareholder Proposals Leaves a Murky Path Forward

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In November 2017, the staff of the Division of Corporation Finance (Staff) of the Securities and Exchange Commission (SEC) issued guidance concerning companies' ability to exclude shareholder proposals from their proxy statements under the "ordinary business" and "relevance" grounds of Rule 14a-8. In particular, Staff Legal Bulletin No. 14I (SLB 14I) invited companies to include in their no-action requests their board's analysis of the significance of a proposal under these exclusions, emphasizing that a well-developed discussion of that analysis would assist the Staff in its review of these requests. Virtually every company that went down this path, however, was unsuccessful, and after the 2018 proxy season many questioned the utility of providing a board analysis.

Perhaps due to this skepticism, heading into the 2019 proxy season the Staff released guidance in Staff Legal Bulletin No. 14J (SLB 14J) that, among other things, reiterated its view that a board analysis could be helpful in analyzing no-action requests and provided a nonexclusive list of items that might be included in a "well-developed discussion." In addition, SLB 14J provided guidance concerning the micromanagement prong of the ordinary business exclusion and on proposals relating to senior executive compensation. While this guidance led to an increase in successful micromanagement arguments, it also created confusion for companies seeking to exclude proposals touching on senior executive compensation.

Although SLB 14I and SLB 14J appeared to present meaningful new avenues by which companies might exclude shareholder proposals, that hope, for the most part, has not been realized. Nevertheless, the Staff's no-action letters issued over the 2019 proxy season offer some potentially helpful guideposts for companies.

**Board Analysis: Not the Fast Lane Hoped For.** During the 2018 proxy season only one no-action request containing a board analysis resulted in exclusion under the relevance test and none resulted in relief under the ordinary business exclusion. Despite SLB 14J, the same occurred in the 2019 proxy season, in that only one no-action request containing a board analysis resulted in exclusion under the relevance test and none obtained relief under the ordinary business exclusion.

In another parallel to 2018, it was unclear that the board analysis contained in the sole successful letter actually was necessary for relief. In obtaining no-action relief, Reliance Steel & Aluminum Company argued that a proposal requesting a report on its direct and indirect political contributions and expenditures 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 any direct political contributions and the only potential indirect contributions were dues paid to a trade association not permitted to give to political campaigns. The no-action request included a board analysis determining that neither the proposal nor the public policy considerations it raised were significantly related to the company's business. The board analysis noted, among other factors, that the company had never before received a shareholder proposal regarding direct or indirect political contributions or similar topics. In granting relief under Rule 14a-8(i)(5), the Staff's response letter indicated that the board's analysis was a significant factor in its decision. Because the company did not actually engage in the activity raised by the proposal, it is not clear that the board analysis was necessary for relief and, accordingly, this no-action grant may be of limited precedential value.

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Perhaps due to doubt about the utility of using board time to conduct these analyses, the number of companies that included a board analysis in their no-action requests in the 2019 proxy season dropped to approximately half the number submitted in the 2018 proxy season. When present, however, board analyses generally were more thorough than in the 2018 proxy season and often followed the list of factors set forth in SLB 14J. Still, these more robust analyses did not carry the day. There was one instance in which the Staff directly addressed the issue, denying relief when the company included a board analysis that tracked SLB 14J and specifically stating that it was “unable to conclude, based on the information presented in your correspondence, including the discussion of the board’s analysis on this matter,” that the proposal was not sufficiently significant to the company’s business operations. In every other instance where a board analysis was provided, the Staff either denied relief without referencing the board’s analysis or granted relief for a different reason (for example, micromanagement). This may indicate that in those instances the board analysis either was deficient in some manner or was not necessary because a traditional path to relief was available.

Nevertheless, the Staff continues to encourage companies to include a board analysis, both in its response letters and through informal public remarks. In some instances, the Staff has called out the lack of a board analysis where it has denied relief. Accordingly, despite the lack of clear success to date, inclusion of a board analysis may still be prudent under the right set of circumstances.

## **Micromanagement: An Increasingly Viable Avenue for Relief.**

Arguments under the micromanagement prong of the ordinary business exclusion continue to enjoy a renaissance of late. As described in SLB 14J, a proposal may be excludable if it micromanages a company (*i.e.*, 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), with the analysis focused on the manner in which a proposal seeks to address an issue, rather than the subject matter of the proposal.

In the 2019 proxy season, the Staff granted no-action relief on the basis of micromanagement in 21 instances, up from 11 in the 2018 proxy season, four during the 2017 season and none during the 2016 or 2015 seasons.

SLB 14J may have encouraged an increase in micromanagement arguments. It not only reiterated the Staff’s traditional interpretation of micromanagement, it also explained that proposals seeking intricately detailed studies or reports may, unlike in the past, be excludable on the basis of micromanagement if the underlying substance of the study or report relates to the imposition or assumption of specific time frames or methods for implementing complex policies.

The Staff also explained in SLB 14J that its concurrence with a company’s micromanagement argument does not necessarily mean the subject matter raised by the proposal is improper for shareholder consideration. Rather, it is the precise manner in which a proposal seeks to address an issue that leads it to be considered “micromanagement.” This distinction held true during the 2019 proxy season, when companies faced proposals on similar topics and achieved different no-action results depending on the specific manner in which the proposal sought to address the topic. For example, the Staff denied requests to exclude proposals that asked generally for a report on a company’s plans (if any) to combat climate change, while it granted on micromanagement grounds requests to exclude proposals specifically asking companies to adopt quantitative targets to reduce greenhouse gas emissions.

