

September 9, 2019

SEC STAFF ANNOUNCES SIGNIFICANT CHANGES TO SHAREHOLDER PROPOSAL NO-ACTION LETTER PROCESS

To Our Clients and Friends:

On September 6, 2019, the Division of Corporation Finance (the “Staff”) of the Securities and Exchange Commission (“SEC”) announced^[1] two significant procedural changes for responding to Exchange Act Rule 14a-8 no-action requests that will be applicable beginning with the 2019-2020 shareholder proposal season:

- **Oral Response by Staff:** The Staff may now respond orally instead of in writing to shareholder proposal no-action requests. The Staff’s oral response will inform both the company and the proponent of its position with respect to the company’s asserted Rule 14a-8 basis for exclusion expressed in the no-action request. The Staff stated that it intends to issue a written response letter to a no-action request “where it believes doing so will provide value such as more broadly applicable guidance about complying with Rule 14a-8.”
- **No Definitive Response by Staff:** The Staff may now more frequently decline to state a view on whether or not it concurs that a company may properly exclude a shareholder proposal under Rule 14a-8. Importantly, the Staff stated that if it declines to state a view on any particular no-action request, the interested parties should not interpret that position as indicating that the proposal must be included in the company’s proxy statement. Instead, the Staff stated that in these circumstances, the company requesting exclusion may have a valid legal basis to exclude the proposal under Rule 14a-8.

In the announcement, the Staff also reiterated that—in the situations described in prior Staff Legal Bulletins^[2]—it continues to find an analysis by the board of directors useful when a company seeks to exclude a proposal on grounds of either ordinary business (Rule 14a-8(i)(7)) or economic relevance (Rule 14a-8(i)(5)). The Staff also noted that parties continue to be able to seek formal, binding adjudication on the merits of Rule 14a-8 issues in court.

Background of the Staff’s Announcement

Under Rule 14a-8(j), if a company intends to exclude a shareholder proposal from its proxy materials, it must notify the SEC no later than 80 calendar days before it files its definitive proxy statement, and must simultaneously provide the shareholder proponent with a copy of its submission. The company’s submission must include an explanation of why the company believes that it may exclude the proposal under Rule 14a-8, and the explanation “should, if possible, refer to the most recent applicable authority, such as prior [Staff] letters issued under the rule.”^[3] This mandatory process has evolved into the practice of companies submitting no-action requests that ask the Staff to concur with their view that

shareholder proposals are properly excludable under one of the procedural requirements or substantive bases set forth in Rule 14a-8.

Rule 14a-8 contemplates that the Staff will respond to these requests. For example, Rule 14a-8(k) states that a shareholder proponent can respond to a company's exclusion notice, but states that proponents should make such submissions as quickly as possible so that the Staff "will have time to consider fully your submission before it issues its response." In Staff Legal Bulletin No. 14, the Staff stated, "Although we are not required to respond [to a no-action request], we have, as a convenience to both companies and shareholders, engaged in the informal practice of expressing our enforcement position on these submissions through the issuance of no-action responses. We do this to assist both companies and shareholders in complying with the proxy rules."^[4] Thus, for the past several decades, the Staff has responded to almost every shareholder proposal no-action request, except in limited situations (discussed below). Similarly, the Staff has treated Rule 14a-8 no-action requests differently than no-action requests in other contexts by publicly disclosing the Rule 14a-8 no-action requests promptly following submission, whereas most no-action requests not involving Rule 14a-8 are publicly disclosed only after the Staff has responded to the request.^[5]

Following the 2018-2019 shareholder proposal season, during which the Staff performed the Herculean task of timely responding to hundreds of shareholder proposal no-action requests notwithstanding the month-long partial government shutdown, the Staff stated in a number of forums that it was considering changing its practice of expressing its views in writing in response to every no-action request. For example, Division of Corporation Finance Director William Hinman was quoted as stating, "Going forward . . . we are going to be thinking about whether every request for a no-action letter need[s] a formal response from us."^[6] Director Hinman added, "If we don't think we have something to add, we may not issue a letter. Something we are thinking about. We may actively monitor the area and not necessarily give a response."^[7]

As a result of these reports, a number of groups met with and/or wrote to the Staff regarding its proposal, raising concerns with the proposed change.^[8]

Perspectives on the Staff's Announcement

The Staff's announcement provides few details on how and in what circumstances its new policy will be implemented. While the full implications of the Staff's announcement thus are difficult to assess, some initial observations follow.

