
# ESG Shareholder Proposals More Likely After Issuance of a New Staff Legal Bulletin

By: Jeffrey T. Haughey and Emma C. Kincade
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The Staff of the SEC's Division of Corporation Finance (Staff) significantly changed guidance on shareholder proposals in its recently released Staff Legal Bulletin (SLB) 14L. The new guidance rescinds SLBs 14I, 14J, and 14K (issued in 2017, 2018 and 2019, respectively), along with any prior Staff guidance that could be interpreted contrary to SLB 14L.

Rule 14a-8 provides an avenue for shareholders to present proposals for inclusion in a company's proxy statement. Under limited exceptions, a company may exclude shareholder proposals from its proxy materials. The Rule intends to balance two needs: (1) promotion of shareholder engagement and (2) preservation of board decision-making. Companies may request assurance that the Staff will forego enforcement action if a proposal is properly excluded under an exception ("no-action relief"). On November 3rd, the Staff issued SLB 14L, intending to streamline Staff's consideration of no-action relief requests under the ordinary business exception and the economic relevance exception. Other rules generally impacting shareholder proposals and related notices received a remix as well.

## Ordinary Business Exception

The ordinary business exception, found in Rule 14a-8(i)(7), provides a basis for exclusion of shareholder proposals "deal[ing] with matter[s] relating to the company's ordinary business operations." The existing exception rests on two central considerations: (1) the proposal's subject matter, and (2) the degree to which the proposal would "prob[e] too deeply into maters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."

### The Expansion of the "Significant Social Policy" Carve-Out

A company cannot exclude a shareholder proposal under the ordinary business exception if it concerns a "significant social policy." This carve-out to the exception has been and still is the rule. The test, however, for determining whether a proposal involves a significant social policy has been greatly expanded. In the past, the Staff used a fact-intensive, company-specific review of the issues underlying the proposal, focusing on the significance of the policy to a particular company. Companies submitted board analyses in support of their decision to exclude a proposal under this exception. Under that test, if the Staff found the underlying social policy was not significant to the company, then the company could exclude the proposal.

Under SLB 14L, submission of board analysis of a proposal's significance to the company is no longer required. The Staff will now focus on whether the proposal raises issues with a "broad societal impact, such that [the issues] transcend the ordinary business of the company." No factors were provided for determining when the business of a company has been transcended by the social issue involved. This

void gives rise to the concern that social policy initiatives will be taken up not in a court of law or on Capitol Hill, but via shareholder proposals reviewed by securities attorneys.

As such, it appears that shareholder proposals related to ESG topics such as climate change and human capital management will be difficult to exclude in the future.

The Micromanagement Exclusion is Narrowed

Another change to the ordinary business exception comes in the Staff's rework of the micromanagement prong of this exception. A company can exclude a shareholder proposal from its proxy statement if it would result in shareholder micromanagement of the company's board. The Staff has rescinded guidance which it believes "may have been taken to mean that any limit on company or board discretion constitutes micromanagement." Specific methods, timelines or detail will not, on their own, amount to micromanagement and their inclusion in a proposal does not automatically merit exclusion. The Staff will now focus on the "granularity sought in the proposal" and the extent to which it "inappropriately" limits board discretion. Investor sophistication, availability of data, and robustness of public discussion and analysis will now be guiding factors in the Staff's determination of whether a matter is "too complex" for an informed judgment by shareholders (and thus better-suited for the discretion of the board). For proposals involving disclosure, target-setting, and timeframes, the Staff will also consider references to national or international frameworks as evidence that the proposal is suited for shareholder decision. If a proposal gives management discretion to determine how to achieve a timeframe or target, the Staff will not be likely to permit its exclusion. This new approach to assessing micromanagement can be seen in action in Staff's recent letter to ConocoPhillips Company, where the Staff denied no-action relief sought for a proposal requesting the greenhouse gas emission reduction targets (but did not specify a method for determining the target values).

Going forward, a close review will be required to determine (1) whether a proposal touches issues that have broad societal impact, and (2) whether the level of intrusion into the board's discretion is enough to warrant exclusion if it were to request no-action relief.

## Economic Relevance Exception

Under Rule 14a-8(i)(5), a company can exclude a shareholder proposal that relates to operations which account 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." Under the Staff's new guidance, even if the language of 14a-8(i)(5) appears to warrant exclusion, a proposal may nevertheless be included in a company's proxy statement because of its impact on "issues of broad social or ethical concern related to the company's business." The Staff indicated that board analysis in this context is no longer required in a company's request for no-action relief.

## Technical Matters

While the Staff recognized the potential for abuse for use of graphics to bypass the 500 word cap, the guidance nevertheless permits graphics and pictures so long as they do not (1) make the proposal false or misleading, (2) render the proposal inherently vague or indefinite, (3) impugn character or personal reputation, (4) make charges concerning improper, illegal or immoral conduct (without factual foundation), or (5) contain irrelevant information. Any words in the graphics or pictures go toward the 500 word limit.

Sample language for shareholder verification of ownership was updated (although brokers and banks are not required to follow the format provided in Staff's guidance). Companies should not take an overly technical approach to the verification of a proponent's ownership. The Staff also emphasized that companies should identify specific defects in the proof of ownership letters to the proponent even when the company has already sent a deficiency notice prior to receiving the proof of ownership.

The Staff encouraged the use of emails for submission of proposals, delivery of notice of defects in shareholder proposals, and responses to notices of defects. The applicable party should seek a reply email to confirm delivery and acknowledge receipt as appropriate. If companies decide to use email delivery in this context, then they should consider disclosing the appropriate email address in their proxy statements for proponents to use for shareholder proposals.

We expect companies will see more ESG shareholder proposals going forward, which will be more difficult to exclude under SLB 14L.

For questions regarding shareholder proposals under Rule 14a-8 and SLB 14L, please contact your GableGotwals attorney or a member of our Corporate & Securities team.


Jeffrey T. Haughey
918-595-4837
jhaughey@gablelaw.com

Emma Kincade
918-595-4856
ekincade@gablelaw.com