**Senior Executive Compensation Proposals.** Historically, proposals relating to general employee compensation and benefits have been excludable under the ordinary business exclusion while proposals focusing on senior executive and/or director compensation generally have not because they were viewed by the Staff as relating to a significant policy matter. SLB 14J addressed these proposals in three ways. First, it reiterated the existing framework for analyzing proposals that address both senior executive and/or director compensation and ordinary business matters. Second, it set forth a new approach in which the micromanagement prong of the ordinary business exclusion would be applicable to proposals relating to senior executive and/or director compensation. Third, SLB 14J articulated new guidance that would make the ordinary business exclusion available in instances where proposals address aspects of senior executive and/or director compensation that also are available or applicable to a company’s general workforce. Again, application of the guidance has not met companies’ expectations.

**Senior Executive Compensation Proposals Focusing on Ordinary Business Matters.** As noted in SLB 14J, where proposals address both senior executive and/or director compensation and ordinary business matters, the Staff analyzes whether the underlying concern of the proposal is primarily focused on one or the other. This was a useful reminder but did not represent a new position by the Staff. For example, as might have been expected prior to SLB 14J, in the 2019 proxy season the Staff granted a company’s request to exclude a proposal that asked the board to amend the compensation of certain executive officers to take into account the company’s debt rating as an incentive metric, noting in its no-action letter that the proposal related to the ordinary business matter of management of existing debt.

**Senior Executive Compensation Proposals That Micromanage.** SLB 14J reversed the Staff’s previously held position that proposals addressing senior executive and/or director compensation

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could not be excluded on the basis of micromanagement. Under SLB 14J, proposals addressing senior executive and/or director compensation that seek intricate detail, or seek to impose specific time frames or methods for implementing complex policies, may be excluded on the basis of micromanagement.

This new approach was demonstrated during the 2019 proxy season in a number of instances where the Staff concurred with arguments that proposals relating to executive compensation sought to micromanage the company. For example, the Staff granted a request to exclude on the basis of micromanagement a proposal that asked the company's board to adopt a policy prohibiting the vesting of equity-based awards for senior executives who voluntarily resign to enter government service. This contrasts with the Staff's denial of a request to exclude a nearly identical proposal in 2016 and its statement in that no-action letter that the proposal did not seek to micromanage the company.

**Aspects of Senior Executive Compensation That Also Are Generally Available to Employees.** While SLB 14J articulated new guidance that would make the ordinary business exclusion available for proposals that address aspects of senior executive and/or director compensation that also are available or applicable to a company's general workforce, the Staff has not yet agreed with the exclusion of a proposal on this basis. Moreover, in a number of instances the Staff indicated through its response letters that companies had not appropriately analyzed this basis for exclusion. As a result, companies yet again must consider whether the new guidance has any practical utility.

Seemingly straightforward, the guidance in SLB 14J stated that a proposal that addresses senior executive and/or director compensation may be excludable if a primary aspect of the targeted compensation is broadly available or applicable to a company's general workforce and the company demonstrates that the executives' or directors' eligibility to receive the compensation does not implicate significant compensation matters. Nevertheless, there have been variations in the way the new guidance has been interpreted because SLB 14J also restated its guidance without any reference to an analysis of "significant compensation matters," specifically stating that "it is difficult to conclude that a proposal does not relate to a company's ordinary business when it addresses aspects of compensation that are broadly available or applicable to a company's general workforce, even when the proposal is framed in terms of the senior executives and/or directors."

Shareholder proponents argued that the new guidance imposed a two-part test, requiring companies to demonstrate that (1) the

compensation targeted by a proposal applies generally to their workforce and (2) such aspect of compensation does not implicate "significant compensation matters," a term referenced but not defined in SLB 14J.

In practice, it appears that the Staff has agreed with the existence of a two-part test as suggested by shareholder proponents. In some instances, for example, the Staff noted in its response letters that the no-action request did not address whether the proposal implicated significant compensation matters. In addition, in at least one example, the Staff stated that a company failed to meet its burden of demonstrating the proposal could be excluded and specifically noted the absence of the board's analysis to determine whether the proposal implicated significant compensation matters.

Thus, while companies were hopeful that SLB 14J would lead to an increased ability to exclude proposals touching on senior executive compensation matters, application of the new guidance resulted in more confusion than positive results for companies. Given the Staff's application of a two-part test to decide whether a proposal is excludable when it relates to an aspect of senior executive compensation generally available to the workforce, it appears to have reverted to its traditional approach of analyzing such proposals. That is, the Staff still appears to concentrate its analysis on whether the proposal focuses on the significant policy issue of senior executive compensation and, if so, will decide that the proposal is not excludable.

## Looking Forward

SLB 14J and Staff no-action decisions from the 2019 proxy season provide important guideposts, but the path forward on many shareholder proposals remains murky. The Staff seemingly wants companies to include a board analysis but, except in the narrowest of circumstances, has been hesitant to concur with one. And though the Staff's evolving views on micromanagement hold promise, the availability of a successful argument relies heavily on the specific proposal's request rather than its subject matter. Finally, it remains to be seen whether SLB 14J will have any meaningful impact or utility with respect to proposals addressing aspects of senior executive compensation available to the general workforce.

These items, together with the inclusion of potential amendments to Rule 14a-8 on the SEC's near-term rulemaking agenda, will continue to create uncertainty and unpredictability for companies and shareholder proponents alike.