Shareholder Proposal No-Action Requests in the 2021 Proxy Season: Dearth of No-Action Response Letters Leaves Companies Guessing

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As calendar year-end companies received shareholder proposals for their 2021 annual meetings, they faced a variety of uncertainties and challenges, including navigating the COVID-19 pandemic, addressing the racial inequities brought to the fore by the killings of George Floyd and others, and steering through a hyper-partisan and unprecedented U.S. presidential transition. The shareholder proposals received by companies reflected many of these broad themes.

Unlike in the prior three years, the staff of the Division of Corporation Finance (Staff) of the U.S. Securities and Exchange Commission (SEC) did not issue new guidance regarding companies' ability to exclude shareholder proposals from their proxy statements heading into the 2021 season. Although this may have hinted at some stability in the no-action process, that was not to be the case. The Staff issued significantly fewer no-action response letters than in previous years, opting instead to respond mostly through informal decisions that were included in a chart on the SEC's website. Because these informal responses provided the Staff's conclusions without additional explanation, the Staff's reasoning in a number of decisions was unclear.

Nevertheless, whether by response letter or chart entry, there were a number of notable no-action decisions and trends. As in prior years, many of these concerned the ability to exclude proposals as relating to a company's ordinary business. In addition, some related to procedural items that might have seemed fairly straightforward. Reviewing the guideposts provided by Staff decisions from the 2021 proxy season helps in attempting to understand the Staff's current approach to shareholder proposals.

Despite Increased Success of Board Analyses, Numbers Do Not Tell the Full Story

Building on past experience, the number of no-action requests containing a board analysis increased slightly year-over-year, and the number of such requests granted increased significantly. Based on informal responses, it appears that companies successfully used board analyses in no-action requests under the ordinary business, relevance and substantial implementation exclusions during the 2021 proxy season.[1] As described below, however, most of these successful requests followed paths carved in the 2020 proxy season and broke little new ground. Also, as in prior years, the Staff denied some requests for no-action relief despite the presence of a board analysis, serving as a reminder that even a well-informed board analysis will not always carry the day.

Ordinary Business

In two instances, the Staff concurred with a company's view that a proposal could be excluded as ordinary business, and while the no-action request contained a board analysis, it was not obvious that a board analysis was necessary for relief and the Staff's charted responses did not indicate whether the board analysis impacted the Staff's view. In two other instances, the Staff concurred with ordinary business arguments containing a board analysis to exclude proposals requesting a report on the potential risks associated with omitting the terms "viewpoint" and "ideology" from the company's equal

[1] As a brief reminder, the Staff introduced the concept of including a board analysis to support shareholder proposal no-action requests in Staff Legal Bulletin No. 14I. Specifically, the Staff indicated that a board analysis could be helpful to the Staff in making determinations to exclude proposals relating to the company's "ordinary business" under Rule 14a-8(i)(7) or as lacking "relevance" to the company under Rule 14a-8(i)(5). One year later, in Staff Legal Bulletin No. 14J, the Staff provided further guidance regarding the types of factors that a "well-developed" board analysis might address. In the next year, the Staff expanded its guidance on two particular factors of a board analysis in Staff Legal Bulletin No. 14K — the "delta" analysis and prior voting results.

employment opportunity policies. The Staff did not issue no-action letters in these instances, but the companies' arguments aligned with those from a successful no-action request in the 2020 proxy season in which the Staff issued a no-action response letter citing the company's board analysis. It may be the case that the Staff will not issue formal no-action responses when a board analysis included in a request aligns with one it previously found persuasive.

Relevance

It continues to be the case that most of the successful board analyses under the relevance grounds for exclusion relate to proposals that may not be widely applicable. For instance, in the 2020 proxy season, one of the successful relevance board analyses related to wild animal displays. This proxy season, the successful board analysis involved a large insurance company arguing to exclude a proposal requesting a report on how the company could reduce the potential for "racist police brutality" through its products. After demonstrating that the proposal's subject matter was not economically significant to the company, the company submitted an analysis from its nominating and corporate governance committee that concluded the proposal was not otherwise significant to the company. The committee's analysis noted, among other factors, that the proposal's significance to the company's business was not apparent on its face and that shareholders had not previously raised the issue in the proposal. The Staff responded without a letter, granting relief under the relevance exclusion.

