Proxy Season 2018

Shareholder Proposal Decision-Making
of the Securities and Exchange Commission

Analysis and Recommendations of the
Shareholder Rights Group

SHAREHOLDER RIGHTS GROUP

www.ShareholderRightsGroup.com

The **Shareholder Rights Group** is an association of investors defending share owners' rights to engage with public companies on governance and long-term value creation.

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SUMMARY

In the 2018 proxy season decision-making, the Securities and Exchange Commission (SEC) applied new guidelines on whether to allow companies to exclude shareholder proposals from the annual proxy statement. The invitation under Staff Legal Bulletin 14I (November 1, 2017) for Board of Directors "findings" regarding the significance of proposals to companies led to a cogent outcome: **most boards of directors proved unable to demonstrate to the SEC Staff that topics of shareholder proposals were insignificant to their companies**. Instead, the new process had the counterproductive effect of **increasing legal costs for both investors and companies**.

While the Bulletin itself did not increase the exclusion of proposals, other changes in SEC practice did. Changes to interpretation of **micromanagement** interfered with the long-standing work of investors and fiduciaries to encourage improve performance on companies' climate change responses. At a time in which shareholder proposals are receiving unprecedented levels of voting support due to recognition of risks to investments, the micromanagement rulings **threaten to undermine market-wide investment objectives on an array of issues implicating corporate risk management and financial and ESG performance.**

Further, other decisions under Rule 14a-8(i)(9) excluded shareholder proposals as a result of management introducing "conflicting" proposals that merely ratified the status quo. This had the effect of **allowing corporate gamesmanship to override shareholder rights.**

To rectify these problems we respectfully recommend that the Staff issue additional guidance:

1. **Confirm that proposals requesting that a company set targets or improve its performance on significant policy issues are not considered micromanagement** unless they attempt to direct minutiae of operations.

2. **Prevent the abuse of the conflicting proposals rule**, Rule 14a-8(i)(9). Establish a rebuttable presumption against a "conflict" when a management seeks ratification of an existing policy.

3. **Provide additional detail in no-action decisions**, applying the decision-making rule to the facts and language of the proposal to clarify the decisive issues.

4. **Identify categories of proposals where Board "findings" tend to be less relevant:**

    - Where the company's externalities can impose portfolio-wide impacts for investors;
    - Where the company's activities may pose systemic risks;
    - Where the company has material gaps in its ESG disclosure.

5. **Identify categories of proposals that the Staff views as "governance" proposals** exempt from relevance and significance challenges.

6. **Clarify the need for the board section of a no-action request to include analysis of the substance and significance of the proposal**, as well as documentation regarding the content of the board process.

(1)

THE SHAREHOLDER PROPOSAL PROCESS

Rule 14a-8 administered by the Securities and Exchange Commission authorizes investors who have held more than $2000 in shares for more than a year to file proposals to be considered by fellow investors through public companies' annual corporate proxy statements.[1] This crucial right of shareholder democracy has long been a core vehicle for shareholders to engage with one another and with their companies – to monitor and assess risks, reform corporate governance and provide feedback to companies on critical issues.

Shareholder proposals are typically non-binding. They offer a flexible mechanism for investors with diverse goals and objectives to request enhanced disclosures and increased accountability of corporate boards and managers regarding emerging, neglected, or systemic long-term risks and opportunities. Many current corporate practices, such as the issuance of sustainability reports, and effective attention to long-term environmental and social risks such as climate change, have been substantially initiated and shaped by shareholder proposals.

Securities and Exchange Commission Rule 14a-8 sets forth the process for determining whether or not a shareholder proposal may appear on a corporation's annual proxy statement. Decision-making under the rule is overseen by SEC Staff through an informal process of correspondence between companies, Staff and proponents. If a company's management believe that a proposal does not meet the criteria articulated in the rule for acceptable proposals, it can write to the Staff and request that the Staff confirm that it will "take no action" if the Company omits the proposal from the proxy statement. This *no-action letter process* is determinative of the fate of many proposals each year.

Recently, SEC and external actions have had – or propose to have – a significant impact on this process. Portions of the corporate community have long resisted the proposal process. Efforts by corporate lobby groups, such as the US Chamber of Commerce, to roll back the shareholder proposal process have reached a fever pitch since the 2016 election. In 2017, the US House of Representatives passed the Financial Choice Act. Section 844 of the bill would have eviscerated the shareholder proposal process by confining the filing of shareholder proposals to only the largest institutional investors, and by making it more difficult to resubmit proposals at a company. While the prospects are dim for that bill becoming law, the pressure on the SEC from the corporate community to limit shareholder proposals has persisted, and may have helped to prompt changes in policy at the SEC during the 2018 proxy season.

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[1] 17 CFR 240.14a-8, https://www.gpo.gov/fdsys/pkg/CFR-2013-title17-vol3/pdf/CFR-2013-title17-vol3-sec240-14a-8.pdf

On November 1, 2017, the Staff issued guidance regarding the process on (Staff Legal Bulletin 14I), for the first time inviting boards of directors to weigh in on whether proposals received are "relevant" or address "significant issues for the company" pursuant to Rule 14a-8(i)(7) (ordinary business) and Rule 14a-8(i)(5) (relevance).[2]

While the invitation for board findings under SLB 14I increased expenses and uncertainties for investors and companies without changing decision outcomes, important deviations from prior practice related to *micromanagement* and *conflicting proposals*.

