MAYER | BROWN

October 22, 2019

Legal Update

SEC Staff Legal Bulletin No. 14K Provides Further Shareholder Proposal Guidance

On October 16, 2019, the staff (Staff) of the Division of Corporation Finance of the US Securities and Exchange Commission (SEC) issued Staff Legal Bulletin No. 14K (SLB 14K) to provide additional guidance on shareholder proposals submitted pursuant to Rule 14a-8 under the Securities Exchange Act of 1934.[1] SLB 14K, which is the 12th Staff Legal Bulletin devoted to shareholder proposal matters, addresses:

- The analytical framework of Rule 14a-8(i)(7);
- Board analyses provided in no-action requests to demonstrate that the policy issue raised by the proposal is not significant to the company;
- The scope and application of micromanagement as a basis to exclude a proposal under Rule 14a-8(i)(7); and
- Proof of ownership letters.

Rule 14a-8(i)(7)

Rule 14a-8(i)(7) allows a shareholder proposal to be excluded from a company's proxy statement to the extent that it "deals with a matter relating to the company's ordinary business operations." According to the SEC, there are two central considerations underlying this provision: (i) the subject matter of the proposal and (ii) the degree to which the proposal would micromanage the company. SLB 14K provides guidance in three areas relevant to the application of Rule 14a-8(i)(7).

Significant Policy Exception. For purposes of Rule 14a-8(i)(7), generally a proposal relates to a company's ordinary business operations if it raises matters that 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." However, proposals are not excludable as ordinary business if they "transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote."

According to SLB 14K, the appropriate focus of an ordinary business argument is whether the proposal deals with a matter relating to *that* company's ordinary business operations or raises a policy issue that transcends *that* company's ordinary business operations. In either case, a company's analysis in its no-action request should be tailored to the particular company. SLB 14K states that the Staff uses "a company-specific approach in

evaluating significance, rather than recognizing particular issues or categories of issues as universally 'significant.'" Therefore, a policy issue may be significant to one company but not significant to another. If a proposal raises a policy issue that appears to be significant, the company's no-action request should explain the significance of the relevant issue to that company.

Board Analysis. In the fall of 2017, in Staff Legal Bulletin No. 14I (SLB 14I), the Staff indicated that it could find a board analysis helpful to its review of no-action requests involving exclusions of a proposal under the ordinary business grounds of Rule 14a-8(i)(7) or the economic relevance grounds of Rule 14a-8(i)(5).[2] Last year, based on its evaluation of no-action requests received following the issuance of SLB 14I, Staff Legal Bulletin No. 14J (SLB 14J) identified six examples of the types of considerations that may be appropriate for inclusion in the board analysis discussion of a no-action request.[3] SLB 14K offers additional guidance on two of the factors that the Staff raised in SLB 14J.

One of these considerations is whether the company has previously addressed the subject of the proposal in some manner, including a discussion of the difference between the proposal's request and the steps already taken, and whether the differences present a significant policy issue for the company. SLB 14K elaborates on the benefits of this "delta" analysis, noting that it could be useful where a company has acted to address the issues raised by a proposal but may not have substantially implemented the proposal for the purposes of Rule 14a-8(i)(10). For example, this could be the case where the company responded to a concern with a different approach than the one requested by the proposal. SLB 14K also indicates that a delta analysis can be helpful to the Staff's understanding of whether the difference between the company's prior actions and the proposal's request represents a significant policy issue for the company. For instance, this type of analysis could be relevant where the company's actions diminished the significance of the policy issue to such an extent that the proposal no longer presents a policy issue that is significant for the company. According to SLB 14K, "a delta analysis is most helpful where it clearly identifies the differences between the manner in which the company has addressed an issue and the manner in which a proposal seeks to address the issue and explains in detail why those differences do not represent a significant policy issue for the company."

SLB 14J also mentioned prior shareholder votes on a matter and the board's view of the related voting results as a factor for a board analysis being submitted with a no-action request. In this regard, SLB 14K explains that during the most recently completed proxy season, the Staff found discussions of prior votes not persuasive when the companies argued:

- The voting results were not significant given that a majority of shareholders voted against the prior proposal;
- The significance of the prior voting results was mitigated by the impact of proxy advisory firms' recommendations; or
- When considering the voting results based on shares outstanding, instead of votes cast, the voting results were not significant.