- **No Immediate Relief for Companies or Proponents:** While the number of Rule 14a-8 no-action requests submitted to the Staff has been trending downward,^[9] the new procedures may further relieve some of the burdens on the Staff of the shareholder proposal process. However, they do not appear to lessen the costs and burdens of the shareholder proposal process on companies. Under Rule 14a-8(j), a company must still notify the Staff if it intends to exclude a shareholder proposal from its proxy statement under Rule 14a-8, and it must still explain why the company believes that it may do so. Because the Staff's announcement provides no clear standards on when the Staff will apply its new procedures, companies likely will

conclude that they should continue to request no-action relief and fully explain and cite support for their position. Likewise, shareholder proponents may continue to conclude that it is worthwhile for them to submit responses seeking to refute companies' positions on the excludability of proposals.

- **Uncertainty over Effect of Staff's Decisions to Decline to State its Views:** The Staff historically has only rarely declined to state its views on a no-action request under Rule 14a-8, typically adopting that position when a proposal topic was subject to pending litigation.^[10] Importantly, the Staff announcement noted that its determination to not state its views on a no-action request does not mean that it disagrees with a company's analysis or conclusion and that, in fact, the company requesting exclusion may have a valid legal basis to exclude the proposal under Rule 14a-8. Nevertheless, a company faced with this situation will have the dilemma of determining whether in fact to exclude the proposal. As noted by the Council of Institutional Investors ("CII") in its letter to the Staff,^[11] the result may be that some companies include proposals in their proxy statements that, in the past, the Staff would have concurred could be excluded. That result would require all of the company's shareholders (many of whom already have been overburdened with assessing how to vote on proposals during proxy season) to expend valuable time and resources on such proposals, even though, in CII's words, "[s]ome of these proposals are likely to be misguided or on trivial issues."^[12] In considering whether to omit a proposal in such situation, a company will need to consider the potential reaction of its shareholders, the risk of adverse publicity, possible reactions from proxy advisory firms (discussed below), the risk of litigation, and the possibility that including the proposal in its proxy statement will attract more proposals in future years.
- **Response of Proxy Advisors:** Both Institutional Shareholder Services ("ISS") and Glass Lewis have policies under which they may recommend votes against directors if a company excludes a proposal without having received a Staff response or court order agreeing that the proposal is excludable or withdrawal from the proponent.^[13] However, these policies were issued before the Staff's announcement and statement that their declining to state a view on a no-action request does not mean that a company has failed to state a valid basis to exclude the proposal. Given concerns that have been expressed over burdens imposed on all shareholders if the Staff's new policies result in an increase in the number of proposals included in company proxy statements, it will be important to watch whether the proxy advisory firms adopt a more nuanced approach to their analyses of company decisions to omit shareholder proposals when the Staff has declined to state a view, particularly in light of the SEC's recent interpretive guidance on the applicability of Rule 14a-9 to the firms' voting recommendations and cautions regarding the fiduciary duties of investment advisors relying on such recommendations.^[14]
- **Increased Risk of Litigation and Related Costs:** Although Staff no-action letter responses reflect only informal views of the Staff and not binding adjudications, both companies and proponents have tended to defer to the Staff's views, and litigation under Rule 14a-8 has been rare.^[15] Shareholder proposal litigation is costly (especially compared to the costs of obtaining a no-action letter response), and federal district courts cannot be relied upon to consider and adjudicate shareholder proposal disputes on the expedited schedule required during proxy

season. Nevertheless, it has always been the case, as noted in the Staff's announcement, that "the parties may seek formal, binding adjudication on the merits of [a Rule 14a-8 interpretive] issue in court." The Staff's announcement increases the risk to both proponents and companies that they may find themselves in court addressing the excludability of a shareholder proposal under Rule 14a-8.

