SEC Division of Corporation Finance Addresses Ordinary Business Basis for Shareholder Proposal Exclusion

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On October 16, 2019, the SEC Division of Corporation Finance (the "Division") issued **Staff Legal Bulletin No. 14K** ("SLB 14K"). SLB 14K outlines the analytical framework of the Division regarding Exchange Act Rule 14a-8(i)(7), the ordinary business exception, which permits a company to exclude from its proxy materials shareholder proposals that deal with the company's ordinary business and do not focus on significant policy issues, or where the proposals "micromanage" the company. SLB 14K also briefly discusses the Division's views on the proof of securities ownership requirements.

I. Key Takeaways of SLB 14K

- Reaffirms that whether a proposal raises a significant policy issue depends on whether the policy issue transcends a particular company's ordinary business operations, not the overall significance of the policy issue in isolation.
- Reiterates that the inclusion of a board's analysis of whether the policy issue raised by the proposal is sufficiently significant to the company would support the Division's evaluation of a no-action letter request.
- Clarifies that "micromanagement" arguments must focus on the level of prescriptiveness of the proposal, e.g., imposing specific time frames and methods that a company should implement and, as a result, replacing the judgment of the board or management.
- Explains that proofs of ownership will be viewed under a "plain meaning" approach rather than a "technical reading."

II. Criteria for Significant Policy Issues

The 14a-8(i)(7) ordinary business exception is not applicable for proposals that raise significant policy issues that transcend the company's day-to-day business matters. Whether a proposal raises a significant policy issue depends on the connection between the policy issue and a company's business operations.

As proponents and companies have often focused in the past on the overall significance of the policy issue raised by a proposal, SLB 14K reiterates that the Division uses a company-specific approach to evaluate significance, rather than recognizing particular issues or categories of issues as universally "significant." A policy issue that is significant to one company may not be to another. SLB 14K states for example that the same climate change proposal may not raise significant policy issues for a software development company as it would for an oil and gas company.

III. Board Analysis

Previous Staff Legal Bulletin Nos. **14I** and **14J** noted that given the difficult judgment calls involved, the Division believes a company's board of directors is well-situated to analyze whether the policy issue raised by the proposal is not significant in relation to the company. According to SLB 14K, during the most recent proxy season, the Division was unable to agree with some requests for ordinary business exclusion that did not contain a board analysis, especially where the significance of a policy issue may have depended on factors that are not self-evident.

Delta Analysis. Staff Legal Bulletin No. 14J previously indicated that a board analysis could focus on the difference, or delta, between what the proposal requests and what the company has already done to address the issues presented by the proposal. SLB 14K states that a delta analysis is most helpful where it clearly identifies "in detail" the differences between the manner in which the company has addressed the issue and the manner in which a proposal specifically requests the same issue be addressed, and explains "in detail" why the differences in approach do not represent a significant policy issue to the company. For example, SLB 14K states that a board analysis on a proposal asking for disclosure of a customer privacy policy could explain how the company's cybersecurity policy addresses the issues covered by the proposal, and how the difference (or delta) between the two approaches would not raise a significant policy issue for the company.

Prior Voting Results. Many companies have expressed concern that prior voting results of around 25% or more support of a similar or same proposal seem to have an outsized influence on the Division's review of a no-action request that includes a board analysis. SLB 14K clarifies that the Division would find it helpful if a company includes in a board analysis, for example, a "robust discussion" that explains how the company's subsequent actions, intervening events or "other objective indicia of shareholder engagement" on the issue bear on the significance of that issue to the company. For example, if after a proposal receives "significant" support, a company engages with its shareholders, the Division would find it useful if the board's analysis included a description of how the board's view on significance is informed both by those engagements and any actions the company took to address the proposal's concerns. In contrast, SLB 14K notes that, with regard to this past season, the Division found some explanations unpersuasive, such as (1) voting results were insignificant because a majority of shareholders did not vote in favor of the prior proposal and (2) the influence of proxy advisory firm recommendations on the vote tallies.

IV. Micromanagement

The second prong of 14a-8(i)(7) is known as the "micromanagement" exception, which examines the manner in which the proposal seeks to address the subject matter, and not the subject matter itself. SLB 14K clarifies that the micromanagement exception does not rest on the complexity of the actions specified in a proposal. A proposal framed as a request that the company consider, discuss the feasibility of, or evaluate the potential for a particular issue would not be viewed as micromanagement. Instead, the Division looks to whether a proposal requests intricate detail or imposes a specific strategy, method, action, outcome or timeline for addressing an issue.

For example, the Division has agreed that proposals were excludable for micromanagement reasons when they prescribed specific, time-bound targets for greenhouse gas emissions reductions. The Division has found that those proposals required too specific a method for implementing the complex policy of emissions reduction. Other proposals were excludable because they did not take into account specific circumstances or the possibility of reasonable exceptions when these proposals urged that boards adopt policies prohibiting the adjustment of financial-performance metrics to exclude compliance costs when determining executive compensation. On the other hand, the Division did not agree with the exclusion of proposals that asked companies to describe if and how they planned to reduce their contribution to climate change, since they left management with discretion on implementation.

V. Proof of Ownership Letters

In **Staff Legal Bulletin No. 14F**, the Division provided sample language for proponents to follow when submitting ownership verification. SLB 14K indicates that adherence to the formulation is not mandatory, and is not the exclusive means to demonstrate ownership. The Division believes that some companies have been applying an "overly technical reading" of ownership letters. Instead, the Division expects companies to apply a "plain meaning approach" and not exclude proposals based on "drafting variances" if the language used is "clear and sufficiently evidences" the ownership requirements.

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