

M&A Update

SEC Issues Guidance on Issuers' Ability to Exclude Shareholder Proposals under Rule 14a-8

November 20, 2017

Background

On November 1, 2017, the staff of the Division of Corporate Finance of the Securities and Exchange Commission published Staff Legal Bulletin No. 14I. SLB 14I provides additional guidance to companies and shareholders regarding circumstances in which the Staff will consider granting no-action relief for a company to exclude a shareholder proposal from its proxy statement pursuant to Rule 14a-8. Specifically, the bulletin provides helpful insight into the Staff's decision-making process as it relates to the "ordinary business" and "economic relevance" exceptions under Rule 14a-8, and the type of information the Staff will consider persuasive. SLB 14I also provides additional guidance regarding proposals submitted by third parties on behalf of shareholders and the use of graphs or images in shareholder proposals.

Ordinary Business Exception

Under the "ordinary business" exception to Rule 14a-8, a company may exclude a shareholder proposal from its proxy statement if the proposal is "so fundamental to management's ability to run a company on a day-to-day basis that [it] could not, as a practical matter, be subject to direct shareholder oversight." However, companies may not exclude proposals that focus on "policy issues that are sufficiently significant [that] they transcend ordinary business and would be appropriate for a shareholder vote."

In SLB 14I, the Staff states that the board of directors of the company, given its fiduciary duties to the company's shareholders and its intimate knowledge of the company's business, is best positioned to determine whether a particular proposal is sufficiently significant to transcend the company's ordinary business. In light of this view, the Staff expects that future no-action requests on these grounds will include a discussion that reflects the board's analysis of the particular policy issue raised and its significance to the company, as well as a detailed description of the specific processes employed by the board to ensure that its conclusions are well-informed and well-reasoned.

Shareholders submitting a shareholder proposal to a company under Rule 14a-8 should be mindful of the Staff's deferential view toward the board's judgment, and seek to present their proposal in a manner that highlights to the board the significance of the policy in question and the connection between the policy and the company's business operations.

Economic Relevance Exception

Under the “economic relevance” exception, a company may exclude a shareholder proposal that (i) relates to operations that account for less than 5% of its total assets, net earnings and gross sales *and* (ii) is not otherwise significantly related to the company’s business. The Staff, however, acknowledged the lack of emphasis it has historically placed on the second prong of this test in considering no-action requests, noting that the Staff has historically rejected a company’s request for no-action relief regardless of a proposal’s significance to the business if “a company conducted any amount of business related to the issue in the proposal and...that issue was of broad social or ethical concern.”

Going forward, the Staff’s analysis will focus on a proposal’s significance to the company’s business when the proposal does not meet one of the 5% tests described above. In SLB 14I, the Staff provides certain practical guidance to shareholders and companies with respect to the “economic relevance” exception:

- Shareholders Must Demonstrate Significance of the Proposal. A shareholder making a shareholder proposal should seek to emphasize the significance of the impact the proposal may have on the company’s business, particularly if the significance of such impact is not apparent on the face of the proposal. By way of example, the Staff noted that a shareholder could seek to demonstrate that such a proposal “may have a significant impact on other segments of the issuer’s business or subject the issuer to significant contingent liabilities.”
- The Implication of Social or Ethical Issues Alone is Not Enough to Withstand Exclusion. The Staff highlighted its intent to change its historical practice of disallowing exclusion of a shareholder proposal in the event any social or ethical issue is implicated, without any further evidence that the issue is significant to the company’s business. To this end, the Staff noted that shareholders may continue to raise social or ethical issues in their arguments, but would need to tie those issues to a significant effect on the company’s business. Furthermore, the Staff noted that the mere possibility of reputational or economic harm will not be dispositive in its decision as to whether to exclude a proposal.
- The Staff Will Make a Fact-Specific Determination. The Staff’s analysis will be more fact-specific than it has historically been, and will depend on the particular circumstances of the company to which the proposal is submitted. In this regard, a matter that is considered significant to one company may not be considered significant to another, and the Staff will make a determination in light of the total mix of information available.
- Corporate Governance Proposals are Generally Considered Significant. The Staff will generally view substantive governance matters to be significantly related to almost all companies, and, as a result, generally not excludable under Rule 14a-8(i)(5).
- Request for No-Action Relief Should Include Board’s Consideration. Similar to the “ordinary business” exclusion, the Staff acknowledges that the board of directors is typically in a better position than the Staff to determine whether a shareholder proposal is “otherwise significantly related to the company’s business.” Thus, a company seeking no-action relief

under the “Economic Relevance Exception” should include in its no-action request the board’s analysis of why the proposal will not have a significant effect on the company.

Proposal by Proxy

While Rule 14a-8 does not expressly address shareholders’ ability to submit proposals through a representative, shareholders frequently elect to do so, a practice commonly referred to as “proposal by proxy.” The Staff continues to be of the view that a shareholder’s submission by proxy is consistent with Rule 14a-8. However, SLB 14I provides that, going forward, a shareholder submitting a proposal by proxy must provide documentation that is signed and dated by the shareholder and identifies:

- the shareholder-proponent and the person or entity selected as proxy;
- the company to which the proposal is directed;
- the annual or special meeting for which the proposal is submitted; and
- the specific proposal to be submitted.

Use of Graphics or Images

SLB 14I reaffirms the Staff’s position taken in no-action letters issued to General Electric that the 500-word limitation set forth in Rule 14a-8(d) does not prohibit the use of graphs or images in shareholder proposals to convey information about their proposals. While the Staff recognizes the potential for abuse in this area, it believes that these potential abuses are appropriately addressed through other provisions of Rule 14a-8. The Staff also confirmed that any words used in the graphics themselves, however, do count towards the 500-word limit.

The full text of SLB 14I can be found [here](#).

* * * * *

If you have any questions, please contact any of the following attorneys or your Cadwalader contact:

Joshua A. Apfelroth	+1 212 504 6391	joshua.apfelroth@cwt.com
Richard M. Brand	+1 212 504 5757	richard.brand@cwt.com
William P. Mills	+1 212 504 6436	william.mills@cwt.com
Matthew Sadofsky	+1 212 504 6352	matthew.sadofsky@cwt.com
Janet Hsueh	+1 212 504 6073	janet.hsueh@cwt.com