(2)
MICROMANAGEMENT

A. Background

The *ordinary business* doctrine under SEC Rule 14a-8(i)(7) is intended to draw a boundary against investors intruding too far into decision-making that is reserved to the board and management. The rule allows exclusion of proposals on:

> Management functions: If the proposal deals with a matter relating to the company's ordinary business operations

There is a balance between everyday operations overseen by board and management, and big strategic questions, on which shareholders are entitled to have a voice. Under Delaware law[3], shareholders have the ability to hire and fire the Board of Directors by voting directors on or off the board. In addition, federal securities law has enshrined the right of investors to advise the management and board through shareholder proposals. The shareholder proposal rule excluding "ordinary business" (Rule 14a-8(i)(7)) preserves board and management discretion on day-to-day management of the company and confines shareholder proposals to big questions.

When a proposal might be considered to address day-to-day "ordinary business," the SEC determination rests on whether the issue addresses policy questions and significant public debates. Such big questions are appropriate for shareholder deliberation**,** while the day-to-day decisions of running a company are reserved to board and management since it

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[2] https://www.sec.gov/interps/legal/cfslb14i.htm

[3] The concept of reserving oversight of ordinary business to the board and management results from state law, including Delaware law, where most companies are incorporated:

> The central idea of Delaware's approach to corporate law is the social utility of an active, engaged central management. That idea is expressed by our statute, which states the fundamental principle that the "business and affairs of the corporation are managed by or under the direction of a board of directors." It is managerial ingenuity that creates stockholder wealth through the invention and exploitation of new products, the development and more efficient provision of services, and sound financial management. Delaware corporate law recognizes that reality by investing central management with wide discretion to make business decisions and a wide choice of means to effect those decisions. Those investments facilitate creativity and risk-taking.

Leo E. Strine, Jr., Delaware Court of Chancery, The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face, European Policy Forum London, England Salisbury Square, July 5, 2005.

would be "impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting." Concisely speaking, the rules on ordinary business state that a "significant policy issue" "transcends" "ordinary business."

Thus, if a proposal appears to address matters that are part of the day-to-day conduct of the business, then in order to survive an ordinary business challenge the proposal must address a significant policy issue that bears a connection (nexus) to the company. Examples of significant policy issues recognized by the Commission and the Staff include such topics as environmental impact, human rights, climate change, discrimination, as well as virtually all issues of corporate governance.

In addition, the proposal must not be written in a form that *micromanages* the company's business. According to SEC pronouncements, a proposal may micromanage the company's business "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."

The Staff has had a long tradition of preserving the right of shareholders to file proposals that make specific requests to companies, determining if a proposal micromanages by evaluating how the request is framed. Staff has generally allowed proposals addressing issues at a ***broad policy level,*** while overly prescriptive proposals in which a proponent sought to dictate the minutiae of a firm's operations were allowed to be omitted.[4] In general, the Staff's traditional *application* of micromanagement exclusions has been sensitive to protecting the rights of investors to encourage improved corporate performance on significant policy issues.[5]

Accordingly, proposals directed toward large business strategy questions related to a significant policy issue have not been excluded as micromanagement. For instance, numerous proposals have asked companies to set greenhouse gas (GHG) emission reduction targets and timelines to respond to the challenges of climate change. These proposals have not been considered by the Staff to micromanage; instead, once the GHG reduction model proposal was treated by Staff as *not* micromanaging, companies and shareholders understood that similar outcomes would be likely at other companies.

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[4] For instance, in *Marriott International Inc*. (March 17, 2010) the proposal addressed minutia of operations – prescribing the flow limits on showerheads. In *Duke Energy Corporation* (February 16, 2001) the proposal attempted to set what were essentially regulatory limits on the company – 80 percent reduction in nitrogen oxide emissions from the company's coal-fired plant and limit of 0.15 lbs of nitrogen oxide per million British Thermal Units of heat input for each boiler excludable despite proposal's objective of addressing significant environmental policy issues.

[5] In discussing its deliberations on ordinary business, the Commission explained this tolerance for allowing proposals to address questions of business strategy in the 1998 release:

> …. in the Proposing Release we explained that one of the considerations in making the ordinary business determination was the degree to which the proposal seeks to micro-manage the company. We cited examples such as where the proposal seeks intricate detail, or seeks to impose specific time-frames or to impose specific methods for implementing complex policies. Some commenters thought that the examples cited seemed to imply that all proposals seeking detail, or seeking to promote time-frames or methods, necessarily amount to ordinary business.
>
> We did not intend such an implication. **Timing questions, for instance, could involve significant policy where large differences are at stake, and proposals may seek a reasonable level of detail without running afoul of these considerations**. [emphasis added]
> https://www.sec.gov/rules/final/34-40018.htm

B. Breaking with Prior Practice

Implementation of micromanagement during the 2018 season seems to have diverged from this approach. Of greatest concern to many in the proponent community is the Staff decision in ***EOG Resources, Inc.*** (February 26, 2018), which allowed *exclusion as micromanagement* of a proposal asking the company to set company-wide, quantitative, time-bound targets for reducing greenhouse gas (GHG) emissions and issue a report discussing its plans and progress towards achieving these targets.

