Harvard Law School Forum on Corporate Governance

SUPPORTED BY: pwc

SEC Increases the Unpredictability of the Shareholder Proposal No-Action Process

Posted by Marc S. Gerber and Ryan J. Adams, Skadden, Arps, Slate, Meagher & Flom LLP, on Wednesday, July 20, 2022

Editor's note: Marc S. Gerber is partner and Ryan J. Adams is counsel at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum.

Key Points

- Numerous no-action letters relating to the 2022 proxy season overturned both recent and long-standing precedent, creating a level of uncertainty that companies will need to factor into their future no-action strategies and engagement with shareholder proponents.
- With Staff Legal Bulletin 14L, the SEC Division of Corporation Finance Staff realigned its approach for determining whether a proposal relates to "ordinary business" with a previous standard providing an exception for certain proposals raising significant social policy issues.
- Staff Legal Bulletin 14L also outlined a revised and more stringent approach to the micromanagement prong of the ordinary business exclusion.
- The 2022 proxy season revealed the Staff's approach to recent amendments to the shareholder proposal rule, including narrowly applying the one-proposal limit.

The shareholder proposal no-action process relating to the 2022 proxy season was bound to be interesting and contentious for a number of reasons.

Investors showed significantly increased support for environmental and social shareholder proposals in the 2021 proxy season and submitted more prescriptive proposals for the 2022 season.

In November 2021, the Staff of the Division of Corporation Finance (Staff) of the Securities and Exchange Commission (SEC) published Staff Legal Bulletin No. 14L (SLB 14L), announcing that certain analytical approaches adopted under the prior SEC leadership would be abandoned or modified. (See our November 5, 2021, client alert "SEC Staff Issues New Shareholder Proposal Guidance, Rescinding 2017-2019 Guidance.")

In addition, proposals submitted for consideration at 2022 annual meetings provided the first opportunity for the Staff to consider arguments for and against exclusion of shareholder proposals under amendments to the shareholder proposal rule adopted by the SEC in 2020.

The combination of the publication of SLB 14L and the 2020 rule amendments going into effect put companies and proponents on notice that there would be a greater level of uncertainty in the no-action process for the 2022 proxy season.

The surprise, however, was that the Staff ultimately revisited and reversed both recent and long-standing no-action letter precedent, introducing a new level of unpredictability into the no-action letter process.

Background on the No-Action Process

Although the SEC Staff no-action letter process is not a formal judicial or administrative one, companies factor previous Staff no-action decisions into their assessments of shareholder proposals and their arguments for excluding them. The Staff likewise—at least historically—looks to prior no-action letters that do or do not support the company's and shareholder's positions.

Over the years, this created an informal body of precedent and provided companies and shareholders with a certain level of predictability and informed decision-making in conducting their affairs with respect to shareholder proposals.

Although not bound to do so, when the Staff determines to change its analytical approach to shareholder proposal matters, it traditionally notifies stakeholders through the publication of a Staff Legal Bulletin in advance of the "high season" for no-action letters.

SEC Publishes Staff Legal Bulletin 14L

SLB 14L effectively reset the Staff's analytical approach to the "ordinary business" and "relevance" exclusions for shareholder proposals to prior to November 2017, rescinding Staff Legal Bulletin Nos. 14I, 14J and 14K from 2017, 2018 and 2019, respectively.

Specifically, among other things, the guidance eliminated the Staff request that companies provide a board analysis to support "ordinary business" and "relevance" no-action requests and also addressed the use of arguments under the micromanagement prong of the ordinary business exclusion.

Ordinary Business: Human Capital Management

The Staff previously introduced the concept of including a board analysis in no-action requests in part to aid its analysis under the ordinary business exclusion of the significance of a proposal to a company's business. In SLB 14L, the Staff made clear that a board analysis would have no utility going forward. According to the Staff, the rescinded SLBs placed "an undue emphasis … on evaluating the significance of a policy issue to a particular company at the expense of whether the proposal focuses on a significant social policy."

Henceforth, the Staff stated it would "realign its approach for determining whether a proposal relates to 'ordinary business' with the standard the Commission initially articulated in 1976, which provided an exception for certain proposals that raise significant social policy issues."

The Staff noted further that in making this determination, it would consider "whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company."

Of course, the question of whether an issue has "broad societal impact" is an inherently subjective standard and a judgment that may be unlikely to remain static over time.

In resetting the Staff's approach to the ordinary business exclusion, SLB 14L warned that some Staff decisions would conflict with recent precedent, citing as an example that proposals "squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company." This approach was evident during the 2022 proxy season.

