

SIDLEY UPDATE

SEC Staff Issues New Guidance on Shareholder Proposals

New Staff Legal Bulletin No. 14I Provides Important Information About How the Staff Will Analyze No-Action Requests

On November 1, 2017, the staff of the SEC's Division of Corporation Finance (the Division Staff) issued [Staff Legal Bulletin No. 14I \(CF\)](#) (SLB No. 14I), which provides new guidance on the excludability of shareholder proposals under Exchange Act Rule 14a-8. The new guidance sets forth a revised framework for analyzing no-action requests under Rule 14a-8(i)(5) (the "economic relevance" exception), which should expand that exclusion's availability. In addition, in no-action requests under Rule 14a-8(i)(5) and Rule 14a-8(i)(7) (the "ordinary business" exception) in which the significance of the proposal to the company's business is at issue, the Division Staff would expect to see a well-developed discussion of the board's analysis of the proposal and its significance to the company's business. SLB No. 14I suggests that the Division Staff will give some deference to a board's well-informed and well-reasoned analysis. Finally, the new guidance outlines enhanced information requirements for "proposals by proxy" and clarifies when graphs or images may render a proposal excludable. The table below summarizes the new guidance in SLB No. 14I.

"Ordinary Business" Exception (Rule 14a-8(i)(7))

A company may exclude a proposal under Rule 14a-8(i)(7) if it "deals with a matter relating to the company's ordinary business operations." However, the Division Staff will not permit a company to exclude a proposal if it transcends the company's day-to-day business matters by raising a policy issue so significant that it would be appropriate for a shareholder vote. The Division Staff is of the view that the company's board is generally in a better position than the staff to make this determination given the board's fiduciary duties and knowledge of the company's business.

New Guidance for Companies: Going forward, the Division Staff would expect a no-action request under Rule 14a-8(i)(7) making the argument that the proposal does not raise a significant policy issue for the company to include a discussion (i) reflecting the board's analysis of the particular policy issue raised and its significance and (ii) explaining the specific processes the board employed to ensure that its conclusions are well-informed and well-reasoned. The new guidance does not provide examples or otherwise elaborate on what these processes may be.

"Economic Relevance" Exception (Rule 14a-8(i)(5))

A company may exclude a proposal under Rule 14a-8(i)(5) if it relates to operations which account for less than 5% of the company's total assets, net earnings and gross sales and "is not otherwise significantly related to the company's business." Historically, the Division Staff has not focused on a proposal's significance to the company's business, and has instead only considered whether the company conducted *any* amount of business related to the issue raised in the proposal and whether the issue was of broad social or ethical concern. The Division Staff believes this approach has unduly limited the exclusion's availability.

New Analytical Framework: Going forward, the Division Staff will focus on a proposal's significance to the company's business when it otherwise relates to operations that account for less than 5% of total assets,

net earnings and gross sales (regardless of whether the proposal raises issues of social or ethical importance in the abstract). In evaluating significance, the Division Staff will consider the proposal in light of the “total mix” of information about the company. The determination will depend on a company’s particular circumstances, but the Division Staff would generally view substantive governance matters to be significantly related to almost all companies.

Finally, going forward, the Division Staff will no longer consider its analysis of the proposal under the “ordinary business” exception in Rule 14a-8(i)(7) when determining whether a proposal is excludable under Rule 14a-8(i)(5). Each basis of exclusion will be analyzed separately to ensure that it serves its intended purpose.

New Guidance for Proponents: If a proposal’s significance to a company’s business is not apparent on its face, the proponent must prove that it is “otherwise significantly related to the company’s business.”

- The proponent can provide information demonstrating the proposal “may have a significant impact on other segments of the issuer’s business or subject the issuer to significant contingent liabilities.”
- The proponent must connect any social or ethical issues raised in its arguments to a significant effect on the company’s business. The potential for reputational or economic harm will not preclude no-action relief.

New Guidance for Companies: Similar to the “ordinary business” exception discussed above, the Division Staff is of the view that the company’s board is generally in a better position than the staff to make the determination as to whether a proposal is “otherwise significantly related to the company’s business.” Going forward, the Division Staff would expect a no-action request under Rule 14a-8(i)(5) to include a discussion (i) reflecting the board’s analysis of the proposal’s significance to the company and (ii) explaining the specific processes the board employed to ensure that its conclusions are well-informed and well-reasoned.