Numerous companies have made commitments to science-based greenhouse gas reduction targets after receiving shareholder proposals.

This decision runs contrary to long-standing precedent, as the Staff had long found identical proposals, including at oil and gas companies, to be not excludable and to not constitute micromanagement. For instance, in *ONEOK, Inc.* (February 25, 2008) the proposal requested that the board of this oil and gas company prepare a report concerning the feasibility of adopting quantitative goals, based on current and emerging technologies, for reducing total GHG emissions from the company's operations.

The company argued the proposal related to the Company's ordinary business operations, adding that ordinary business problems should be confined to management and the board of directors, "since it is it is impracticable for shareholders to decide how to solve such problems at an annual shareholder meeting." The company's no-action request noted that its greenhouse gas emissions are related to control of "line loss" of natural gas in its pipelines, which is a complex policy issue managed on a day-to-day basis and directly related to its profitability and therefore ordinary business and micromanagement. The proponent had argued in response:

> …the mere fact that the subject matter of the Proposal is "complex" is not dispositive. In fact, the Staff repeatedly has rejected arguments that the alleged complexity of a proposal's subject matter renders it an attempt to micromanage… As the Proposal does not seek shareholder input on the analysis or resolution of complex issues – but, rather, asks nothing more than that the Board determine what is possible – the alleged complexity of its subject matter is beside the point.
>
> Finally, that the Company evaluates pipeline integrity and formulates policies relating to GHG emissions in the ordinary course of its business is of no moment. Again, the Proposal does not purport to tell the Company how to perform these – or any other – functions. It merely asks for an assessment of whether a given course of action (*i.e.,* the adoption of quantitative goals for the reduction of GHG emissions) is possible.

The Staff rejected the company's micromanagement argument and did not allow the company to omit the proposal. The same result occurred at other companies, including those in other sectors. In *Great Plains Energy Incorporated* (February 5, 2015) the proposal directed toward a utility requested that the company adopt quantitative, time bound, carbon dioxide reduction goals to reduce corporate carbon emissions, and issue a report to shareholders on its plans to achieve the carbon reduction goals it sets. As with ONEOK, Great Plains asserted that the proposal was micromanaging by potentially affecting the company's mix of energy sources.

In rejecting exclusion and following the ONEOK precedent, the Staff stated: "In our view, the proposal focuses on reducing greenhouse gas emissions and does not seek to micromanage the company to such a degree that exclusion of the proposal would be appropriate."

In the recent season, companies' assertions of micromanagement, and successful exclusions, swelled. At least eight shareholder proposals were excluded for micromanagement.[6]

Most notable was EOG Resources. The company and its board of directors asserted that the proposal micromanaged, because if it implemented the proposal's advisory request, it could require the company to alter its priorities by giving greater focus on to reducing GHG emissions. They claimed that debating such a change in company priorities is impractical for shareholders to do in an annual meeting.[7] In a break with prior practice, the Staff allowed the proposal to be excluded as micromanaging. The decision stated: "In our view, the Proposal seeks to micromanage the 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. Accordingly, we will not recommend enforcement action to the Commission if the Company omits the Proposal from its proxy materials in reliance on rule 14a-8(i)(7)."

Undermining the right to file these proposals threatens to interrupt this long-standing and productive interchange between shareholders and their companies.

[6] *Apple Inc.,* (December 21, 2017), *Deere & Company* (December 27, 2017), *JPMorgan Chase & Co*. (March 30, 2018) (two decisions), *PayPal Holdings, Inc*. (March 6, 2018), *Amazon.com, Inc.,* (January 18, 2018), *Verizon Communications Inc.,* (March 6, 2018), *EOG Resources, Inc.,* (February 26, 2018).

[7] The company clarified its argument for micromanagement in a supplemental letter:

> Implementing the Proposal **would require EOG's management to potentially prioritize quantitative emissions reduction targets over a wide variety of factors involved in oil and gas exploration and production operations** (such as geologic formation characteristics, operational considerations, rate-of-return economics and the then-current commodity price environment), **in each case at the expense of management's own judgment,** at least if such quantitative targets are to be meaningful at all.
>
> Likewise… the requested quantitative targets would potentially displace or disrupt management's judgment regarding, energy opportunity growth among other operational factors, the location, timing, and mix of production, which are at the core of EOG's daily business decisions as an exploration and production company. This is the very definition of micro-management.

The proponents replied:

> … the Proposal does not specify the target to be set by EOG. The Proposal simply asks the Company to set GHG emissions reduction targets that would align with the Company's approach to this significant social policy issue.
>
> * * *
>
> It is evident that the Proposal does not infringe on management's ability to select an appropriate mix of production methods, production regions, or production mix. Nor does the Proposal mandate what the quantitative targets could or should be, or how they should be set. The Company is free to set and accomplish these goals in whatever manner it chooses to reduce GHG emissions and protect shareholder value. The simple question of whether or not a company should adopt and report on greenhouse gas emissions reduction targets is easily understood by shareholders and does not delve to deeply into the Company's operations.