Relief Denied

- **Paid sick leave policy.** The Staff denied no-action relief for a proposal that asked the company to adopt and disclose a policy requiring that all employees accrue paid sick leave. The company argued that the proposal related to the ordinary business matter of the management of its workforce. The Staff had permitted exclusion of a similar proposal in the 2021 proxy season but this time concluded that the proposal transcended ordinary business matters "because it raises human capital management issues with a broad societal impact."
- **Report on workforce practices and inequality.** The Staff denied exclusion of a proposal requesting a report on whether a company prioritized financial performance in setting compensation and workforce practices over the economic and social costs and risks created by inequality and racial and gender disparities. The Staff said the proposal was not excludable under ordinary business because it raised "human capital management issues with a broad societal impact."

As a result, it is clear that some proposals implicating human capital management issues have become difficult to exclude on ordinary business grounds. However, there were a number of successful ordinary business arguments relating to a company's management of its workforce—in other words, relating to human capital management.

Relief Granted

- **Employee safety and temporary workers.** A company successfully argued that a proposal requesting a report on the dangers of industrial accidents arising from the use of temporary workers was focused on the company's ordinary business, despite the proposal making reference to human capital management and broad societal impacts.
- **Reactions to gay pride flag.** A company successfully argued that a proposal focused on the management of its workforce where the proposal requested a report on employees' reactions to the company's public display of a gay pride flag.
- **Pandemic turnover and DEI.** A proposal requesting a report on the workforce turnover rates at a company as a result of COVID-19 and its impact on diversity, equity and inclusion (DEI) was determined excludable as ordinary business and, according to the Staff, did not focus on significant social policy issues.

While these decisions indicate that the ordinary business exclusion relating to workforce management matters remains viable, they offer little clarity on the standards the Staff uses to determine when such proposals implicate significant human capital management policy matters that transcend a company's ordinary business.

Ordinary Business: Micromanagement

In addition to the updated guidance on traditional ordinary business arguments, SLB 14L outlined a revised and more stringent approach to the micromanagement prong of the ordinary business exclusion.

Specifically, in SLB 14L the Staff explained that its previous approach (under the rescinded SLBs) may have "been taken to mean that any limit on company or board discretion constitutes micromanagement."

The Staff stated it will now take a "measured approach" to micromanagement arguments, focusing on "the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management."

In particular, SLB 14L noted that the Staff will not concur with exclusion of climate change proposals that "suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals."

In light of this guidance, companies made fewer micromanagement arguments in the 2022 proxy season and had little success. Nevertheless, there were a handful of winning micromanagement arguments.

Relief Granted

- **Employee training materials.** The Staff granted relief for three proposals seeking the publication of content from employee training materials (along with materials involved in the creation of such content) noting that the proposals probed "too deeply into matters of a complex nature by seeking disclosure of intricate details regarding the Company's employment and training practices."
- **Prior shareholder approval of political statements.** The Staff agreed that a proposal requesting the company submit proposed political statements for shareholder approval prior to their public issuance constituted micromanagement.

These decisions reflect that micromanagement remains a viable basis for exclusion under the right circumstances.

Ordinary Business: Litigation Strategy Matters

Deviations from recent precedent were not limited to the circumstances outlined in SLB 14L. Historically, companies have been able to exclude proposals as relating to ordinary business when the proposal might, if implemented, affect litigation to which the company is a party.

Although this should be a straightforward factual question, some Staff decisions in the 2022 proxy season appeared to deviate from past practice.

Relief Denied

- **Civil rights audit.** The Staff denied no-action relief for a proposal requesting a third-party civil rights audit where the company argued that the proposal would interfere with its litigation strategy because it was involved in a number of lawsuits filed on behalf of employees alleging racial and gender discrimination. In the 2021 proxy season, however, the Staff granted relief for a similar proposal seeking a racial equity audit where the company was involved in litigation alleging that its actions had an adverse impact on communities of color.
- **Pay gap report.** In a similarly inexplicable reversal, the Staff denied no-action relief for a proposal that sought a report on risks related to pay gaps across race and gender where the company was subject to a lawsuit alleging it had unfair pay practices by gender; in 2018, the Staff had granted relief for a similar proposal at a company involved in similar litigation.

These decisions may indicate that the Staff is taking a new—but not yet articulated—approach to no-action requests relating to litigation strategy, an area in which the Staff historically had been willing to grant relief even when proposals raised significant policy issues.

