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THE PENDULUM SWINGS (FAR): SEC STAFF ISSUES NEW GUIDANCE ON SHAREHOLDER PROPOSALS

New Guidance Unwinds Four Years of Staff Precedent and Raises the Burden for Companies Seeking to Exclude Environmental and Social Proposals from Proxy Statements

To Our Clients and Friends:

On November 3, 2021, the Division of Corporation Finance (the "Staff") of the U.S. Securities and Exchange Commission (the "Commission") published Staff Legal Bulletin 14L ("SLB 14L"), which sets forth new Staff guidance on shareholder proposals submitted to publicly traded companies under SEC Rule 14a-8. As discussed in greater detail below, SLB 14L:

- rescinds each of the Staff Legal Bulletins issued under the Clayton Commission; specifically, Staff Legal Bulletin 14I (Nov. 1, 2017) ("SLB 14I"), Staff Legal Bulletin 14J (Oct. 23, 2018) ("SLB 14J"), and Staff Legal Bulletin 14K (Oct. 16, 2019) ("SLB 14K") (collectively, the "Prior SLBs");
- reverses the Prior SLBs' company-specific approach to evaluating the significance of a policy issue that is the subject of a shareholder proposal for purposes of the ordinary business exclusion in Rule 14a-8(i)(7) (thereby negating the need for a board analysis or "delta" analysis to support future no-action requests);
- reverses the Prior SLBs' approach on micromanagement arguments for purposes of the ordinary business exclusion in Rule 14a-8(i)(7);
- outlines the Staff's view regarding application of the economic relevance exclusion in Rule 14a-8(i)(5), which reverses the Prior SLBs' approach that proposals raising social concerns could be excludable where not economically or otherwise significant to the company;
- republishes prior guidance regarding the use of graphics and images;
- furthers the Staff's retreat in applying the procedural requirements of Rule 14a-8 by reflecting more leniency in interpreting proof of ownership letters and suggesting the use of a second deficiency notice in certain circumstances; and
- provides new guidance on the use of email for submission of proposals, delivery of deficiency notices and responses (encouraging a bilateral use of email confirmation receipts by companies and shareholder proponents alike).

The new guidance was issued with the 2022 shareholder proposal season already underway and – unlike with many past Staff Legal Bulletins – was not previewed or discussed in advance at the traditional "stakeholders" meeting with proponents and companies (as the Staff did not host such a meeting this year). As a result, SLB 14L injects more uncertainty for companies evaluating shareholder proposals under Rule 14a-8 and further clouds an already opaque no-action review process. The Staff states that SLB 14L is intended to streamline and simplify the Staff's process for reviewing no-action requests, and to clarify the standards the Staff will apply. Notably, however, the Staff has not addressed changes to its process for responding to no-action letters, including its 2019 decision to no longer issue individual responses explaining its views on each no-action request, which has been decried by both proponents and companies.

Summary of the New Staff Guidance

In SLB 14I, the Staff addressed standards for evaluating both the ordinary business exclusion and the economic relevance exclusion, including challenges in determining whether a particular proposal focused on a policy issue that was sufficiently significant to the company's business. SLB 14I also introduced the concept of a board analysis by a company to buttress its no-action analysis on whether a proposal raised a significant policy issue or was relevant to a company's business. Subsequently, SLB 14J and SLB 14K provided further interpretive gloss on these bases for exclusion, including the use of a "delta" analysis to distinguish whether a proposal's request represented a significant variance from actions already taken by a company. SLB 14J and SLB 14K also provided the Staff's expanded view of when proposals could be excluded on the basis of micromanagement (leading to a notable increase in climate proposals subsequently being excluded based on micromanagement). New SLB 14L tosses all of that guidance and analysis and announces, among other things, the Staff's intent to apply a "realigned" approach to analyzing significance and social policy issues.

1. ***Changes to the Application of the Ordinary Business Exclusion in Rule 14a-8(i)(7).***

Company-Specific Approach to Significance is Out; Significant Social Policy Issues are Back; and Board and Delta Analyses are No Longer Necessary.

