

# Observations and Recommendations on the SEC's Recent Process Changes for Excluding Shareholder Proposals

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## Overview

Earlier this month, the SEC's Division of Corporation Finance announced that its staff may respond orally instead of in writing to some shareholder proposal no-action requests, beginning with the 2019-2020 proxy season. Furthermore, the staff may now more frequently decline to state a view on the no-action request, whereas in the past, it had typically concurred or disagreed with a company's asserted basis for exclusion.

As background, companies submit no-action requests in order to exclude shareholder proposals from their annual meeting proxy statements. When these requests are granted under Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the staff will not recommend that the SEC take enforcement action in response to the exclusion of a shareholder proposal. Over the last proxy season (since October 1, 2018), more than 230 no-action requests were submitted to the SEC for review.. Transitioning to oral responses is intended to make the process more efficient for the staff in light of the large volume of requests. The staff still intends to issue a response letter where it believes doing so would provide value, such as more broadly applicable guidance about complying with Rule 14a-8.

The SEC's announcement lacked a number of important details and leaves much to speculation. It remains to be seen how frequently the staff will issue oral versus written determinations. In remarks before the U.S. Chamber of Commerce in July, Director of the Division of Corporation Finance Bill Hinman had commented that under an updated process, requests based on difficult topics, such as the ordinary business exclusion, would likely continue to receive responses from the staff. In the announcement, the staff reiterates that board analysis is often useful for requests on the basis of the ordinary business or economic relevance exceptions. Whether the staff responds orally or in writing, it will inform the proponent and the company of its position, which may be that the staff concurs, disagrees or declines to state a view, with respect to the company's

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asserted basis for exclusion.

As discussed below, in light of the revised no-action process, it becomes more important for companies to designate an appropriate and prepared representative to receive the staff's call and to keep a careful record of the discussion. For more discussion on the SEC's announcement, see the Observations and Recommendations below, and register for our upcoming webinar, Shareholder Proposals: Strategies and Tactics.

## **Observations and Recommendations**

There will be more flexibility for staff, but likely less information publicly available. Until now, companies and proponents have been able to review a complete database of the staff's responses, which have all been issued in written form, to discern trends, and to observe consistencies as well as inconsistencies in the determinations. Under the updated process, it is not clear whether the staff will provide public access to its oral responses. SEC Rule 81 only provides for public access to the staff's *written* communications in connection with no-action requests, as soon as practicable after the response has been sent or given. If their oral responses are not made public, and if they have more flexibility to decline to state a view, the staff will also have more latitude to make case-by-case determinations under less scrutiny.

Faster responses to no-action requests? In keeping with the staff's commitment to a more efficient process, oral versus written responses may facilitate more prompt turnaround on no-action requests, though the staff has made no such commitment.

The staff likely will not provide information in calls beyond what is stipulated in the announcement. In each case, the staff will communicate their determination with respect to the asserted basis for exclusion, to both the company and the proponent. However, we do not expect additional substantive information to be communicated verbally. The staff will avoid conflicting messages, or unnecessarily prejudicing either party, for example, by providing one party with more detail or nuance than has been received by the other party. Furthermore, the staff is unlikely to entertain additional requests, such as requests for reconsideration, on a call. This approach would be aligned with the spirit of previous guidance. In SLB 14B, the staff stated that "In order to ensure that the staff's process is fair to all parties, we base our determinations on the written materials provided to us. While we will respond to telephone questions from the company or the shareholder proponent regarding the status of a request, we do not discuss the substantive nature of any specific no-action request with either the company or the shareholder proponent. Therefore, we request that any additional information that the company or the shareholder proponent would like to provide be submitted to us and the other party in writing."

Written no-action letters may contain more guidance, and they will receive more scrutiny. Currently, the staff will often issue a determination with little or no explanation for why they concur or disagree with the bases cited in the no-action request. Since the staff has now specified that written letters will now be issued where they may provide "broadly applicable guidance," we expect that the letters will contain more substantive guidance

than they have in the past.

Companies will need to carefully assess alternatives if the staff declines to state a view on any particular request. Negotiated withdrawals may become even more attractive. The announcement confirms that if the staff declines to state a view on any particular request, the interested parties should not interpret that position as indicating that the proposal must be included. In such circumstances, the staff is not taking a position on the merits of the arguments made, and the company may have a valid legal basis to exclude the proposal under Rule 14a-8. As an alternative, the parties may seek formal, binding adjudication on the merits of the issue in court—an option that has always been available but rarely pursued.

It is unclear how frequently the staff will decline to take a view on a no-action request. There are certain bases for exclusion that may more readily invite this position. For example, where companies cite a violation of law as a basis for exclusion under Rule 14a-8(i)(2), the staff may be more likely to defer to rulings by courts, the SEC or other state or federal authorities, as the staff largely did in their response to Johnson & Johnson regarding a proposal for the adoption of mandatory arbitration bylaws, discussed [here](#).

Without a definitive staff determination, and faced with the unappealing prospect of litigation, parties may accelerate the already existing trend towards negotiated withdrawals on a broad range of shareholder proposals. In the absence of a withdrawal, the company still has the option either to exclude the proposal without a staff concurrence, which carries some risk of potential litigation, or present it for a shareholder vote.

Will companies exclude shareholder proposals without staff concurrence? Some commentators posit that the staff's refusal to state a view will provide companies with more latitude to exclude proposals, but it appears that investor and proxy advisory firm pressure will discourage companies from unilaterally excluding proposals. While it is the exception rather than the rule that proponents have resorted to litigation in the past to challenge the exclusion of a shareholder proposal, coalitions of investors are finding that the influence and the resources to do so in order to pressure companies into settlement. Furthermore, institutional investors and proxy advisory firms may take a dim view of a company's unilateral determination to exclude a proposal. Under their existing voting policies, ISS and Glass Lewis may recommend votes against directors of companies that exclude proposals without a no-action determination or court order, though these policies may be modified in light of the staff's expanded ability to decline to state a view.

Will there be more shareholder proposals submitted and voted on? The staff's potential refusal to take a view creates greater uncertainty around the no-action process. The absence of a complete written record of the staff's position on no-action letter request during a proxy season will make it more difficult to assess the probability of success going forward. This lack of transparency may deter companies from making requests, particularly where they are not confident that there is a firm basis for exclusion. As a result, the announcement may encourage a greater number and a greater variety of

shareholder proposals to be submitted, and once submitted, to be voted on instead of excluded.

Designate an appropriate and prepared representative and keep a record on conversations with the staff. In light of the revised no-action process, companies should designate an appropriate and prepared representative to receive the staff's calls. This representative should be an individual who is generally familiar with the no-action process and with the specific request at issue, such as the general counsel, the corporate secretary or outside counsel. If the staff does not concur with the company's position, the company likely will not be able to make requests on the call, but will continue to be able to make subsequent, written requests for reconsideration. The representative should be provided with guidelines for conducting the call and asking appropriate questions in order to obtain as much clarity as possible. The company should also create a record of its written and oral communications with the staff. The record will provide a basis for a report to the board and the company's decision-makers with regard to current and future shareholder proposals.