Staff Applies Restrictive Standard to Substantial Implementation Exclusion

The unpredictability faced by companies seeking no-action relief for shareholder proposals during the 2022 proxy season was not limited to arguments under the ordinary business exclusion. In particular, it seemed as though the Staff applied an unusually restrictive standard to arguments under the substantial implementation basis for exclusion, including with regard to a number of well-established corporate governance proposal topics. In practice, the Staff appeared to deny relief when companies did anything outside of precisely what the proposal requested.

Proposals To Eliminate Supermajority Voting Requirements

The Staff applied new standards to substantial implementation arguments relating to proposals seeking to eliminate supermajority voting requirements in companies' governing documents.

Relief Denied

- A company argued that it had substantially implemented a proposal that the board take the necessary steps to replace greater-than-simple-majority voting requirements in its charter and bylaws with a majority-of-votes cast standard. The company explained that its governing documents did not contain any supermajority voting provisions. It acknowledged that it was subject to certain supermajority voting requirements under state law but noted that the Staff had routinely determined that companies substantially implemented similar proposals in the past under similar facts. Despite this past application of the substantial implementation basis for exclusion, the Staff denied the company's no-action request, stating that "the Company appears to be subject to certain

supermajority voting requirements under applicable state law and that the Company's governing documents do not otherwise provide for a lower voting standard."

- Perhaps even more surprising, the Staff denied substantial implementation arguments on similar proposals where the company proposed to adopt amendments to its governing documents that would replace supermajority voting provisions with a majority-of-the-outstanding-shares voting standard, stating that "if shareholders approve the Charter Amendments at the Company's 2022 annual meeting, future shareholder-approved amendments to the Company's bylaws would require the approval of a majority of the outstanding shares of common stock, rather than a majority of votes cast, as the Proposal requests." This was inconsistent with a large body of precedent going back to at least 2013, indicating a new and unanticipated standard for substantial implementation arguments.

Proposals To Adopt Proxy Access

The Staff applied a new approach to substantial implementation arguments in the context of proposals requesting the adoption of proxy access rights.

In precedent going back to 2016, the Staff agreed that dozens of companies—adopting a proxy access bylaw providing proxy access rights to a group of up to 20 shareholders owning, in the aggregate, at least 3% of a company's shares for at least three years—substantially implemented shareholder proposals requesting adoption of proxy access rights for an unlimited number of shareholders holding at least 3% of a company's shares for at least three years.

Relief Denied

- In a number of instances similar to the above examples, the Staff this year denied no-action requests, stating that "[d]ue to the differences in the new [proxy access] provision and the Proposal … in our view the board's action has not substantially implemented the Proposal." The only notable difference in the 2022 proposals from those made in past years was their declaration that "the most essential feature" of the proposal was that shareholders forming a nominating group not be limited with regard to the number in a participating group. But the proposals that had been excluded under the same fact pattern in prior years also had requested a proxy access right without an aggregation limit. If the Staff's new position is that proponents can declare the one deviation between the proposal and the company's action to be the "most essential feature," this basis for exclusion could be effectively eviscerated.

Proposals To Adopt Special Meeting Rights

The Staff denied a number of no-action requests premised on substantial implementation for proposals requesting that companies amend their governing documents to give holders of a specified percentage of company stock the power to call a special meeting.

In prior years, the Staff routinely granted relief under the substantial implementation basis for similar proposals where companies implemented a special meeting right with the ownership requirement threshold requested in the proposal. In a stark departure from this approach, however, a number of companies were denied no-action relief in the 2022 proxy season where

they had implemented a proposal's requested ownership percentage but otherwise included common procedural safeguards in their special meeting rights.

Relief Denied

- A company amended its governing documents to allow one or more shareholders holding at least 25% of the company's common stock to call a special meeting, where the proposal requested that the company amend its governing documents to give the owners of 25% of its common stock the power to call a special meeting. On its face, the company's action appeared to fully implement the proposal. Surprisingly, in its response letter, the Staff explained that the proposal was not substantially implemented because the company's "governing documents enable only stockholders of record to call a special shareholder meeting."
- The Staff denied relief for a similar proposal seeking an amendment to allow shareholders with 10% ownership of the company's common stock the power to call a special meeting where the company's bylaws already provided that power. In its response letter, the Staff noted that it was unable to conclude the proposal was substantially implemented because the company's bylaws contained a one-year ownership requirement to call a special meeting—an element of special meeting bylaws at many companies.