“Proposals By Proxy”

The Division Staff allows a shareholder to submit a proposal by proxy (i.e., through a representative), but recognizes that this may raise concerns about whether (i) the eligibility requirements of Rule 14a-8(b) have been met and (ii) the shareholder knows that a proposal is being submitted on the shareholder’s behalf.

New Guidance for Proponents: Going forward, if a shareholder submits a proposal by proxy, the Division Staff will consider whether the shareholder provides signed and dated documentation which describes the shareholder’s delegation of authority to the proxy and identifies the:

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

A failure to provide this information may be a basis to exclude the proposal under Rule 14a-8(b). However, under Rule 14a-8(f)(1), a company must notify the proponent of a specific defect within 14 days of receiving the proposal, which triggers a 14-day period in which the proponent may cure the defect.

Use of Graphs and Images (Rule 14a-8(d))

Under Rule 14a-8(d), a “proposal, including any accompanying supporting statement, may not exceed 500 words.” The Division Staff is of the view that Rule 14a-8(d) does not prohibit shareholders from using graphs or images in their proposals but recognizes the potential for abuse in this area.

New Guidance: The new guidance confirms that a proposal would be excludable under Rule 14a-8(d) if the total number of words in the proposal, including words in the graphics, exceeds 500. Furthermore, graphs and/or images in a proposal would be excludable under Rule 14a-8(i)(3) (addressing vague and indefinite proposals) where they:

- make the proposal materially false or misleading;
- render the proposal so inherently vague or indefinite that neither the shareholders voting on the

proposal, nor the company in implementing it, would be able to determine with any reasonable certainty exactly what actions or measures the proposal requires;

- directly or indirectly impugn character, integrity or personal reputation, or directly or indirectly make charges concerning improper, illegal or immoral conduct or association, without factual foundation; or
- are irrelevant to a consideration of the subject matter of the proposal, such that there is a strong likelihood that a reasonable shareholder would be uncertain as to the matter on which he or she is being asked to vote.

New Guidance for Companies: In a footnote to SLB No. 14I, the Division Staff cautions that companies should not “minimize or otherwise diminish the appearance of a shareholder’s graphic.”

- A shareholder’s graphics should have similar prominence to company graphics in the proxy statement.
- Including a black and white version of a shareholder’s color graphic is acceptable if the rest of the proxy statement is in black and white.

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

Holly J. Gregory

Partner

holly.gregory@sidley.com

+1 212 839 5853

John P. Kelsh

Partner

jkelsh@sidley.com

+1 312 853 7097

Thomas J. Kim

Partner

thomas.kim@sidley.com

+1 202 736 8615

Rebecca Grapsas

Counsel

rebecca.grapsas@sidley.com

+1 212 839 8541

Claire H. Holland

Special Counsel

cholland@sidley.com

+1 312 853 7099

Sidley Corporate Governance and Executive Compensation Practice

Lawyers in Sidley’s Corporate Governance and Executive Compensation practice regularly advise corporate management, boards of directors and board committees on a wide variety of corporate governance matters, including shareholder activism and engagement, fiduciary duties, board oversight responsibilities, board investigations and special committees, SEC disclosure, legal compliance, corporate responsibility, board evaluation, board and committee structures and issues arising under Sarbanes-Oxley and Dodd-Frank. Our advice relates to the procedural aspects as well as the legal consequences of corporate and securities transactions and other corporate actions, including takeover defenses, proxy contests, SEC filings and disclosure issues, stock option issues and general corporate law matters. Our broad client base allows us to provide advice regarding best practices and trends in such matters as directors’ and officers’ responsibilities, board and committee practices, disclosure controls and procedures, internal controls, executive compensation and other matters.

To receive Sidley Updates, please subscribe at www.sidley.com/subscribe.

SIDLEY

BEIJING · BOSTON · BRUSSELS · CENTURY CITY · CHICAGO · DALLAS · GENEVA · HONG KONG · HOUSTON · LONDON · LOS ANGELES
MUNICH · NEW YORK · PALO ALTO · SAN FRANCISCO · SHANGHAI · SINGAPORE · SYDNEY · TOKYO · WASHINGTON, D.C.