In a contrasting example, a large financial institution unsuccessfully argued that a proposal seeking disclosure of the company's lobbying payments was not relevant to the company's business. As above, after explaining that the proposal's subject matter was not economically significant to the company, the company submitted an analysis from its nominating and corporate governance committee that concluded the proposal was not otherwise significant to the company, noting that shareholder support for similar proposals had declined from approximately 30% of votes cast in 2017 to approximately 15% in 2020. In a previous season, the Staff denied a relevance argument by the same company for a similar proposal, noting at the time that the company's board analysis failed to adequately address prior voting results. Again, the Staff denied the request, this time without issuing a letter.

Substantial Implementation

The majority of no-action letters granted during the 2021 proxy season that included a board analysis were granted under the substantial implementation exclusion. Staff guidance on board analyses had not indicated that a board analysis could be helpful outside the ordinary business or relevance grounds for relief, but the Staff opened the door to this approach in the 2020 season. To date, all of the successful examples of a board analysis used to support a substantial implementation argument relate to proposals seeking a review of how a company could implement the Business Roundtable's "Statement on the Purpose of a Corporation." In the 2020 proxy season, the Staff issued a response letter granting relief under the substantial implementation basis where the company noted that its nominating and corporate governance committee concluded that no additional actions or assessments were required to implement the proposal. While that request also featured a robust ordinary business argument, many of the successful no-action requests on this proposal topic in the 2021 proxy season skipped the ordinary business argument and only argued for substantial implementation, with the board analysis largely following the reasoning of the 2020 letter.

Whether a board analysis can successfully support a substantial implementation argument for any other proposal topic remains to be seen. Notably, the Staff denied no-action relief where a company sought to exclude a proposal seeking a racial equity audit, arguing that it had substantially implemented the proposal and noting the conclusion of its corporate governance and nominating committee that the company had already taken the actions requested by the proposal.

Ordinary Business: Spotlight on 'Significance'

In Staff Legal Bulletin (SLB) 14K, the Staff reminded companies and shareholder proponents that it evaluates a proposal's significance under the ordinary business exclusion on a company-specific basis, and "a policy issue that is significant to one company may not be significant to another." In doing so, the Staff explicitly rejected the notion of "universally" significant topics. In a proxy season generating only a small number of no-action letters, it is notable that the topic of universal significance specifically came up in two response letters. This serves as an important reminder to companies that regardless of any notion of the significance of a topic to society at large, the relevant analysis is whether the proposal relates to a topic of actual significance to the company.

In one instance, a large retailer successfully argued that a proposal asking for a report on the feasibility of giving "paid sick leave … as a standard employee benefit not limited to COVID-19" related to the company's ordinary business and was not significant to the company. The Staff issued a response letter noting that proposals related to paid sick leave "may" raise a significant policy issue, but the proposal "does not demonstrate how offering paid sick leave as a standard employee benefit is sufficiently significant to [this] Company" and, citing SLB 14K, the Staff "does not recognize particular issues or categories of issues as universally 'significant.'"

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In another instance, a retail pharmacy company successfully argued that a proposal requesting a report on the "external public health costs" created by the company's retail food business was excludable under the ordinary business exception and was not significant to the company. The Staff granted the no-action request without issuing a letter. Shortly before deciding the request, the Staff denied relief for a nearly identical proposal submitted to a large food and beverage manufacturer, also without issuing a letter. The proponent of the proposal at the retail pharmacy company requested reconsideration, noting that the two proposals were nearly identical and related to many of the same products. In denying the reconsideration request, the Staff wrote that while a proposal "may raise a significant policy issue that transcends a company's ordinary business operations" (citing the no-action decision at the food and beverage manufacturer), the proposal at the retail pharmacy "does not demonstrate how external public health costs created by the Company's retail food business are sufficiently significant to the Company."

The Waning Success of the Micromanagement Prong of Ordinary Business

The micromanagement prong of the ordinary business exclusion experienced a resurgence over the past few years, although Staff guidance in SLB 14K provided a road map for proponents to evade these arguments. Accordingly, the number of successful no-action requests premised on micromanagement declined in the 2020 proxy season. This downward trend continued in the 2021 season, with both the number and success of such requests declining.

As the Staff explained in SLB 14K, when considering arguments for exclusion based on micromanagement the Staff often assesses the level of prescriptiveness with which a proposal addresses a subject. Examples of proposals excluded on the basis of micromanagement from the 2021 proxy season include a proposal that would have required the company to include diverse candidates in the initial candidate pool for hiring for all positions at the company, another that would reduce CEO pay ratio by a specified amount, and another to prohibit equity compensation grants to senior executives when the company's common stock fell below a particular price.