SLB 14L begins with a rebuke of the Staff's more recent company-specific approach to significance, as articulated and developed in the Prior SLBs. The Staff expressed its current view that this approach has placed undue emphasis on evaluating the significance of a policy issue to a particular company at the expense of whether or not the proposal focuses on a significant social policy, noting too that such approach did not always yield "consistent, predictable results." SLB 14L states that, going forward, the Staff plans to "realign" its approach with the standard outlined in Release No. 34-12000 (Nov. 22, 1976), and which the Commission subsequently reaffirmed in Release No. 34-40018 (May 21, 1998) (the "1998 Release"), which SLB 14L interprets as having the Staff focus on the social policy significance of the issue that is the subject of the proposal, including considering whether the proposal raises issues with a broad societal impact such that they transcend the company's ordinary business.

It is unclear how much this reflects a return to past interpretations under Rule 14a-8(i)(7), or represents a wholesale abandonment of any assessment of relevance of a proposal to a company's business (as compared to relevance to society at large). Notably, SLB 14L states that the Staff "will no longer focus on determining the nexus between a policy issue and the company." However, the "nexus" concept was embedded in the 1998 Release, as stated in Staff Legal Bulletin 14E (Oct. 27, 2009), at footnote 4 (citing the 1998 Release), and reaffirmed in Staff Legal Bulletin 14H (Oct. 22, 2015). Ominously, SLB 14L states that it also supersedes any earlier Staff Legal Bulletin to the extent the views expressed therein are contrary to the views expressed in SLB 14L. Indeed, SLB 14L concedes that its "realigned" approach will result in nullifying certain recent precedent, citing specifically to a shareholder proposal that raised human capital management issues but which was determined excludable under Rule 14a-8(i)(7) because the proponent failed to demonstrate that the issue was significant to the company.[1]

In connection with the Staff's rejection of the company-specific approach to evaluating significance, SLB 14L also rejects the use of board analyses and "delta" analyses by companies in their no-action requests. Specifically, the Staff no longer expects a board analysis as part of demonstrating that a proposal is excludable under the ordinary business exclusion, referring to the board analysis as both a distraction from the proper application of Rule 14a-8(i)(7) and as muddying the application of the substantial implementation standard under Rule 14a-8(i)(10) (in situations where the board analysis involved a "delta" component).

Hitting the Brakes on Micromanagement.

The Staff determined that recent application of the micromanagement exclusion, as outlined in SLB 14J and SLB 14K, expanded the concept of micromanagement beyond the Commission's intent, and SLB 14L specifically rescinds guidance suggesting that any limit on a company's or board's discretion constitutes micromanagement. The new guidance indicates that the Staff "will take a measured approach" to evaluating micromanagement arguments, stating that proposals seeking detail, suggesting targets, or seeking to promote time frames for methods do not *per se* constitute impermissible micromanagement, provided that the proposals afford discretion to management as to how to achieve the desired goals. The Staff will instead focus on the level of granularity sought by the proposal and whether and to what extent it inappropriately limits discretion of the board or management. Moreover, the Staff states that it expects proposals to include the level of detail required to enable investors to assess a company's impact, progress towards goals, risk or other strategic matters.

While much of the language surrounding the Staff's new application of the micromanagement exclusion relates to climate change shareholder proposals, including a reference to the Staff's decision in *ConocoPhillips Co.* (Mar. 19, 2021)[2] as an example of the Staff's current approach to micromanagement, SLB 14L also addresses the Staff's views on the micromanagement exclusion generally. For example, the Staff states that in order to assess whether a proposal probes too deeply into matters of a complex nature, the Staff "may consider the sophistication of investors generally on the matter, the availability of data, and the robustness of public discussion and analysis on the topic" as well as "references to well-established national or international frameworks when assessing proposals related to disclosure, target setting, and timeframes as indicative of topics that shareholders are well-equipped to evaluate."[3]

The Staff explained that these changes are designed to help proponents navigate Rule 14a-8: enabling them to craft proposals with sufficient specificity and direction to avoid exclusion under substantial implementation (Rule 14a-8(i)(10)), while being general enough to avoid exclusion under micromanagement. The foregoing should come as no surprise given the Commission's numerous public statements indicating that climate change and social issues are a priority.[4]

2. ***Changes to the Application of the Economic Relevance Exclusion in Rule 14a-8(i)(5).***

SLB 14L announces the Staff's return to a pre-SLB 14I approach to interpreting the economic relevance exclusion under Rule 14a-8(i)(5), in what the Staff described as consistent with *Lovenheim v. Iriquois Brands, Ltd.*[5] As a result, shareholder proposals that raise issues of broad social or ethical concern related to the company's business may not be excluded, even if the relevant business falls below the economic thresholds in Rule 14a-8(i)(5). Relatedly, a board analysis (which had been largely used to demonstrate the qualitative insignificance of the subject matter of the proposal vis-à-vis the company) will no longer be necessary.