C. Undermining Clear Investor Support for Monitoring and Elevating Performance

Proposals that request companies to set and disclose targets allow investors to more clearly understand and compare companies' ambitions and performance. At the same time, setting targets on material issues like greenhouse gas emissions "provide companies with a clearly defined pathway to future-proof growth by specifying how much and how quickly they need to reduce their greenhouse gas emissions."[8] Many companies have already set science-based targets (SBTs) in order to combat climate change by reducing their GHG emissions. Currently 412 companies are making science-based climate commitments, and 106 companies have approved SBTs.[9] A significant portion of these companies have made these commitments to science-based targets after receiving shareholder proposals, and either having seen the proposals go to a vote, or having proponents withdraw the proposals in exchange for company commitments. Undermining the right to file such proposals would interrupt this productive interchange between shareholders and their companies.

The support for these proposals is clear and continues to grow. In 2017 and 2018, various companies either agreed to set SBTs or received a significant amount of shareholder support on these proposals. In 2017, proposals won 33.98 percent of the vote at Emerson Electric,[10] 33.9 percent at Nucor,[11] and 30.06 percent at Danaher.[12] In 2018, shareholder support was 41.6 percent at Fluor, 57.2 percent at Genesee & Wyoming Inc., 39.0 percent at Emerson Electric, 37.8 percent at CH Robinson, 24.6 percent at Illinois Tool,[13] and 21.44 percent at J.B. Hunt.[14] Minerals Technology shareholders withdrew their proposal asking for SBTs after the company formalized a new process to review its environmental impacts and set reduction targets.[15]

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[8] http://sciencebasedtargets.org/what-is-a-science-based-target/

[9] http://sciencebasedtargets.org/companies-taking-action/

[10] https://www.sec.gov/Archives/edgar/data/32604/000162828017001100/a2017votingresults8-kbody.htm

[11] 8-K: https://www.sec.gov/Archives/edgar/data/73309/000119312517172145/d397199d8k.htm Proxy: https://www.sec.gov/Archives/edgar/data/73309/000119312517092987/d309622ddef14a.htm#toc309622_23

[12] https://www.sec.gov/Archives/edgar/data/313616/000119312517167384/d385458d8k.htm

[13] http://www.trilliuminvest.com/shareholder-proposal/illinois-tool-works-greenhouse-gas-emissions-reduction-targets-2018/

[14] http://www.trilliuminvest.com/shareholder-proposal/j-b-hunt-greenhouse-gas-emissions-2018/

[15] http://www.trilliuminvest.com/shareholder-proposal/minerals-technologies-greenhouse-gas-emissions-reduction-2018/. Similarly, in 2018 various companies agreed to, or received significant votes from shareholders, to disclose any targets on GHG emissions. In this regard, proposals for sustainability reporting that also requested disclosure of goals received 57.2 percent of shareholder support at Middleby Corporation (http://www.trilliuminvest.com/shareholder-proposal/middleby-corporation-sustainability-report-2018/) and 49.8 percent support Acuity Brands (http://www.trilliuminvest.com/shareholder-proposal/acuity-brands-sustainability-ghg-reporting-2018). See also https://corpgov.law.harvard.edu/2018/06/27/surprises-from-the-2018-proxy-season/ for a summary of recent support for environmental, governance and social proposals.

Investor demand for climate disclosures in general and science-based targets specifically has increased substantially as the risks have become more apparent. For instance:

- Anne Simpson, Investment Director, Sustainability, at California Public Employees' Retirement System: "Mapping a company's carbon footprint, or the emissions it produces, and measuring its progress in this area is an important and growing part of our portfolio analysis. Over the long-term investors are saying to these companies that we want them to align their business strategy with the Paris Agreement."
- Ingrid Dyott, Portfolio Manager of $2.5 billion Neuberger Berman Socially Responsive Fund: "If [companies] can't show that they've got systems in place to manage their environmental challenges then it suggests that management may not be up to standard in other areas too."
- Jeanett Bergan, Head of Responsible Investment at KLP states the potential of better long term returns from setting SBTs: "If we as active owners improve the performance of CO2 intensive companies, that will help us secure better returns in the future."[16]

The support for better disclosure and target setting by individual investment firms and experts has been accompanied by increasing recognition of the need for investor disclosure on climate change, including through the recommendations of the global Task Force on Climate-Related Financial Disclosures.[17] Moreover, when it comes to the concerns raised at EOG Resources, there even more compelling evidence has emerged in recent months to demonstrate that omitting a proposal regarding failure to engage in GHG reduction goal-setting is likely to be a material issue for an oil and gas company.[18]

Thus, despite long-standing and widespread utilization by shareholders of proposals asking companies to set GHG targets, clear justification from an investment standpoint, and increasing support from a wide range of investors, the Staff decision in EOG Resources offers the prospect that each company presented with such a proposal can challenge the proposal *de novo*, and that shareholders cannot be assured that the company will not be able to claim an exception to the precedents finding this proposal appropriate for corporate proxy statements.

