



Securities Law ADVISORY ■

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SEC Provides Guidance on Exclusion of Shareholder Proposals

On November 1, 2017, the staff of the Division of Corporation Finance of the U.S. Securities and Exchange Commission (SEC) released [Staff Legal Bulletin \(SLB\) No. 14I](#) concerning certain shareholder proposals submitted under Rule 14a-8 of the Exchange Act of 1934, as amended. Specifically, SLB 14I addresses the scope and application of the “ordinary business” exception under Rule 14a-8(i)(7) and the “economic relevance” exception under Rule 14a-8(i)(5). Additionally, SLB 14I addresses proposals submitted on behalf of shareholders and the use of graphs or images in shareholder proposals in light of Rule 14a-8(d).

Exclusions Under Rule 14a-8(i)(7) – Ordinary Business Exception

Rule 14a-8(i)(7) contains the “ordinary business” exception, which is one of the substantive bases for exclusion of a shareholder proposal. A company is permitted to exclude a proposal that “deals with a matter relating to the company’s ordinary business operations.” The exclusion is meant to limit decision-making of ordinary business matters to management and the board of directors.

Staff’s application of Rule 14a-8(i)(7)

The policy underlying the ordinary business exception takes into account two considerations: (1) the proposal’s subject matter; and (2) the degree to which the proposal “micromanages” the company. In evaluating the first consideration, the staff has stated that proposals that raise matters that are “so fundamental to management’s ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight” may be excluded by the company. However, proposals that raise significant policy issues may transcend ordinary business and would be appropriate for shareholder vote.

New staff guidance

Noting that the determination of whether proposals that address ordinary business matters contain significant policy issues that are appropriate for shareholder vote can raise difficult judgment calls for the staff, the staff has determined that a company’s board of directors is in the best position to determine whether an underlying policy issue contained in a shareholder proposal is sufficiently significant that the issue would be appropriate for shareholder vote despite its relationship to ordinary business.

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Going forward – board review

In light of this determination, the staff expects going forward that a company's no-action request will include the board's analysis of the particular policy issue raised by the proposal and its significance. Ideally, the analysis will include the processes used by the board to ensure that its conclusions are well-informed and well-reasoned. Including the board discussion and analysis in a company's no-action requests will assist the staff in its review of such exclusions.

Exclusions Under Rule 14a-8(i)(5) – Economic Relevance Exception

Rule 14a-8(i)(5) contains the economic relevance exception, which is another substantive basis for exclusion of a shareholder proposal. Under this rule, a company is permitted 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." The staff has characterized the exception as relating "to proposals concerning the functioning of the economic business of an issuer and not to such matters as shareholders' rights, e.g., cumulative voting."

Staff's application of Rule 14a-8(i)(5)

SLB 14I acknowledges that the staff has only infrequently agreed with a company's exclusion under the "economic relevance" exception. The staff expressed concern in SLB 14I that the availability of the exclusion contained in Rule 14a-8(i)(5) has been unduly limited because insufficient emphasis has been placed on the second prong of the rule regarding whether the proposal "deals with a matter that is not significantly related to the issuer's business." The staff's analysis over the years has focused on "whether a company conducted any amount of business related to the issue in the proposal and whether the issue was of broad social or ethical concern." In addition, the staff's analysis of whether a proposal is "significantly related to the issuer's business" has been informed by its analysis under the ordinary business exception. In the staff's view, this practice is problematic and separate analytical frameworks should be applied to each basis for exclusion.

New staff guidance

Going forward, the staff's analysis will focus on a proposal's significance to the company's business when the proposal relates to operations that make up less than 5 percent of the company's total assets, net earnings, and gross sales. Therefore, the analysis will be more fact-specific and will depend on the particular circumstances of the company submitting the proposal. While certain topics, such as substantive governance matters, will apply to all companies, other matters that might be significant to one company might play no significant role in another. SLB 14I provides further guidance that if the proposal's significance to a company's business is not apparent on its face, it may be excluded unless the proponent of the proposal demonstrates that it is "otherwise significantly related to the company's business." The staff will consider the total mix of information about the issuer when evaluating significance.

Going forward – board review

Similar to the guidance provided in connection with the ordinary business exception, the staff believes that the board of directors is in the best position to determine whether a proposal is "otherwise significantly related to the company's business." Therefore, the staff expects that a company's Rule 14a-8(i)(5) no-action request will include the board's analysis of the significance of the proposal to the company's business and a discussion of its process to ensure that its conclusions are well-informed and well-reasoned.

Proposals Submitted on Behalf of Shareholders

Although Rule 14a-8 does not provide for the submission of shareholder proposals through a representative or “proposal by proxy,” it is common practice, and the staff has held the view that proposal by proxy is consistent with Rule 14a-8. Despite the staff’s acceptance of proposals by proxy, the practice does raise certain challenges and concerns, such as whether the eligibility requirements of Rule 14a-8(b) have been satisfied or whether the representative is submitting a proposal on behalf of a shareholder without his or her knowledge.

Going forward, the staff will require that documentation describing a shareholder’s delegation of authority to the proxy accompany any proposal by proxy. The accompanying documentation must:

- Identify the shareholder-proponent and the person or entity selected as proxy;
- Identify the company to which the proposal is directed;
- Identify the annual or special meeting for which the proposal is submitted;
- Identify the specific proposal to be submitted (e.g., proposal to lower the threshold for calling a special meeting from 25 percent to 10 percent); and
- Be signed and dated by the shareholder.

In the staff’s view, including this documentation will alleviate some of the concerns and challenges that arise in the context of proposals by proxy and will assist companies and the staff in determining whether a proponent has satisfied the eligibility rules of Rule 14a-8(b). Proposals that do not provide this information may be subject to exclusion in accordance with Rule 14a-8(b).

Use of Graphs and Images in Shareholder Proposals Consistent with Rule 14a-8(d)

Rule 14a-8(d) provides one of the procedural bases for excluding a shareholder proposal and specifies that a “proposal, including any accompanying supporting statement, may not exceed 500 words.” The staff has expressed in two recent no-action decisions that despite not being expressly addressed in Rule 14a-8(d), the use of graphs or images in proposals is not prohibited. However, the staff clarifies in SLB 14I that if the total number of words in a proposal, including words in the graphs or images, exceeds 500, exclusion of the proposal would be appropriate under Rule 14a-8(d).

Although there is potential for abuse in the use of graphs and images in proposals, the staff is of the view that the potential abuses can be addressed through other provisions of Rule 14a-8. For example, excluding graphs or images would be appropriate if they make the proposal materially false or misleading or are irrelevant to a consideration of the subject matter of the proposal, which are both prohibited by Rule 14a-8(i)(3).

Looking Forward

The new guidance has been issued in time for the start of the 2018 proxy season; however, including such a discussion and analysis in a company’s no-action request will require additional time and resources from the board. A company that wants to exclude a shareholder proposal from its proxy materials under Rule 14a-8 should review the new guidance and build in time for any necessary board action and determinations contemplated by SLB 14I and should consider how best to develop and document a process to ensure that the board’s decisions are well-informed well-reasoned.

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghai Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-8580 ■ 919.862.2200 ■ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650-838-2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333