SLB 14K suggests that a board analysis may be more helpful if it contains a robust discussion explaining "how the company's subsequent actions, intervening events or other objective indicia of shareholder engagement on the issue bear on the significance of the underlying issue to the company."

Micromanagement. SLB 14K explains that the micromanagement analyses of two proposals involving the same subject matter may yield

different results based on the level of prescriptiveness in each proposal. According to SLB 14K, when a proposal "prescribes specific actions that the company's management or the board must undertake without affording them sufficient flexibility or discretion in addressing the complex matter presented by the proposal, the proposal may micromanage the company to such a degree that exclusion of the proposal would be warranted." This is the case even if the proposal is advisory in nature. To determine the underlying concern or central purpose of a proposal, the Staff will look to the proposal in its entirety. Therefore, the Staff will take the supporting statement into account when determining if a proposal seeks to micromanage a company. On the other hand, the Staff is not likely to concur with a micromanagement analysis for a proposal if the proposal defers to management's discretion to consider if and how to address the issue and asks the company to consider relative benefits and drawbacks of several actions. SLB 14K advises that if a company asserts micromanagement as a basis to exclude a shareholder proposal, the Staff expects the company "to include in its analysis how the proposal may unduly limit the ability of management and the board to manage complex matters with a level of flexibility necessary to fulfill their fiduciary duties to shareholders."

Proof of Ownership

A shareholder submitting a proposal pursuant to Rule 14a-8 must provide the company with proof that the shareholder continuously held the requisite amount of securities for at least one year by the date the proposal is submitted. Previously, in an effort to reduce common errors, Staff Legal Bulletin No. 14F provided a suggested format for supplying the required verification of share ownership to the company.[4] SLB 14K emphasizes that while the Staff encourages use of the sample language when providing evidence of ownership, there is no requirement to do so. SLB 14K indicates that the Staff is not generally persuaded by arguments to exclude shareholder proposals based on overly technical readings of proof of ownership letters. Indeed, SLB 14K urges companies not to "seek to exclude a shareholder proposal based on drafting variances in the proof of ownership letter if the language used in such letter is clear and sufficiently evidences the requisite minimum ownership requirements."

Practical Considerations

Companies that are, or may soon be, in the process of responding to shareholder proposals for the upcoming proxy season should consider the impact of SLB 14K's interpretations. In particular, to the extent that a company is preparing a no-action request seeking exclusion of a shareholder proposal on the basis of the ordinary business exclusion contained in Rule 14a-8(i)(7) or challenging a proponent's proof of ownership, it should take into account the specific Staff guidance discussed above.

If a company intends to include a board analysis in a no-action request, it should emphasize the specific facts applicable to the company that justify the board's determination. Statements that assert a conclusion without backing it up with specific facts should be avoided because they are less likely to be persuasive to the Staff.

SLB 14K warns that when the significance of a proposal is at issue, the Staff's ability to state a view regarding exclusion may be impacted if the company's no-action request "does not include a robust analysis substantiating the board's determination that the policy issue raised by the proposal is not significant to the company."

In September, the Staff announced changes to its process with respect to reviewing no-action requests submitted pursuant to Rule 14a-8.[5] In that announcement, the Staff indicated that it may respond to no-action requests by declining to state a view with respect to the company's asserted basis for exclusion. It is not clear whether SLB 14K is signaling that the absence of a board analysis would increase the likelihood that the Staff would decline to state a view on the request, but that is a possibility companies should consider.

For more information about the topics raised in this Legal Update, please contact the author Laura D. Richman, any of the following lawyers or any other member of our Corporate & Securities practice.

Laura D. Richman
+1 312 701 7304
lrichman@mayerbrown.com

Robert F. Gray, Jr.
+1 713 238 2600
rgray@mayerbrown.com

Lawrence R. Hamilton
+1 312 701 7055
lhamilton@mayerbrown.com

Michael L. Hermsen
+1 312 701 7960
mhermsen@mayerbrown.com

David A. Schuette
+1 312 701 7363
dschuette@mayerbrown.com

Endnotes

[1] Available at https://www.sec.gov/corpfin/staff-legal-bulletin-14k-shareholder-proposals.
[2] Available at https://www.sec.gov/interps/legal/cfslb14i.htm.
[3] Available at https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals.
[4] Available at https://www.sec.gov/interps/legal/cfslb14f.htm.
[5] Available at https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests.

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our "one-firm" culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience.

Please visit mayerbrown.com for comprehensive contact information for all Mayer Brown offices.