

Professional Perspective

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SEC Staff Guidance Paves Way for More ESG Proposals

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With more ESG proposals passing than ever before, the 2021 proxy season was a watershed moment for shareholder proposals on ESG issues and a [significant increase in negotiated settlements](#). The November 2021 updated guidance from the staff of the U.S. Securities and Exchange Commission's Division of Corporation Finance paves the way for even more of these proposals in 2022. The guidance signals an important evolution in the SEC's balancing of the interests of companies with that of shareholders regarding ESG proposals.

Shareholders of public companies rely on Rule 14a-8 of the Securities Exchange Act of 1934, as amended, to have their proposals included in company proxy statements and brought to a shareholder vote at an upcoming annual shareholder meeting. However, the Rule provides 13 bases under which companies may seek to exclude a shareholder proposal from their proxy statement. Using previous staff guidance, companies frequently relied on two of those bases—the controversial ordinary business exclusion provided under Rule 14a-8(i)(7) and the economic relevance exclusion provided in Rule 14a-8(i)(5)—to try to exclude ESG proposals.

[Staff Legal Bulletin 14L](#), issued Nov. 3, 2021, revises that earlier guidance and significantly narrows the ability of these provisions to exclude ESG proposals from shareholder ballots.

Ordinary Business Exclusion

The ordinary business exclusion under Rule 14a-8(i)(7) allows companies to seek to exclude a shareholder proposal on the basis that it raises matters that are either:

- “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” (ordinary business prong) or
- Seek to “micromanage” a company by “probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment” (micromanagement prong)

Originally, the [SEC established](#) that Rule 14a-8(i)(7) should not be used to exclude proposals that “transcend day-to-day business matters,” such as those relating to significant social policy issues. However, staff guidance issued over the past several years, including Staff Legal Bulletins (SLBs) [14I](#), [14J](#), and [14K](#), sought to extend the exclusionary principals of the ordinary business prong by focusing on the specifics of each company and choosing not to “recogniz[e] particular issues or categories of issues as universally ‘significant.’” This guidance established that companies could argue—using a detailed board analysis—that a proposal that transcended day-to-day business matters was still excludable if a sufficient nexus did not exist to the company's business for it to warrant a shareholder vote. SLBs [14J](#) and [14K](#) sought to expand the application of the micromanagement prong of Rule 14a-8(i)(7) by allowing for exclusion when proposals sought to place any limit on company or board discretion.

As the staff has explained in [SLB 14L](#), the staff “will now focus on the social policy significance of a shareholder proposal rather than its nexus to a company's business” and deemphasize the importance of board analyses in no-action letters. This potentially means that significant social policy proposals that the staff would have previously viewed as excludable will no longer be viewed as excludable under Rule 14a-8(i)(7), even when the social policy in question is not directly related to the company or its business operations. It is likely that this revised approach would make it more difficult for companies to exclude proposals focused on a company's emissions or environmental impact.

With respect to the micro-management prong, the staff will “take a measured approach to evaluating companies’ micromanagement arguments—recognizing that proposals seeking detail or seeking to promote timeframes or methods do not per se constitute micromanagement.” Contrary to previous staff guidance, [SLB 14L](#) goes on to note that the staff will not concur in the exclusion of proposals that suggest targets or timelines “so long as the proposals afford discretion to management as to how to achieve such goals.”

This new holistic approach emphasizes the level of detail needed to enable investors to properly assess a company's approach to the matter raised in the shareholder proposal and takes into account “the sophistication of investors generally on the matter, the availability of data, and the robustness of public discussion and analysis on the topic.”

Economic Relevance Exclusion

The economic relevance exclusion provided by Rule 14a-8(i)(5) allows exclusion of proposals relating to company operations that account for less than five percent of the company's total assets, less than five percent of its net earnings and gross sales, and that are not otherwise significantly related to the company's business. The question then becomes how to determine whether the issue in the proposal is “significantly related to the company's business.”

Before November 2017, the staff considered a proposal to be relevant if a company conducted any amount of business related to the issue in the proposal. Responding to what SEC staff felt were undue limitations on the exclusion later that month, however, the staff issued Staff Legal Bulletin 14I, reaffirming the importance of a proposal's significance on a company's business in determining the applicability of the economic relevance exclusion. With [SLB 14L](#), the staff returns to an interpretation of the economic relevance exclusion that emphasizes the ethical and social significance of the issue in the proposal: “[P]roposals that raise issues of broad social or ethical concern related to the company's business may not be excluded, even if the relevant business falls below the economic thresholds of Rule 14a-8(i)(5).” As with the ordinary business exception, the new guidance should make it more difficult for companies to exclude proposals that relate to policy issues of concern to shareholders.

Additional Clarifications

The staff clarified that certain guidance included in the rescinded SLBs (14I, 14J, and 14K) will remain in effect, including guidance:

- Concerning the use of graphics and images in shareholder proposals
- Cautioning against aggressive attempts by companies to exclude proof of ownership letters through technicalities
- Suggesting that companies provide shareholders with notice and sufficient opportunity to cure any deficiencies in those letters.

The staff encourages both companies and shareholders to confirm receipt from the other party when communicating via email regarding 14a-8 shareholder proposals.

Conclusion

[SLB 14LB](#) indicates a shift in the staff's approach toward ESG-related matters by focusing on the impact of a proposal, rather than how such a proposal may interact with the operations or business of a company. This potentially makes it more difficult for companies to argue that environmental and social issues are irrelevant to their businesses. It also strikingly lends credence to the view that environmental and social issues are relevant to all companies and that shareholders have a right to weigh in on those issues through a shareholder vote.