D. Errors of Omission are Far More Harmful to Investors Than Errors of Over-Inclusion

In deciding whether to allow exclusion of shareholder proposals, the Securities and Exchange Commission must consider its clearly stated investor protection mission. History has shown it can be far more detrimental to that mission to make errors of omission (wrongly omitting proposals) than to make errors of inclusion. Recent history contains numerous examples of proposals that were excluded only to later prove to have been early warnings of highly material risks.

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[16] http://sciencebasedtargets.org/what-investors-are-saying/

[17] https://www.fsb-tcfd.org/

[18] See the recent New York Times article: The Natural Gas Industry Has a Leak Problem http://nyti.ms/2lqOsHm?

As early as 2000, shareholders recognized the risk posed by subprime lending, a practice which contributed to the mortgage crisis of the mid-2000s. The risks taken by individual financial institutions generated concern amongst shareholders, who filed some on-target resolutions that were excluded by the SEC as pertaining to ordinary business.

In 2000, Household International was one of the largest subprime lenders in the United States. Predatory lending in the subprime market was of growing concern to some investors as it became clear that borrowers were unable to repay these loans and were losing their homes. Subprime lending was already beginning to indicate the financial risks that would ultimately produce the housing bubble, the mortgage meltdown, and the financial crisis. There had already been bankruptcies of several large subprime lenders over the course of 1998-99.

Shareholders of Household International brought a resolution in 2000 citing interest in predatory lending amongst policy makers on the national and state level, and large settlements with lenders already being required by the FTC. The shareholder resolution filed in 2000 requested the establishment of a committee of outside directors to develop and enforce policies to ensure "that accounting methods and financial statements adequately reflect the risks of subprime lending and … employees do not engage in predatory lending practices" and issue a report to shareholders. In *Household International,* (March 13, 2000) the Staff determined that this proposal could be excluded as ordinary business. These shareholders who had the foresight to sound the alarm were rebuffed, and by 2002 Household International subsequently settled a groundbreaking case with 20 state attorneys general over predatory lending (Iowa DOJ News Release, October 11, 2002). A significant opportunity to alert shareholders and boards of directors to the problems and risks posed was barred by the SEC decision.

By 2007 it became clear that subprime lending posed systemic risk, and as subprime lending burst the housing bubble, several proposals at *Washington Mutua*l (February 5, 2008), M*errill Lynch* (February 19, 2008; February 20, 2008), KB Home (January 11, 2008), and *Lehman Brothers* (February 5, 2008) were excluded. Even as the market was in early signs of collapse, these proposals were considered by the SEC to be excludable, regardless of the fact that these risky practices were at the time clearly causing systemic risk. In fact, the collapse of Lehman Brothers, one of the hedge funds whose shareholders submitted a proposal, was a uniquely catastrophic event in the crisis. Lehman's shareholders were denied their opportunity to engage with the company in 2007 *Lehman Brothers* (February 5, 2008). Lehman collapsed in September 2008.

Experience shows that errors in omission of shareholder proposals are far more harmful to investor protection and company interests than errors of over-inclusion. The no-action process should be guided by this.

In contrast, when the SEC allows shareholders to do their work through the shareholder proposal process, many smaller and institutional investors attentive to early warning signs can spur management and board attention where due. To cite one example, some religious pension fund shareholders that were in some instances able to flag subprime lending issues in 2000 through the shareholder proposal process, assisted some companies that cooperated to avoid the disastrous fate met by numerous big banks. As Attorney Paul Neuhauser has noted although a number of other proposals on subprime lending:

> survived company challenges at the SEC, [but] they never appeared on any proxy statement because the recipients in each case agreed to a change of policy with regard to predatory lending to subprime borrowers (in one case the securitizer called the proponent the day after it lost its no-action request at the SEC to request a meeting and dialogue on the matter and at the meeting agreed to alter its due diligence process with respect to loans purchased for securitization). Notably, the securitizers that received the precatory proposals and changed their practices have not been among those who have suffered during the recent unpleasantness.[19]

To cite one of many other errors of omission in Staff decisions, ordinary business exclusions were allowed for a proposal at Wells Fargo inquiring about whether the employee compensation system was exposing the bank or economy to excess risk. *Wells Fargo* (February 14, 2014) These proposals were early warnings of what later proved a scandalous and costly crisis due to fraudulent cross selling spurred by employee incentives. To date, Wells Fargo has paid at least over a $1 billion in fines and penalties for its reckless risk management and employee incentives, including penalties for opening 3.5 million accounts for customers without their consent, abusive auto loan practices, and in related suits by customers and investors.

Are the Staff decisions today allowing exclusion of proposals that seek improved performance and risk management destined to be viewed in hindsight as further "errors of omission"? The strong market sentiment in favor of vigilance and engagement on multiple, high risk policy issues seems to point in that direction.

