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Shareholder Proposal No-Action Requests in the 2023 Proxy Season

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Key Points

- Companies lodged fewer no-action requests for the exclusion of shareholder proposals in the 2023 proxy season after the SEC Staff outlined new guidelines in 2021 and the Staff rejected many requests in the 2022 season.
- Companies are finding it more difficult to predict how their no-action requests will be treated, but some lessons can be drawn from the SEC Staff's responses in the 2023 proxy season about the types of requests that will fare best.
- The SEC Staff continues to grant no-action requests in some cases where companies argue that a shareholder proposal relates to ordinary business matters, would result in micromanagement or suffers from a procedural defect, among other things.

Following a tumultuous 2022 shareholder proposal no-action letter season, the 2023 season contained fewer surprises from the Staff of the Division of Corporation Finance (Staff) of the Securities and Exchange Commission (SEC). Nevertheless, companies continued to struggle to decipher the contours of the Staff's approach to requests for no-action relief regarding shareholder proposals.

As we discussed in the June 2022 edition of *Insights*, the process was upended by the publication of Staff Legal Bulletin No. 14L (SLB 14L) in November 2021 and the Staff's restrictive posture toward no-action requests seeking to exclude shareholder proposals in 2022. As a direct result, the number of such requests in the 2023 season dropped by approximately a quarter from the prior year, with companies appearing less willing to invest resources and energy in challenging some proposals.

This selectivity on the part of companies may have created the misleading impression that the Staff was more willing to grant no-action requests this year. Although the overall environment for shareholder proposal no-action relief remains challenging and, in many cases, unpredictable, there are some important takeaways to be gleaned from the 2023 season.

(See also "Changes in the Market and the Emergence of New Players Together Are Impacting Activism.")

Companies Successfully Assert Ordinary Business Basis for Exclusion

Consistent with prior seasons, the "ordinary business" basis for exclusion was the ground most frequently asserted by companies in no-action requests. The Staff concurred with nearly half of these requests.

While the Staff may be taking a more expansive view of proposals that "transcend" a company's ordinary business and therefore cannot be excluded, a number of proposals were excluded pursuant to a seemingly straightforward application of the ordinary business exclusion. For example, the Staff granted relief for requests to exclude proposals that:

- Would have required hospitals to provide plant-based food options to patients and employees.
- Sought a report on a company's rationale behind its participation in and support of external organizations and interest groups.
- Related to establishing, terminating or continuing certain business relationships.
- Sought a report on the number and categories of user account suspensions and closures that could result in limiting free speech.
- Requested that a company issue dividends in the form of NFTs.

Practice point: In many of these instances, the Staff concurred with the company that the proposal related to an ordinary business matter even though the proponent portrayed the proposal as relating to a broader social policy matter.

Words Matter When Analyzing Proposals

Companies must carefully consider the phrasing of proposals, as the question of whether a proposal focuses on an ordinary business matter or a significant policy issue can vary even among seemingly similar proposals. For example, in the 2023 season, two financial services companies faced proposals concerning merchant code categorization of transactions involving firearms and related goods.

- In one case, the Staff denied a request to exclude a proposal seeking a report on board oversight of management's decisions with regard to the company's efforts to work with an international standards organization to establish a merchant category code for gun and ammunition stores. The proponent cited the need to curb illegal activity and societal harm in the proposal.
- In the other instance, the Staff granted relief to exclude a proposal requesting a report on how the company could reduce the risks associated with tracking information regarding the processing of payments for the sale and purchase of firearms through merchant code categorization.

Notably, the latter proposal concerned whether the company should refrain from tracking firearms sales, with the proponent claiming in the proposal that tracking such sales could impinge Second Amendment rights. As a result, the Staff may have determined that, while the proposals related to the same topic, they were focused on fundamentally different considerations, and a significant social policy issue was present in one but not the other.

Practice point: Companies should be mindful to avoid categorical thinking when analyzing proposals. As shown above, scope or perspective can impact the analysis.

Responses Regarding Human Capital Management Proposals Are Difficult To Analyze

In SLB 14L, the Staff noted that proposals "squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company."

Since publication of SLB 14L, the Staff has denied no-action relief for most proposals focusing on human capital management issues, but it has granted relief in some circumstances, leaving the contours of this aspect of the ordinary business exclusion unclear. For example:

- During the 2022 season, the Staff denied relief for a proposal that asked the company to adopt and disclose a policy requiring that all employees accrue paid sick leave.
- In the 2023 season, the Staff granted relief for a proposal that requested the board prepare a report assessing the effects of the company's "return to office" policy on employee retention and corporate competitiveness.
- In another 2023 case, the Staff granted relief for a proposal that asked the company to adopt a policy enabling employees to work from any location.

