Davis Polk

Shareholder Proponents Take Issue with SEC Staff Decisions on Exclusion of Proposals

July 24, 2018 | Client Update | 3-minute read

Earlier this month, the **Shareholder Rights Group**, which consists of 15 well-known shareholder proponents, issued a report on this proxy season's no-action letters. More than half of the report by the Shareholder Rights Group is devoted to arguing that the SEC staff wrongly applied the micromanagement doctrine to exclude at least eight shareholder proposals this season.

According to the report, efforts by the corporate community to limit shareholder proposals have reached a "fever pitch" since the election two years ago. The report suggests that this "pressure" on the SEC may have even led the staff to change its policy on interpreting no-action letter requests.

The report asserts that shareholder proposals generally lead to better corporate behavior, with a lengthy discussion that implies that the prior SEC "error" of allowing companies to omit proposals on subprime lending in the early 2000s accelerated the financial crisis, by contrasting the outcome of some smaller banks that "cooperated" in the shareholder proposal process on these issues and included the proposals in proxy statements through negotiations with proponents as managing "avoid the disastrous fate met by numerous big banks." The report concludes that SEC decisions to permit some proposals to be omitted may constitute worse mistakes than any errors the regulator could make of overly including proposals, as the "tragic and costly" errors of omission leads to significant societal harm down the road.

The micromanagement argument in essence can be viewed as a subset of the ordinary business exclusion that can overcome policy matters. The report accuses the SEC staff of not only recently changing its mind in the application of the rule but also using doctrine never before cited, including that a proposal can be excluded for seeking to impose specific methods for implementing complex policies.

The report discusses recognized trends that more investors are focused on ESG matters, more companies are providing ESG information and more shareholder proposals on ESG issues are gaining higher support. What is less clear is whether these external forces are supposed to affect the SEC staff decision making on interpreting Rule 14a-8.

Perhaps since only one letter successfully used Staff Legal Bulletin 14I this past season, there was less outrage about that in the report. In fact, here the report views the SEC findings to be demonstrably correct. Since many letters failed to effectively cite to SLB 14I, the report determined that this means "most" boards had a "strikingly difficult time" and ultimately "proved unable to show" that proposals were insignificant. There is no conjecture that in some of these instances perhaps there were also SEC staff "errors."

Among the recommendations in the report about SLB 14I is a request to cut out large swaths of proposal topics from being subject to board findings on insignificance, including when "externalities can impose portfolio-wide impacts," corporate activities pose systemic risks or a material gap exists in ESG disclosure. It would seem that these categories are so broad that nearly all social proposal topics would fit. In addition, the report asks the SEC staff to require detailed corporate documentation, like board minutes.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Ning Chiu
+1 212 450 4908
ning.chiu@davispolk.com