- **Greater Uncertainty in Rule 14a-8 Interpretations:** A number of questions remain on the potential impact of the Staff's new policies on the long-term transparency around and dynamics of the Rule 14a-8 process.
- For example, the Staff currently maintains two Rule 14a-8-related websites for shareholder proposal no-action requests: one where it posts incoming no-action requests, and one where it posts Staff responses to no-action requests. The Staff could effectively maintain the same level of transparency as in the past by maintaining this practice and, when it issues an oral response, including some indication on the website where it posts decided no-action letters, indicating the nature of its oral response (Concur, Unable to concur, or No View) and, if it concurs, the basis of its concurrence. However, the Staff announcement does not indicate whether the Staff intends to inform the company and proponent of the basis of its decision when issuing an oral response to a no-action request that makes multiple exclusion arguments (including, for example, that it concurs with the company on the basis of its Rule 14a-8(i)(7) argument), much less whether it will include some public indication on its website in such instances.
 - Clearly there will be less definitive guidance on the application of Rule 14a-8 when the Staff declines to state a view on whether a proposal may properly be excluded from a company's proxy statement. Nevertheless, depending on the frequency, context, and disclosure (if any) around the Staff's determinations not to state a view, we expect that participants will seek to interpret or read meaning into the situation, rightly or wrongly.
 - The Staff announcement indicates that one instance in which the Staff will issue response letters will be to provide "more broadly applicable guidance about complying with Rule 14a-8." Although the Staff has on occasion used a Rule 14a-8 no-action response to elaborate on its interpretation of the rule, historically the Staff has utilized Staff Legal Bulletins to provide "more broadly applicable guidance" regarding its interpretation of Rule 14a-8. The Staff's announcement appears to suggest that it now will more commonly spring guidance on the shareholder proposal community in the middle of the season and in the context of specific factual situations, which may make such guidance harder to apply in other contexts than if the Staff addressed such issues more generally.

In light of the foregoing, there is concern that the Staff's procedural changes will result in companies and proponents being less able to easily or accurately determine the Staff's views on the applicability of Rule 14a-8 to a certain proposal.^[16] In the absence of any written record, third parties may not know whether a proposal that was challenged in a no-action letter was excluded, and on what grounds, or if the Staff declined to state its position (the Staff's announcement did not indicate that it would cease to disclose when a no-action request was

withdrawn). If that does occur, over time this may (ironically) result in an increase in the number of shareholder proposals submitted to companies and the number of no-action exclusion requests submitted to the Staff, as proponents and companies have less guidance on when and on what grounds proposals are excludable.

Conclusions

Although the shareholder proposal landscape is constantly evolving, the Staff's announcement heralds a more significant shift in the landscape. Combined with the implications of the SEC's recent guidance for proxy advisory firms and investment advisers engaged in the proxy voting process,^[17] it means that the 2019-2020 shareholder proposal season could be particularly tumultuous. Moreover, it remains likely that the SEC will propose amendments to Rule 14a-8 in the near future,^[18] although any such rules are unlikely to be in effect for much of the 2019-2020 shareholder proposal season. Nevertheless, shareholder proponents likely will be mindful of these dynamics when evaluating whether to submit novel proposals, and companies should consider now how these changes may bear on their approaches in seeking no-action exclusion of shareholder proposals and engaging with their shareholders in advance of and during the upcoming proxy season.

[1] Available at <https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests>.

[2] See, e.g., Staff Legal Bulletin No. 14I (Nov. 1, 2017), available at <https://www.sec.gov/interps/legal/cfslb14i.htm>, and Staff Legal Bulletin No. 14J (Oct. 23, 2018), available at <https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals>.

[3] Rule 14a-8(j)(2)(ii).

[4] Staff Legal Bulletin No. 14, Shareholder Proposals (July 13, 2001), available at <https://www.sec.gov/interps/legal/cfslb14.htm>. As stated in the Division of Corporation Finance's "Informal Procedures Regarding Shareholder Proposals" (Nov. 2, 2011), which in the past the Staff has attached to each of its Rule 14a-8 no-action letter responses, "The Division of Corporation Finance believes that its responsibility with respect to matters arising under Rule 14a-8 [17 C.F.R. § 240.14a-8], as with other matters under the proxy rules, is to aid those who must comply with the rule by offering informal advice and suggestions and to determine, initially, whether or not it may be appropriate in a particular matter to recommend enforcement action to the Commission." Available at <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8-informal-procedures.htm>.

[5] See 17 C.F.R. § 200.82 (providing for public availability of materials filed pursuant to Rule 14a-8(d)).

[6] The Deal, "SEC's Clayton Eyes Tougher Rules for Proxy Firms, Proposals" (July 16, 2019). See also Bloomberg Law, "SEC May Curb Review of Contested Shareholder Proposals" (July 16, 2019).

[7] *Id.*

[8] For example, *see* Council of Institutional Investors, Letter to Staff: SEC Corporation Finance 14a-8 Process (August 12, 2019), *available* at https://www.cii.org/files/issues_and_advocacy/correspondence/2019/August%2012%202019%2020190812%2014a-8%20No-Action%20Process%20letter.pdf.

[9] The following statistics are based on information we have compiled from the SEC’s website and the Institutional Shareholder Services shareholder proposals and voting analytics databases.