3. ***The Staff Reaffirms its Views on the Use of Images in Shareholder Proposals, Including When Exclusion is Appropriate.***

SLB 14L republishes the Staff's guidance on the use of images in shareholder proposals, previously set forth in SLB 14I. The guidance appears to have been republished simply to preserve the Staff's views on this topic since SLB 14I is rescinded.

In short, the Staff continues to believe that Rule 14a-8(d) does not preclude shareholders from using graphics and/or images to convey information about their proposal. That said, recognizing the potential for abuse in this area, the Staff also reaffirmed its views on when exclusion of such graphics/images would be appropriate under Rule 14a-8(i)(3), and that it is appropriate to include any words used in the graphics towards the total proposal word count for purposes of determining whether or not the proposal exceeds 500 words. Helpfully, SLB 14L indicates that companies do not need to give greater prominence to proponent graphics than to their own, and may reprint graphics in the same colors used by the company for its own graphics.

4. ***The Staff Reaffirms its Plain Meaning Approach to Interpreting Broker Letters; Adds New Burden for Companies.***

In SLB 14K, the Staff explained its approach to interpreting proof of ownership letters; namely, that it takes a "plain meaning" approach to interpreting the text of proof of ownership letters and generally finds arguments to exclude based on "overly technical reading[s]" unpersuasive.[6] SLB 14L largely republishes and reaffirms the Staff's prior guidance in this regard, with two notable exceptions.

First, the guidance provides an updated, suggested (but not required) format for shareholders and their brokers or banks to follow when supplying proof of ownership. In this regard, the updated language references the new ownership thresholds reflected in the Commission's 2020 rulemaking. The format is as follows:

As of [date the proposal is submitted], [name of shareholder] held, and has held continuously for at least [one year] [two years] [three years], [number of securities] shares of [company name] [class of securities].[7]

Consistent with prior guidance, SLB 14L provides that use of the aforementioned format "is neither mandatory nor the exclusive means of demonstrating ownership" under Rule 14a-8(b), and that "companies should not 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."[8] The Staff also confirms that the recent amendments to the ownership standards under Rule 14a-8 are not intended to change the nature of proof of ownership provided by proponents' brokers and banks.

Second, and more notably, the guidance suggests that if, after receiving an initial deficiency letter from a company, a shareholder returns a deficient proof of ownership, the Staff believes that the company should identify such defects explicitly in a follow-up deficiency notice. SLB 14L provides no citation in support of this position, and it does not attempt to reconcile the position with decades of precedent that are based on the language of Rule 14a-8, which ties the deadlines for addressing a deficiency notice to when a proposal is first submitted. Since in many cases a company may not receive a proponent's response to a deficiency notice within 14 days of the date that the proposal was received by the company, it is unclear whether the Staff intends this process to impose obligations on companies that are outside the scope of Rule 14a-8 and presents a quandary on whether companies need to follow new procedures beyond those expressly provided for in Rule 14a-8.

5. ***Guidance on the Use of Email Communications.***

The new guidance recognizes the growing reliance by proponents and companies alike on the use of emails to submit proposals and make other communications. Consistent with prior no-action letter precedent in this area, SLB 14L provides that, unlike third-party mail delivery (which provides the sender with a proof of delivery), methods for email confirmation of delivery may vary. In particular, the Staff states its view that email delivery confirmations and company server logs may not be sufficient to prove receipt of emails as they only serve to prove that emails were sent. In light of this, the Staff suggests that both parties increasingly rely on email confirmation from the recipient expressly acknowledging receipt. The Staff encourages both companies and shareholder proponents to acknowledge receipt of emails when requested, and it suggests the use of email read receipts (if received by the sender).