E. The New "Specific Methods" Doctrine for Micromanagement Raises Additional Concerns

Later in the proxy season, decisions explicitly excluded proposals as micromanaging by ***"seeking to impose specific methods for implementing complex policies*."** Our research indicates that this specific phrase, drawn from the 1998 Release,[20] has never been expressly applied or quoted as a rationale of prior Staff decisions.

The SEC invoked the specific methods language first at J.P. Morgan Chase for two different proposals excluded as micromanaging. *JPMorgan Chase* (March 30, 2018). One proposal related to financing of tar sands production of oil and gas, with its related climate and financial risks.[21] The second proposal requested that the Company establish

[19] Paul Neuhauser, comment letter to SEC, Oct. 2, 2007, https://www.sec.gov/comments/s7-16-07/s71607-476.pdf

[20] The 1998 Release involved the recasting of the shareholder proposal rule into the current Q&A format, and also considered and rejected amendment to the resubmission threshold.

[21] The proposal sought a report on the reputational, financial and climate risks associated with project and corporate lending, underwriting, advising and investing for tar sands production and transportation, and specified that the report should include assessments of:

- Short- and medium-term risk of portfolio devaluation due to stranding of high-cost tar sand assets.
- Whether the Company's tar sands financing is consistent with the Paris Agreement's goal of limiting global temperature increase to "well below 2 degrees Celsius."
- How tar sands financing aligns with the Company's support for Indigenous Peoples' rights.
- Reducing risk by establishing a specific policy, similar to that of other banks, restricting financing for tar sands projects and companies.

a human and indigenous peoples rights committee.[22]

In both no-action requests, JPMorgan Chase summarized its micromanagement theory:

> The Company is a global financial services firm… As such, the Company's decisions with respect to the origination and management of specific financial products and services are central to its ability to run the business on a day-to-day basis. The Company's management invests a significant amount of time, energy and effort on a daily basis in determining how the Company will offer its products and services, while generating an attractive return to the Company's shareholders… ***Management focuses extensively on establishing appropriate standards for making products and services decisions***, which are then considered on a day-to-day basis by management and employees who are making the products and services decisions. [Emphasis added]

At issue in both proposals was whether the standards being set by the company for its product and service decisions were adequate to the task of addressing what are clearly significant policy issues – human rights and environmental impacts. While there may be room for disagreement as to whether the wording of those proposals could have been less directive, the proponents in both instances made a compelling argument that the existing standards of the company are inadequate and leave the company exposed to significant financial, reputational and operational risks. For example, JPMorgan Chase is the largest financer of tar sands operations, ($8.4 billion in financing from 2014 to 2017), assets which many analysts believe are at high risk of becoming stranded due to climate change.

Investors often urge their companies to set targets on various issues – and thus the urgency and importance of questions about the scope of Staff's new interpretation of micromanagement.

Moreover, the proposals at JPMorgan Chase were preceded by similar successful investor engagement that led *other* companies to reform their policies. For instance, the Presbyterian Church's engagement with Phillips 66 – which has a significant investment in the Dakota Access Pipeline (DAPL) project – help to encourage the company to strengthen its human rights and Indigenous rights policies, a necessary part of respecting the Standing Rock Sioux tribe's human right to water. Similarly, As You Sow engaged with Morgan Stanley and Goldman Sachs – which provide capital to the oil, gas and mining sectors and provided financing for the DAPL project – encouraging them to review their due diligence processes for financing projects with potential community impacts. Enbridge was asked to report on the due diligence processes it uses when reviewing potential acquisitions to identify and address social and environmental risks. The resolution at Enbridge received 30 percent support.

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[22] The proposal asked that, at a minimum, the committee would adopt policies and procedures to require the Company and its fiduciaries in all relevant instances at the corporate level, project or consortium financing, ensure consideration of finance recipients' policies and practices for potential impacts on human and indigenous peoples' rights, and ensure respect for the free, prior and informed consent of indigenous communities affected by all Company financing.

Despite the market wide implications, and the presence of an issue of obvious significance to the company and society, in both instances, the decision stated that the proposals could be excluded under Rule 14a-8(i)(7):

> In our view, the Proposal **micromanages the Company by seeking to impose specific methods for implementing complex policies**. [emphasis added]

In the absence of articulated limits, this new "specific methods" doctrine applied for the first time in these JPMorgan Chase decisions will inevitably invite new challenges from companies in many of their no-action requests.

F. Proposals Seeking Company Performance Targets Apply to an Array of Significant Policy Topics

The EOG Resources decision raises obvious concern for proponents filing proposals asking companies to set performance targets related to climate change. However, efforts by shareholders to encourage companies to set targets extends to many other issue areas, therefore raising urgent and important questions about the scope of the new approach to micromanagement.

One example is the surge of investor efforts to encourage companies to improve diversity. In 2017 and 2018, numerous proposals urged companies to adopt time-bound, measurable, benchmarks for improving diversity among their boards of directors and workforces. In a similar vein, shareholders also requested that companies amend their policies towards lesbian, gay, bisexual and transgender (LGBT) workers to ensure equal treatment, hiring opportunities, and protections for the LGBT community. Many of these proposals to improve corporate diversity either request *specific methods* for addressing company policies, or request that companies set targets to improve their performance.