No-Action Request Statistics			
	2019*	2018*	2017*
Total number of proposals submitted	792	788	827
Total no-action requests submitted	228	256	288
No-action submission rate	29%	32%	35%
Staff responses	180	194	242
Exclusions granted	119 (66%)	125 (64%)	189 (78%)
Exclusions denied	61 (34%)	69 (36%)	53 (22%)

* Year references are to each year’s shareholder proposal season, which we define to mean the period from October 1 of the preceding year through June 1 of the indicated year. The number of Staff responses is lower than the number of no-action requests submitted due to withdrawals and also reflects no-action letters submitted late in the season that are responded to after our June 1 measurement date.

[10] *See, e.g., Electronic Arts Inc.* (avail. May 23, 2008) (“We note that litigation is pending in the United States District Court for the Southern District of New York with respect to EA’s intention to omit the proposal from EA’s proxy materials. In light of the fact that arguments raised in your letters and that of the proponent are currently before the court in connection with the litigation between EA and the proponent concerning this proposal, in accordance with staff policy, we will not comment on those arguments at this time. Accordingly, we express no view with respect to EA’s intention to omit the instant proposal from the proxy materials relating to its next annual meeting of security holders.”).

[11] *See* note 8.

[12] *Id.*

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[13] ISS, U.S. Proxy Voting Research Procedures & Policies (Excluding Compensation-Related) Frequently Asked Questions (Aug. 13, 2018), FAQ 67 (*available at* <https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf>):

[U]nder our governance failures policy, ISS will generally recommend a vote against one or more directors (individual directors, certain committee members, or the entire board based on case-specific facts and circumstances), if a company omits from its ballot a properly submitted shareholder proposal when it has not obtained:

- 1) voluntary withdrawal of the proposal by the proponent;
- 2) no-action relief from the SEC; or
- 3) a U.S. District Court ruling that it can exclude the proposal from its ballot.

... If the company has taken unilateral steps to implement the proposal, however, the degree to which the proposal is implemented, and any material restrictions added to it, will factor into the assessment.

Glass Lewis, 2019 Proxy Paper™ Guidelines, An Overview Of The Glass Lewis Approach To Proxy Advice – United States (2019) (*available at* https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf):

In instances where companies have excluded shareholder proposals . . . Glass Lewis will take a case-by-case approach, taking into account the following issues:

...

The company's overall governance profile, including its overall responsiveness to and engagement with shareholders . . .

Glass Lewis will make note of instances where a company has successfully petitioned the SEC to exclude shareholder proposals. If after review we believe that the exclusion of a shareholder proposal is detrimental to shareholders, we may, in certain very limited circumstances, recommend against members of the governance committee.

[14] Gibson, Dunn & Crutcher LLP, "SEC Issues New Guidance for Proxy Advisors and Investment Advisers Engaged in the Proxy Voting Process," *available at* <https://www.gibsondunn.com/sec-issues-new-guidance-for-proxy-advisors-and-investment-advisers-engaged-in-proxy-voting-process/>.

[15] *But see TransDigm Group Incorporated* (avail. Jan. 28, 2019) (New York City Office of the Comptroller commenced litigation over the proposed exclusion of its proposal prior to the Staff issuing its no-action letter response).

[16] Agenda, "SEC Launches 'Brand New' Changes to No-Action Process" (Sept. 6, 2019) (quoting the New York City Comptroller and representatives from the Council of Institutional Investors and As You Sow expressing concern with the Staff announcement).

[17] *See* note 14.

[18] *See* Commission Elad L. Roisman, "Statement at the Open Meeting on Commission Guidance and Interpretation Regarding Proxy Voting and Proxy Voting Advice" (Aug. 21, 2019), *available at*

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<https://www.sec.gov/news/public-statement/statement-roisman-082119> (“As our Regulatory Flexibility Agenda notes, in the near future the Commission expects to consider . . . proposed rules to amend the submission and resubmission thresholds for shareholder proposals under Rule 14a-8 under the Exchange Act”); Gibson Dunn Securities Regulation Monitor, “SEC To Propose Shareholder Proposal and Proxy Advisory Firm Rule Amendments” (May 24, 2019), *available at* <https://www.securitiesregulationmonitor.com/Lists/Posts/Post.aspx?ID=367>.



Gibson Dunn’s lawyers are available to assist with any questions you may have regarding these issues. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work in the Securities Regulation and Corporate Governance practice group, or any of the following lawyers:

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