The Staff goes on to specifically address the use of email for submission of proposals, delivery of deficiency notices, and submitting responses to such notices. In regards to submissions, the Staff encourages shareholders to submit a proposal by means that permit them to prove the date of delivery, including electronic means (though the Staff acknowledges the inherent risk of using email exclusively as a means of submission in the event timely receipt is disputed and if the proponent does not receive confirmation of receipt from the company). If a company does not provide an email address for receiving proposals in its proxy statement, shareholders are encouraged to contact the company to obtain the proper email address. Similarly, if companies use email to deliver deficiency notices, they are encouraged to seek a confirmation of receipt from the proponent, since the company has the burden of proving timely delivery of the notice. Likewise, if a shareholder uses email to respond to a company's deficiency notice, the burden to show receipt is on the shareholder, and therefore shareholders are encouraged both to use an appropriate company email address and to seek confirmation of receipt.

Commissioners' Dissent Underscores Deep Divisions within the Commission.

Chair Gensler publicly endorsed the Staff's new guidance,[9] asserting that SLB 14L will provide greater clarity to companies and shareholders on when certain exclusions may or may not apply. At the same time, Republican Commissioners Hester M. Pierce and Elad L. Roisman (the "Commissioners") released a joint statement that articulated their concerns regarding the Staff's new guidance.[10] First, the Commissioners expressed disappointment at SLB 14L's explicit singling out of proposals "squarely raising human capital management issues with a broad societal impact," and proposals that "request[] companies adopt timeframes or targets to address climate change" as likely non-excludable.[11] Second, the Commissioners said that the actions of the Staff in publishing the guidance were the result of the current Commission's "flavor-of-the-day regulatory approach."[12] Next, the Commissioners espoused the belief that SLB 14L ultimately creates significantly less clarity for companies, dramatically slows down the Rule 14a-8 no-action request process and wastes taxpayer dollars on shareholder proposals that "involve issues that are, at best, only tangential to our securities laws."[13] Finally, the Commissioners noted that they would be open to either shifting responsibility for the no-action process from the Staff to the Commission directly, or even amending Rule 14a-8 to excise the Commission and Staff from the process altogether. These views, taken together, demonstrate a clear division among the Commission, right down political party lines, on matters relating to shareholder proposals.

Takeaways

While the practical consequences of the Staff's new interpretive guidance will likely become clearer over time, this much is evident: the Staff's latest guidance cements the end of the Trump-era Commission and is a bellwether for the challenging shareholder proposal season that awaits companies, particularly with respect to climate and social proposals, as well as the nature of changes that we might expect to see later in 2022 when the Commission revisits Rule 14a-8 rulemaking.[14] In many respects, SLB 14L serves up what the proponent community has been asking for. For example, shareholder proponents have long argued that the Staff should not be involved in assessing the relevancy of a social policy issue for a company – that shareholders can do so through their voting – and SLB 14L appears to lean in that direction. Similarly, after stating in the Prior SLBs that the extent to which a proposal dealt with a "complex" topic was not a determinative factor under a micromanagement analysis, SLB 14L now suggests that complexity was relevant and that it will be assessing that matter differently. Further, it is notable that SLB 14L follows a shareholder proposal season in which the Staff failed to host its annual "stakeholders" meeting, which historically has been an annual opportunity for various parties that are part of the shareholder proposal process to dialogue with the Staff and each other about Rule 14a-8 issues.

In light of the guidance set forth in SLB 14L, we urge public companies to keep the following in mind.

- ***Companies May Need to Send a Second Deficiency Letter in Certain Circumstances***. Excluding proposals based on a shareholder proponent's failure to satisfy the Rule 14a-8 procedural requirements just got harder. The new Staff guidance increases the burden on companies by now suggesting that they may need to send a second deficiency notice in certain situations.[15] Now, even when a proponent only sends ownership proof in response to a company's deficiency notice requesting such documentation, companies will need to evaluate whether to send a second notice to the proponent identifying any defects in such proof of ownership. At a minimum, this will prolong the uncertainty for companies on whether a proponent has demonstrated eligibility to submit a proposal, and places significant pressure on subsequently challenging eligibility within the time periods set forth in Rule 14a-8. Similarly, while the Staff has objected in years past to arguments to exclude proposals based on minor issues, new SLB 14L reiterates that fact and suggests that the Staff intends for companies to actively assist proponents in complying with well-established procedural requirements.

