

# Following Another Busy Shareholder Proposal Season, SEC Releases New Guidance on Board Analyses and Rule 14a-8 Ordinary Business and Economic Relevance Exceptions

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On October 23, 2018, the staff (the “Staff”) of the Division of Corporation Finance (“Corp Fin”) of the Securities and Exchange Commission (“SEC”) issued Staff Legal Bulletin 14J (“SLB 14J”)<sup>1</sup> to provide the Staff’s views on: (i) board analyses in connection with no-action requests that seek to rely on the “economic relevance”<sup>2</sup> or “ordinary business”<sup>3</sup> exceptions as a basis to exclude shareholder proposals; (ii) the scope and application of “micromanagement” as a basis to exclude a proposal under the “ordinary business” exception; and (iii) the scope and application of the “ordinary business” exception for proposals concerning senior executive and/or director compensation matters.

## Background

In November 2017, the Staff issued Staff Legal Bulletin 14I (“SLB 14I”), which indicated that companies submitting no-action letter requests based on the “economic relevance” exception under Rule 14a-8(i)(5) and the “ordinary business” exception under Rule 14a-8(i)(7), could include a discussion reflecting the board’s analysis of the particular policy issue raised by the proposal and its significance in relation to the company.

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<sup>1</sup> Available [here](#).

<sup>2</sup> Rule 14a-8(i)(5) permits a company to exclude a 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.”

<sup>3</sup> Under Rule 14a-8(i)(7), a company is permitted to exclude a proposal that “deals with a matter relating to the company’s ordinary business operations.”

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Statements made by the Staff<sup>4</sup> following SLB 14I clarified that a board analysis was not required, but *could* be included given that no-action requests made on these bases often raise difficult judgment calls that the Staff believes are matters that the board is generally best suited to analyze. During the 2018 proxy season, a number of companies included board analyses as part of their no-action requests; however, only one such request was granted. In discussing these results in SLB 14J, the Staff noted that board analyses that did not describe the specific factors considered by the board, but were instead merely conclusory or simply described the processes followed by the board, were less helpful in the Staff's consideration of a no-action request. By contrast, those that "focused on...the specific substantive factors the board considered in arriving at its conclusion" were the most helpful in evaluating requests, even when the Staff did not ultimately agree with the company's position.

## Board Analysis

SLB 14J re-emphasizes the Staff's position "that a well-developed discussion of the board's analysis of whether the particular policy issue raised by the proposal is otherwise significantly related to the company's business...or is sufficiently significant in relation to the company...can assist the staff in evaluating a company's no-action request" and offers additional guidance on the types of board analyses that might be more useful to the Staff.

The Staff continues to encourage companies to include their boards' analyses in their arguments and to describe the specific substantive factors considered by the board, which may include, among others:

- The extent to which the proposal relates to the company's core business activities.
- Quantitative data, including financial statement impact, illustrating whether or not the matter is significant to the company.
- Whether the company has already addressed the issue in some manner, including the differences between the proposal's specific request and the actions the company has already taken, and an analysis of whether such differences present a significant policy issue for the company.
- The extent of shareholder engagement on the issue and the level of interest shareholders have expressed on the issue.
- Whether there have been other requests for the action or information sought by the proposal.
- Whether the company's shareholders have previously voted on the matter and, if so, how the board views those voting results.
  - This was a key issue for several no-action letters submitted during the 2018 proxy season.<sup>5</sup> SLB 14J makes clear that the "weight" given to the voting results will depend on the level of support a proposal on the same matter previously received. If a previously voted-on matter received "significant shareholder support," the Staff will consider whether the company has taken any subsequent actions or whether other intervening events have occurred since the vote that may have mitigated or increased the issue's significance to the company. In addition, the more recent a vote, the more likely it is to indicate significance.

The Staff also reminded companies that determinations will be made on a case-by-case basis, although the Staff will generally not concur in exclusion of proposals that focus on substantive governance matters.

The Staff further noted that, the absence of a board analysis will not create a presumption against exclusion, but it may be difficult for the Staff to exclude a proposal without such an analysis when the significance of the issue in question may depend on factors that the board is well positioned to evaluate.

