



SEC Update

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SEC staff revives former guidance on shareholder proposals raising social policy issues

On February 12, the SEC's Division of Corporation Finance issued Staff Legal Bulletin No. 14M (SLB 14M) to update its guidance on the "economic relevance" and "ordinary business" exclusions in Exchange Act Rule 14a-8, which is the SEC's shareholder proposal rule. The SEC staff will apply the guidance during the current proxy season in responding to company no-action requests seeking to exclude shareholder proposals under those provisions.

In this latest statement on the scope of the two exclusions, the Division has rescinded Staff Legal Bulletin No. 14L (SLB 14L) issued in November 2021. The staff in the prior bulletin narrowed the grounds on which companies could exclude from their proxy materials shareholder proposals that raise significant social policy issues, such as those relating to climate change and workforce diversity.

The guidance outlined in SLB 14M reinstates the "company-specific" analysis the staff applied to exclusion determinations before issuing SLB 14L, which can be expected to enlarge the basis for excluding proposals involving social policy issues.

The Division states in SLB 14M that, in evaluating shareholder proposals, a company should not focus solely on whether a proposal raises issues of social or ethical significance (in the case of the economic relevance exclusion) or issues with a broad societal impact or that are universally significant (in the case of the ordinary business exclusion). Even if a proposal raises such issues, the company may exclude the proposal from its proxy materials if the proponent does not establish that the issues are significant in relation to the company or its business.

SLB 14M can be found [here](#).

No-action submissions for this proxy season

The Division confirms in SLB 14M that the staff will apply the new guidance beginning on the bulletin's February 12 issue date. Any company that submitted a pending no-action request before SLB 14M was issued and wishes to raise new legal arguments based on that guidance may do so by submitting supplemental correspondence "in as timely a manner as possible." If a company did not submit a no-action request but wishes to do so based on the new guidance, the staff will consider the publication of SLB 14M to constitute "good reason" under Rule 14a-8(j)(1) for the company to make its submission after the deadline, so long as SLB 14M relates to legal arguments made by the new request and the company submits its request "as soon as possible."

Reinstatement of prior guidance

Echoing a theme sounded in bulletins that preceded SLB 14L, the Division emphasizes that the company-specific analysis defined in SLB 14M aligns the operation of the economic relevance and ordinary business exclusions with policies identified by the Commission in releases it issued in 1976 and 1988. Under those policies, as construed by the staff in SLB 14M, shareholders seeking to bring social policy issues before the company's other shareholders through the proxy process should demonstrate that the issues are significant to their company rather than solely to society at large.

In addition to rescinding SLB 14L, the Division has reinstated its former guidance regarding the application of the exclusions presented in:

- Section C.2 (relating to micromanagement claims) and Section C.3 (relating to proposals addressing senior officer or director compensation) of Staff Legal Bulletin No. 14J (SLB 14J), published in

October 2018 and discussed in the **SEC Update** we issued on November 7, 2018; and

- Section B.4 (relating to micromanagement claims) of Staff Legal Bulletin No. 14K (SLB 14K), published in October 2019 and discussed in the **SEC Update** we issued on October 23, 2019.

We discussed SLB 14L in the **SEC Update** we issued on November 16, 2021.

Guidance on economic relevance exclusion

The Division in SLB 14M returns to its earlier, company-specific analysis for determining whether a company may rely on the economic relevance exception under Rule 14a-8(i)(5) to exclude from its proxy materials a shareholder proposal that raises social or ethical issues that do not have a significant relationship to the company's business.

The economic relevance exclusion permits a company to exclude from its proxy materials a proposal that:

- relates to operations accounting for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year; and
- is "not otherwise significantly related to the company's business."

The Division indicates in SLB 14M that if a shareholder proposal relates to operations that account for less than 5 percent of the company's total assets, net earnings, and gross sales, the company should assess whether the proposal is "otherwise significantly related to the company's business." If the social or ethical issues raised by the proposal are not significantly related to the company's business, the company may exclude the proposal from its proxy materials "notwithstanding their importance in the abstract."

In rescinded SLB 14L, the staff appeared to uncouple analysis of a proposal's social or ethical issues from an evaluation of their significance to the company. In SLB 14M, by contrast, the Division underscores that if a proponent raises social or ethical issues in support of its proposal, it must "tie those matters to a significant effect on the company's business." The staff states that the "mere possibility of reputational or economic harm alone" will not be enough to make the required showing. In evaluating a proposal's significance to the company's business, the staff will

consider the proposal in light of the "total mix" of information about the company.

The Division stresses that whether any social policy issue is significantly related to a company's business depends on the "particular circumstances" of the company to which the proposal is submitted. The staff highlights that such an issue might be significant to one company but not to another. The staff notes, however, that it "would generally view substantive governance matters to be significantly related to almost all companies."

A proposal's significance to the company's business may not be apparent on its face. In these circumstances, as the Division notes in an example cited from a Commission release, the proponent could demonstrate, among other things, that its proposal "may have a significant impact on other segments of the issuer's business or subject the issuer to significant contingent liabilities."

In a change to its approach under SLB 14L, the staff will no longer tie its analysis of whether a proposal is significantly related to a company's business under Rule 14a-8(i)(5) to its analysis of whether the proposal may be excluded under Rule 14a-8(i)(7) as relating to the company's ordinary business operations. The Division says that the different purposes of the two exclusions are better served by an independent analysis of the application of each provision to the particular circumstances.