- ***Companies Should Continue to Send Deficiency Notices Via Mail (and Email).*** In spite of the Staff's well-intended guidance encouraging the use of email, because there can be no guarantee that a proponent will promptly confirm receipt via email, companies seeking certainty should continue to send deficiency letters via a means that enables them to indisputably prove receipt by the proponent (*g.*, overnight mail). That said, some companies may be comfortable with email communications alone depending on the specific shareholder proponent and the nature of their relationship with the company.

- ***The Staff Appears Poised to Enforce the New Ownership Thresholds.*** Although the 2020 amendments to Rule 14a-8 are now in effect for meetings held after January 1, 2022, the Staff has not yet affirmed or denied any no-action requests seeking relief based on any of the amended Rule 14a-8 requirements. That said, despite litigation[16] suggesting that the Staff should not enforce the amended rules, SLB 14L expressly acknowledges the new tiered ownership thresholds (as part of the revised format provided for proof of ownership letters), suggesting that the Staff may concur with exclusion of proposals based on failure to comply with the new one-, two- and three-year ownership requirements.[17]

- ***The Staff Will Once Again be Positioned as Arbiter of Social Issues***. Gone is the company-specific approach to analyzing significance under the ordinary business exclusion, and back in vogue are topically significant policy issues, as determined by the Staff. Determining what constitutes a significant policy issue will be all the more difficult to predict and discern given the Staff's increased reliance on the shareholder proposal no-action response chart[18] and reluctance to issue response letters explaining their reasoning.[19]

- ***Let's Call it What it is: Open Season for Environmental and Social Proposals.*** The Staff's new guidance is likely to lead to an increase in the submission of social, political and environmental shareholder proposals and to an increase in the number of such proposals being included in proxy statements.

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[1] *See Dollar General Corp.* (Mar. 6, 2020).

[2] In *ConocoPhillips Co.*, a decision that was inconsistent with the Staff's position in recent proxy seasons, the Staff denied a request to exclude a shareholder proposal that requested that the company set emission reduction targets. In its only written response letter of the season on this topic, the Staff

indicated that the proposal did not impose a specific method and thus did not micromanage to such a degree that exclusion was warranted under Rule 14a-8(i)(7).

[3] *See* SLB 14L.

[4] In this regard, and as already described in Gibson Dunn's client alert of June 21, 2021, the SEC's recently announced rulemaking agenda highlights the SEC's near-term focus on prescribing climate change disclosure.

[5] 618 F. Supp. 554 (D.D.C. 1985).

[6] *See* SLB 14L.

[7] *Id.*

[8] *Id*.

[9] *See* Chair Gary Gensler, *Statement regarding Shareholder Proposals: Staff Legal Bulletin No. 14L*, SEC (Nov. 3, 2021), *available* here.

[10] *See* Commissioner Hester M. Peirce & Commissioner Elad L. Roisman, *Statement on Shareholder Proposals: Staff Legal Bulletin No. 14L*, SEC (Nov. 3, 2021), *available* here.

[11] *Id*. (quoting SLB 14L)

[12] *Id*.

[13] *Id*.

[14] *See Agency Rule List – Spring 2021 Securities and Exchange Commission*, Office of Information and Regulatory Affairs (2021), *available* here, as discussed in Gibson Dunn's client alert of August 19, 2021.

[15] In this regard, 37% of all successful no-action requests were granted based on procedural grounds in 2021 and the overall success rate for procedural arguments was 84% and 80% in 2021 and 2020, respectively, as discussed in Gibson Dunn's client alert of August 19, 2021.

[16] Compl., Interfaith Ctr. on Corp. Responsibility v. SEC, No. 1:21-cv-01620-RBW (D.D.C. June 15, 2021), ECF No. 1.

[17] The Commission's deadline to submit its response in the aforementioned litigation involving Interfaith Ctr. on Corp. Responsibility, As You Sow and James McRitchie is November 19, 2021.

[18] *Available* here.

[19] As discussed in Gibson Dunn's client alert of August 19, 2021, the number of Staff response letters declined significantly in 2021, with the Staff providing response letters only 5% of the time during the 2021 proposal season, compared to 18% in 2020.

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Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding these developments. For additional information, please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any of the following lawyers in the firm's Securities Regulation and Corporate Governance practice group:

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