> In the absence of articulated limits by the Staff, the new *specific methods for implementing complex policies* doctrine will inevitably invite more efforts to undermine shareholder rights to engage with companies on improved financial and ESG performance.

As with the GHG reduction target examples, the benefits of the actions requested in these proposals are well-founded in investment rationales and evidence in the financial literature. Numerous studies have shown the many benefits diversity and nondiscriminatory policies brings to companies – not just in terms of inclusivity and fairness, but the sharp increases in profitability and productivity. For instance, McKinsey and Company have conducted studies on diversity in the work place for the past few years and have found results suggesting diversity positively affects businesses:

> More diverse companies, we believe, are better able to win top talent and improve their customer orientation, employee satisfaction, and decision making, and all that leads to a virtuous cycle of increasing returns. This in turn suggests that other kinds of diversity – for example, in age, sexual orientation, and experience (such as a global mind-set and cultural fluency) – are also likely to bring some level of competitive advantage for companies that can attract and retain such diverse talent.[23]

[23] The 2018 report notes that "Companies in the top quartile for racial and ethnic diversity are 35 percent

The successful filing of these diversity and nondiscrimination proposals has been pivotal in improving company performance on these issues 2017 and 2018. In 2018, Nike agreed to evaluate the shareholder request and meet quarterly to discuss progress. Priceline Group, Stifel Financial, KeyCorp, CVS Health Corp, Sealed Air, Ansys Corp, PNC Financial and Cigna Corp pledged to improve their diversity data and reporting. LogMeIn agreed to implement the "Rooney Rule" which states that one candidate from each applicant pool must be of a diverse gender, race, or sexual orientation. Alphabet shareholders withdrew their proposal after the appointment of Sundar Pichai to the Executive Committee of the Board. Citigroup also responded to the shareholder concerns and agreed to compile gender/race wage gap data and close the pay gap – the first big bank to do so.[24] Shareholders of Travelers voted 36.38 percent in favor of diversity reporting, 28.7 percent at First Republic Bank and 34.7 percent at Starbucks.[25] Shareholders won LGBT rights proposals at National Oilwell Varco, and SBA Communications. National Oilwell Varco agreed to clarify and update their diversity policy to include gender identity and expression, SBA agreed to publicize their equal employment opportunity and LGBT inclusive policies.

G. Affecting Large Market Stakes in Monitoring and Improving ESG Performance

These diversity and LGBT inclusive proposals that seek targets and specific changes to policy are just one example among a range of proposals addressing environmental and social performance. About a fifth of assets under professional management in the US ($8.72 trillion as of 2016) are engaged in sustainable, responsible or impact investing in the United States.[26] These investors and advisors bear responsibility, through contract and client expectations to ensure that investments are managed consistent with a client's or trustee's strategy/investment mission and, including in many cases a commitment to directly engage with portfolio companies on long-term risks and opportunities.

Moreover, index and passive investors are becoming increasingly aware that they cannot ignore, but rather must be attentive to, the systemic effects of their portfolio investments. For institutional investors whose diversified portfolios are necessarily spread broadly across the whole economy, there is growing recognition of a fiduciary obligation to consider the prospects both for longer-term performance and for systemic impacts, i.e., of the issuer's effects on the whole economy and environment. This brings heightened

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more likely to have financial returns above their respective national industry medians. Companies in the top quartile for gender diversity are 15 percent more likely to have financial returns above their respective national industry medians." The report also found that companies with less diversity tend to perform worse: "Companies in the bottom quartile both for gender and for ethnicity and race are statistically less likely to achieve above-average financial returns than the average companies in the data set (that is, bottom-quartile companies are lagging rather than merely not leading)." https://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters

[24] https://www.prnewswire.com/news-releases/citi-is-first-us-bank-to-respond-to-shareholder-pressure-to-close-gender-pay-gap-300582388.html

[25] http://www.trilliuminvest.com/approach-to-sri/shareholder-proposals/

[26] US SIF, *Report on US Sustainable, Responsible and Impact Investing Trends 2016,* pp 5. Worldwide, the assets committed to responsible, long-term investment includes over 1,400 signatories managing more than US$59 trillion that have endorsed the global Principles of Responsible Investment. United Nations Environmental Programme – Financial Initiative, *Principles for Responsible Investment: An investor initiative in partnership with UNEP Finance initiative and the UN Global Compact*, 2016, pp 4.

attention and sensitivity by the investors to issues of long-term risk, especially "low road" business strategies demonstrating efforts by the corporation to attempt to externalize costs (e.g., pollution of the atmosphere) on the rest of society. In a growing number of instances, even at large investment firms like BlackRock and Vanguard, this leads to support for shareholder proposals addressing long-term ESG issues such as climate change. [27]

Are proposals that address the wide range of systemic risks, portfolio wide risks and ESG performance now in the crosshairs of the Staff's "new micromanagement"? That would be a tragic and costly "error of omission." Without clarification, the decisions of the recent season would seem to create open season on all kinds of proposals, including diversity proposals, that ask companies to take specific action including setting targets.