Practice point: It remains unclear when a proposal relating to employees transcends ordinary business matters, but companies should continue to carefully scrutinize these types of proposals.

Micromanagement Arguments Remain Viable

Companies were slightly more successful in excluding proposals under the micromanagement prong of the ordinary business exclusion in the 2023 season than in the previous season. SLB 14L explained that, in analyzing micromanagement arguments, the Staff will consider the level of granularity sought in the proposal and to what extent, if any, it inappropriately limits discretion of the board or management.

In particular, SLB 14L noted that the Staff will not concur with exclusion of climate change proposals that "suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals."

While this would seem to indicate that micromanagement arguments are less effective in response to environmentally focused proposals, the Staff granted relief under micromanagement for a number of environmental proposals in the 2023 season:

- For a proposal asking the board of an insurance company to adopt a policy to eliminate underwriting risks associated with fossil fuel exploration and development projects. In that instance, the company argued that the proposal would effectively bar it from all activities relating to new fossil fuel developments. A nearly identical proposal was denied relief at the same company the prior year. Similar arguments also were rejected at other companies in 2022, so the 2023 response may represent a new perspective by the Staff.

- For a proposal asking a company to measure and disclose Scope 3 emissions, where the company argued that the proposal would impose a prescriptive standard that differed from the company's existing approach to measuring such emissions.

Successful micromanagement arguments were not limited to environmental proposals.

- The Staff agreed that a proposal requesting adoption of a policy requiring shareholder approval for any future agreements and corporate policies that could obligate the company to make certain payments or awards following the death of a senior executive constituted micromanagement.
- In another example, the Staff granted relief for a proposal requesting a detailed public report of information relating to shareholder ownership of company securities.

Practice point: Companies should continue to carefully review proposals for potential micromanagement arguments, though circumstances where they prevail will likely remain limited.

Procedural Arguments Are Effective

Companies generally were more successful seeking relief on procedural grounds for exclusion in the 2023 season. For the most part, the Staff concurred with procedural arguments absent unusual circumstances. Lessons to be learned from these no-action letters include:

- Transmittal emails to proponents should specifically reference any attached deficiency letters.
- Information relating to the proponent's availability for engagement can be provided by the proponent's representative and need not come directly from the proponent.
- When a proponent's address is a multiunit apartment building, email delivery of a deficiency letter may be preferable to hard copy sent via a courier service in an envelope that could be accepted by another resident of the building.
- Asserting that a proponent's submission does not constitute a "proposal" is a procedural defect that requires a timely deficiency notice and opportunity to cure.
- When providing proposal submission deadlines as required in a merger proxy statement, if the post-transaction company is a new company, it may be prudent to provide a disclaimer that shareholders may not be eligible to submit proposals for the new company until they have independently satisfied the holding period requirements for that company.

Staff Views on Substantial Implementation Remain Strict

In the 2023 season, the Staff continued to deny no-action requests under the substantial implementation basis in many cases where the company did not precisely implement the proposal in full. For example, the Staff denied relief for proposals requesting that:

- A company adopt a policy that directors who do not receive majority support only serve for 180 days or less, where the company already had a majority voting policy with a market-standard requirement to submit a resignation for the board's consideration, but without the 180-day limit on board service.

- The board commission a third-party civil rights audit, where the company already planned to conduct its own. The Staff response letter noted that the company-led audit "will not substantially implement the request for a third-party audit."
- A company adopt a policy seeking shareholder approval of any senior manager's compensation that provides for severance or termination payments with an estimated value exceeding 2.99 times the sum of the executive's base salary plus bonus. The company had a policy in place covering "senior executives" — defined as named executive officers in the company's proxy statement, a narrower scope than the persons covered in the shareholder proposal. The Staff response letter noted this fact in denying relief.

Practice point: Companies should remain selective with substantial implementation arguments.

In Sum

Companies submitting no-action requests to exclude shareholder proposals in the 2023 season seemed to heed the lesson from 2022: that only the strongest arguments would prevail. Despite this, results remained difficult to predict, which may lead to a continued reduction in no-action requests.

Nevertheless, the 2023 season showed relief remains viable when proponents fail to satisfy the procedural requirements of the SEC's shareholder proposal rule, and many proposals are excludable as ordinary business matters or micromanagement. Thus, the no-action process remains an appropriate pathway to exclude certain shareholder proposals.