These results were surprising in their own right, and even more so given the approach signaled by SLB 14L of realigning the Staff's analytical approach with the SEC's "original intention." In this regard, the decisions denying substantial implementation arguments are difficult to reconcile with the SEC's own statements that the substantial implementation basis does not require a proposal to be "fully effected," and that an overly formalistic application of the rule only defeats its purpose.

Other Unexpected Staff Positions

Substantially Duplicative Proposals

Under the shareholder proposal rules, a company may exclude a shareholder proposal if it substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting.

In precedent going back to at least 2009, the Staff's approach was that substantially similar resolution clauses resulted in substantially duplicative proposals even if the supporting statements expressed differing viewpoints.

Relief Denied

- In a notable and unexpected reversal, the Staff denied no-action relief where a company argued that a proposal urging the board to oversee a third-party audit of its policies, practices and products' racial impacts was substantially duplicative of a proposal requesting the board commission a racial equity audit analyzing the company's impacts on civil rights, equity, diversity and inclusion, and the impacts of those issues on the company's business. While the Staff did not provide details of its decision-making, the

proposals approached the topic of the audit from different perspectives: one focused on racial justice and the other on the premise that racial equity training itself could be discriminatory.

Arguing for Exclusion Under Numerous Bases

It is not unusual for companies to argue that a proposal can be excluded under numerous bases, even when those bases may conflict. For example, companies often have argued that a proposal can be excluded on the basis that it is vague and ambiguous and, at the same time, that (if the proposal is not vague and ambiguous) the company has substantially implemented the proposal.

Relief Denied

- The Staff denied a company's no-action request on a number of bases where the proposal related to proxy voting and the company's no-action request argued separately that the proposal was impermissibly vague and indefinite and also substantially implemented. In a surprising development, the Staff's response letter noted "the Company's argument that it has already substantially implemented the Proposal," which, according to the Staff, "suggests that, in the Company's view, the Proposal is not so vague or indefinite that neither the shareholders voting on it, nor the Company in implementing the Proposal (if adopted), would be able to determine with any reasonable certainty exactly what actions or measures the Proposal requires."

Going forward, companies may need to give further thought to the consistency of arguments within their no-action requests and how they present multiple bases for exclusion.

Staff Decisions Stemming From 2020 Amendments

In September 2020, the SEC adopted amendments to the shareholder proposal rule, which took effect for proposals submitted in connection with 2022 annual meetings. The amendments included, among other things, a new requirement that proponents provide information regarding their availability for engagement with a company, and revisions to the one-proposal limit to apply to anyone submitting a proposal as a representative of a shareholder.

Heading into the 2022 proxy season, there were questions about how these new requirements would be considered in no-action requests.

Statement of Availability for Engagement With the Company

In the case of the requirement that proponents provide a statement of their availability to engage with a company, the Staff held proponents to the requirements in the amended rule.

Relief Granted

- In numerous instances, the Staff allowed companies to exclude proposals on procedural grounds where the proponents failed to include a statement of their availability to meet

with the company and failed to cure the procedural defect after receiving timely notice thereof.

One-Proposal Limit

The Staff took a narrow view of the one-proposal limit, focusing on the rule's use of the word "submit."

Relief Denied

- In a few instances, companies attempted to argue that a proponent who submitted a proposal on his or her own behalf and who also was designated to represent another proponent violated the one-proposal rule. The Staff largely denied these arguments, writing that "neither the Proponent, nor the Proponent's representative, submitted more than one proposal, directly or indirectly, to the Company."

Relief Granted

- The Staff permitted a company to exclude a proposal where a proponent initially submitted a proposal under his own name and also was authorized to act on behalf of another proponent, and subsequently submitted a revised proposal on behalf of that other proponent. The Staff explained that in doing so, the proponent "effectively withdrew [the other proponent's] original proposal […] and substituted it with the revised proposal that he, himself, submitted."

Conclusion

Over the course of the 2022 proxy season, the Staff introduced an unanticipated level of unpredictability into the shareholder proposal no-action process through numerous no-action letters that overturned both recent and long-standing precedent. As a result, companies seeking no-action relief for shareholder proposals cannot assume that any no-action letter precedent is on solid ground. Companies will need to factor this uncertainty into their no-action strategies and engagement with shareholder proponents.

It is difficult to know if this greater uncertainty and willingness to dispense with precedent will become a permanent feature of the no-action process. If it does, it will ultimately be to the detriment of both public companies and investors, as well as the SEC, as the process may appear more partisan, less principled and more difficult to navigate for all stakeholders.