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<sup>4</sup> See statements by Corp Fin Director William Hinman and Corp Fin Associate Director Michele Anderson at the November 2017 PLI Securities Regulation Institute, and Corp Fin Senior Special Counsel Matt McNair on a webcast presented by [thecorporatecounsel.net](http://thecorporatecounsel.net), available [here](#).

<sup>5</sup> Specifically, the Staff denied relief in several instances where proponents highlighted past shareholder support, evidenced by prior votes ranging from 25 percent to more than 40 percent of votes cast, even when the board analysis otherwise appeared fulsome. In most of these cases, the Staff said the companies failed to meet their burden of adequately arguing for relief.

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## Ordinary Business Micromanagement

SLB 14J explains that the policy underlying the ordinary business exception of Rule 14a-8(i)(7) rests on both the proposal's subject matter and whether it micromanages a company. A proposal may be excludable on this basis even with a proper subject matter, if it "probe[s] too deeply into matters of a complex nature" if it involves intricate detail, or asks for specific time frames or methods for implementing complex policies. For example, a proposal seeking a plan to reach net-zero greenhouse gas emissions by 2030 which imposed specific time frames or methods was excludable because it was determined to be micromanaging the company.<sup>6</sup>

## Proposals that Address Senior Executive or Director Compensation

Proposals that relate to the management of the workforce and general employee compensation and benefits are generally excludable as ordinary business matters, while those focused on senior executive and/or director compensation generally are not excludable as they are viewed as significant policy matters. SLB 14J provides the following guidance on these types of proposals:

- For proposals that address both senior executive or director compensation and ordinary business matters, the Staff examines whether the underlying concern of the proposal is truly focused on aspects of senior executive or director compensation or merely touches upon or implicates senior executive or director compensation.
- For proposals that address aspects of senior executive or director compensation that are also available to the general workforce, the Staff examines whether a primary aspect of the targeted compensation is broadly available or applicable to a company's general workforce and the company demonstrates that the executives' or directors' eligibility to receive the compensation does not implicate significant compensation matters. If the proposal focuses on elements of compensation generally available to the workforce, then it is likely excludable under the ordinary business exception.
- Historically, the Staff has not excluded proposals addressing senior executive or director compensation on the basis of micromanagement. However, the Staff now agrees that such proposals can be excluded on the basis of micromanagement if they seek intricate detail, or seek to impose specific timeframes or methods for implementing complex policies. For example, a proposal detailing the eligible expenses covered under a company's relocation expense policy such as the type and duration of temporary living assistance, as well as the scope of eligible participants and amounts covered, may be excludable on the basis of micromanagement.

## Practical Considerations

In reinforcing many of the Staff's previous positions, SLB 14J provides useful guidance that will enable companies to better assess and predict the excludability of a shareholder proposal under the "economic relevance" and "ordinary business" exceptions. In evaluating responses to shareholder proposals that might be excludable on these bases, companies should:

- **Consider timing and time constraints of the board as an initial matter.** Shareholder proposals generally must be addressed during an extremely busy time of the year for most companies. Careful consideration should be given as to whether providing a board analysis is a worthwhile investment of the board's time. Thoughtful evaluation by the board<sup>7</sup> may be warranted if the issue in question depends on factors that the company believes are not self-evident and that can be best analyzed and explained by the board. If it is determined that an analysis by the board is appropriate, efforts should be made to streamline the process, provide the board with the requisite information for its analysis and schedule meetings as necessary to finalize the analysis in advance of the deadline for submitting a no-action request.
- **Carefully evaluate proposals that touch on senior executive or director compensation** to determine whether there are any proper bases for exclusion under the ordinary business exception of Rule 14a-8(i)(7). The proposal may be excludable if: (1) its focus is truly on general employee benefits, even if it is related to executive compensation, or (2) it seeks to impose detailed frameworks or timetables that are typically within the purview of management or the board to determine. For example, while certain

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<sup>6</sup> See Apple Inc. (December 5, 2016).

<sup>7</sup> It is also appropriate/acceptable for the requisite analysis to be performed by a committee of the board.

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proposals seek to link executive compensation to social or environmental criteria, they may be excludable if they are not primarily focused on a proper subject matter, or if they seek specific implementation methodologies with respect to complex policies.

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