Interestingly, the Staff denied relief for a proposal requesting an energy company set reduction targets for the greenhouse gas emissions of its operations and energy products (Scope 1, 2 and 3). The company argued the proposal impermissibly micromanaged the company by requesting it adopt greenhouse gas emission reduction targets and compared the proposal to past examples where the Staff permitted exclusion of proposals seeking greenhouse gas emissions targets aligned with the Paris Climate Agreement. The Staff denied relief, stating in a response letter that "the Proposal only asks the Company to set emission reduction targets; it does not impose a specific method for doing so." Going forward, it is not clear where the Staff will draw the line between proposals prescriptive enough to qualify as micromanagement and those that are not, allowing them to survive a challenge.

Despite the guidance in SLB 14K that micromanagement determinations focus on the manner in which a proposal seeks to address an issue rather than the subject matter itself, decisions from the 2021 proxy season continue a trend from the 2020 season suggesting that micromanagement arguments may not be viable in the context of corporate governance proposal topics, even with apparently prescriptive requests. For example, the Staff rejected an argument that a proposal requesting a company amend its certificate of incorporation to convert from a Delaware corporation to a public benefit corporation was overly prescriptive. The Staff also rejected a micromanagement argument where the proposal would have required a company to implement a policy that the initial list of candidates for new director nominees include nonmanagement employees.

Some Surprising Procedural Decisions

Although the 2021 proxy season saw an increased percentage of proposals excluded on procedural grounds, in two instances, with formal response letters, the Staff denied no-action relief due to circumstances relating to COVID-19.

In one instance, a company argued that a proposal could be excluded because the proponent failed to timely respond to a deficiency notice relating to its delegation of authority. The proponent had submitted the proposal to the company by UPS and email and requested further communications be sent to the proponent by email. The company sent a deficiency notice to the proponent's offices by UPS and did not receive a response within the 14-day period following delivery because the proponent's offices were closed due to COVID-19. After becoming aware of the deficiency notice, the proponent responded within two business days. In denying the company's request for no-action relief due to the lack of a timely response to the deficiency letter, the Staff wrote that the proponent's failure to timely correct the deficiency "related to the COVID-19 pandemic and the Proponent's representative responded reasonably after discovering the notice." The Staff specifically noted that the proponent's "initial submission requested communications to be directed to a particular email address, but the Company sent its deficiency notice to the offices of the Proponent's representative via UPS only, and did not otherwise inform the Proponent by email of the mailed deficiency notice."

In another instance, the Staff did not concur with a company's argument that a proposal was untimely when it was delivered to the company's offices six days after the deadline. Typically, proponents must ensure a proposal's timely submission, and delivery even one day past the deadline is sufficient for exclusion. In its response letter, the Staff noted, "Our decision to deny relief is based on the significant and well known delivery delays incurred by the United States Postal Service due to the pandemic and surge in holiday deliveries, which were outside the control of the Proponent." Interestingly, the original anticipated delivery date for the proposal was only one day before the deadline. Whether this decision indicates a more generous approach to timeliness issues by the Staff remains to be seen.

This letter also provided the Staff an opportunity to comment on the use of email for proposal submissions. The Staff noted that while the proponent unsuccessfully attempted to submit the proposal by email, the Staff based its decision only on the proposal's submission to the physical address provided in the company's proxy statement. On using email, the Staff stated, "To the extent a proponent faces obstacles to timely delivery to a mailing address beyond its control and seeks to submit the proposal by an alternate means not provided for in the proxy statement, the proponent should first contact the company to obtain any approved, alternate means for submitting proposals. The proponent also should request that a company employee confirm that the company received the proposal given the proponent bears the burden of proving the date of delivery."

Conclusion

Against the backdrop of the pandemic and social turmoil, the 2021 proxy season was by no means ordinary. The lack of Staff response letters will create continuing uncertainty as companies consider future shareholder proposals. Nevertheless, numerous developments — including the success of no-action requests containing board analyses, the Staff responses highlighting that proposal topics are not universally "significant" and the continuing (if decreasing) viability of micromanagement arguments — confirm that companies should continue scrutinizing shareholder proposals to ascertain whether to include them in proxy materials.