Guidance on ordinary business exclusion

SLB 14M similarly reinstates the company-specific framework for evaluating significant social policies it abandoned in November 2021 for determining whether a company may rely on Rule 14a-8(i)(7) to exclude from its proxy materials a shareholder proposal that "deals with a matter relating to the company's ordinary business operations."

The ordinary business exclusion is based on the general principle of state corporate law that a corporation's directors and officers, rather than its shareholders, are responsible for conducting the corporation's day-to-day operations, and shareholders therefore should not have a vote on matters relating to the company's ordinary business.

The Division indicates that, as framed by the Commission, the policy underlying this exclusion rests on two central considerations:

- the subject matter of the shareholder proposal; and
- whether the proposal seeks to “micromanage” the company.

Consideration of significant policy issues. In assessing whether the subject matter of a shareholder proposal deals with a matter of the company’s ordinary business operations, a proposal that focuses on a social policy generally will not be excludable if it implicates a policy issue of such significance that it transcends the company’s day-to-day business activities, making it appropriate for a shareholder vote.

The Division announces in SLB 14M that the staff’s analysis of whether the significant policy exception to the exclusion applies to a proposal will focus on “the particular policy issue raised by the proposal and its significance in relation to the company.” This company-specific approach shifts the analysis away from a sole focus on whether the proposal raises a policy issue “with broad societal impact” or an issue that is “universally significant” and concentrates instead on the nexus between the policy issue and the company. Consistent with its caution regarding the economic relevance exclusion, the staff underlines that a policy issue for purposes of the ordinary business exclusion may be significant to one company without being significant to another.

Consideration of micromanagement claims.

Even if the subject matter of a shareholder proposal is proper for shareholder oversight, proposals that seek to “micromanage” the company’s operations inappropriately probe into complex matters on which shareholders generally are unable to make an informed judgment.

In indicating how companies should evaluate micromanagement concerns, the Division in SLB 14M relies without additional exposition on the reinstated sections of SLB 14J and SLB 14K noted earlier.

Under its approach to evaluation of micromanagement claims described in SLB 14J, which the Division has adopted in SLB 14M, the staff uses as its analytical framework the Commission’s statement that a proposal entails micromanagement if it “involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies.”

In elaborating on this approach in the reinstated section of SLB 14K, the staff indicates that it will

evaluate micromanagement claims in light of the “level of prescriptiveness” with which a proposal approaches its subject matter. Under this analysis, an overly prescriptive proposal could unduly limit the flexibility of the company’s management and board to manage complex matters. Referring to the Commission’s guidance, the Division says that it might concur with an exclusion determination if the proposal “imposes a specific strategy, method, action, outcome or timeline for addressing an issue, thereby supplanting the judgment of management and the board.”

This approach contrasts with the rescinded guidance under SLB 14L, which stated that proposals seeking excessive detail or seeking to promote time-frames or methods did not per se constitute micromanagement. SLB 14L instead focused the inquiry on the level of granularity sought in the proposal and whether and to what extent it inappropriately limited the discretion of the company’s board and management.

In reviving the approach delineated in SLB 14J and SLB 14K for evaluating micromanagement claims, the Division has effectively withdrawn its criticism of that approach in SLB 14L. The Division expressed the view in SLB 14L that under the former bulletins the staff may have “expanded the concept of micromanagement beyond the Commission’s policy directives” and that this approach may mistakenly “have been taken to mean that any limit on company or board discretion constitutes micromanagement.”

No requirement for board analysis

The Division states, contrary to its directive in bulletins that preceded SLB 14L, that it will not expect companies to include with their no-action requests under the economic relevance or ordinary business exclusion a discussion presenting the company board’s analysis of the particular policy issue raised and its significance to the company. The staff has concluded that board analyses generally have not had a “dispositive effect” on its evaluation of exclusion determinations. A company still may submit a board analysis if it believes the analysis will help the staff evaluate the company’s no-action request.

Procedural requirements for submission of proposals

To preserve its guidance in SLB 14L relating to compliance with procedural requirements governing the submission of shareholder proposals, the Division

in SLB 14M largely reiterates its views relating to the use of images in shareholder proposals, the evaluation of the sufficiency of proof-of-ownership letters submitted by proponents, and the use of e-mail communications between proponents and companies. We discuss the staff's prior presentation of its views on these requirements in our SEC Update on SLB 14L referred to above.

In one change to the prior guidance regarding proof-of-ownership letters, the staff clarifies in SLB 14M that it does not view Rule 14a-8 as requiring a company to send a second deficiency notice to a proponent if the company previously sent an adequate deficiency notice before receiving the proponent's proof of ownership and the company believes that the proponent's proof-of-ownership letter contains a defect.

In addition, in a clarification regarding use of e-mail communications between companies and proponents, the staff indicates that it does not consider screenshots or photographs of e-mails on the sender's device to constitute proof of delivery to the recipient.

Looking ahead

SLB 14M represents an abrupt reversal of the approach the Division has followed since November 2021 in evaluating the application of Rule 14a-8's economic relevance and ordinary business exclusions. The staff has re-positioned its administration of the exclusions to align them more closely with its current perspective on the Commission's policy objectives underlying those provisions. The new standards promise to expand the grounds for excluding proposals that raise social policy issues by focusing the analysis more tightly on whether the issues have a company-specific significance.

This SEC Update is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed in this update.

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