H. Specific Methods for Implementing Complex Policies

The application and scope of the newly articulated "specific methods on complex policies" doctrine of micromanagement appears inconsistent with the Commission's prior statements recognizing the validity of proposals addressing large business strategy questions related to a significant policy issue.

If the Staff will exclude proposals whenever they suggest specific methods for addressing complex policies, many other long-standing shareholder proposals will also become subject to challenge. For example, shareholder proposals that address issues of executive pay have sought clawbacks – the recovery of executive pay as an effective means to hold executives accountable for misconduct – and accordingly often submit shareholder proposals requesting their companies to adopt clawback policies. In light of recent misconduct at Valeant Pharmaceuticals International, shareholders submitted a proposal requesting that the company claw back some of its executive pay incentives. Shareholders proved successful in this instance as Valeant agreed to their demands.[28] Similarly, in 2013 shareholders successfully withdrew a proposal as Wells Fargo and Co. agreed to expand its clawback policy. This proved vital in the wake of Wells Fargo's 2016 corruption scandal, where $60 million was clawed back from two top company executives.[29]

Most issues of concern to investors are likely to involve "complex policies" at their companies. Complexity is not equivalent to "adequacy."

Most issues of concern to investors are likely to involve "complex policies" at their companies. Under the securities rules, the correct avenue for evaluating such company activities as a basis for exclusion of a proposal is under Rule 14a-8(i)(10) (substantial implementation), which involves a rigorous analysis of whether the company's activities are reasonably consistent with the proposal, not under a vague determination that the company policies (however inadequate they may be) are "complex" under Rule 14a-8(i)(7).

[27] A recent state of the industry report, "Tipping Points 2016" found that financial returns and risk reduction are two primary motivators for a growing portion of capital providers to approach investment decisions on a systemic basis. http://tiiproject.com/tiiping-points-2016 (hereinafter "Tipping Points") The study collected data from a group of 50 institutions, including 28 asset owners and 22 asset managers. The report sought to assess whether and to what extent institutional investors consider and manage their impacts on environmental, societal, and financial systems, and to what extent they consider those systems' impacts on their portfolios.

[28] http://www.iccr.org/sites/default/files/resources_attachments/2017iccrimpacts04.20.17.pdf

[29] https://www.nytimes.com/2017/06/16/business/wells-fargo-clawback-fair-choice-act-shareholders.html

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BOARD OF DIRECTORS "FINDINGS"

On November 1, 2017 the SEC issued Staff Legal Bulletin 14I (SLB 14I), inviting boards of directors to submit their findings regarding whether a policy issue raised by a proposal is "significant" to the company under Rule 14a-8(i)(7) and economically relevant under Rule 14a-8(i)(5).

SLB14I raised concern among investors regarding the potential for abuse, because it effectively encouraged companies and boards to seek exceptions for companies allowing exclusion of proposals that had previously been found non-excludable. Proponents were concerned that some companies, with support from their external counsel, routinely engage in knee-jerk efforts to exclude proposals. The Bulletin could empower boards to exclude proposals, even where the proposals were addressed to significant board and management blind spots.

The Staff had made it clear in public communications that the thrust of the Bulletin was on inviting boards of directors to focus on whether a proposal addressed a topic that the board did not consider "significant" to the company.[30] In the board deliberations and submissions that followed, boards had a strikingly difficult time asserting that issues in proposals like climate change, the opioid crisis and human rights are insignificant for their companies.[31] In only one instance, Dunkin' Brands Group, Inc., the board asserted and the Staff accepted the notion, that a proposal addressed an insignificant issue for the company for purposes of Rule 14a-8(i)(5).[32]

Proponents were left with a sense that the Bulletin had caused boards of directors to overreach in asserting proposal topics were insignificant to their companies. This wasted resources of proponents and companies, attempting to revisit long-standing precedents.

Indeed, some companies' boards of directors reportedly avoided submitting such findings because they were unwilling, considering their fiduciary duties and liabilities, to make such assertions of insignificance. Notably,

[30] Matt McNair (Senior Special Counsel, Office of Chief Counsel, SEC's Division of Corporation Finance):

> …the SLB addresses nexus. If a company can demonstrate that a proposal isn't sufficiently significant to its business notwithstanding the social significance or other significance, there would be a basis I think to exclude.

It is really the board's analysis that is going to help us determine whether there's a sufficient nexus. [Note: This was McNair signaling his personal opinion as a member of the Staff, but not necessarily the official view of the SEC. Nevertheless, it represented the best available clarification of the meaning of the Bulletin.] https://www.thecorporatecounsel.net/Webcast/2017/11_14/transcript.htm

[31] For instance, from the very first company implementation of the Bulletin, in submissions by Apple Inc., it was apparent that the Board of Directors was unable to assert that issues of climate change, freedom of expression and human rights are not "significant" to the company. Instead, the Company and its board took the position that proposals addressed issues that were quite significant to the company. The board and management asserted that the company had already considered the issues and adopted complex policies for addressing the issues, such that shareholder proposals and deliberation were unwarranted and impractical.

[32] That proposal addressed the use of so-called K cups by Dunkin' Donuts as a waste generation issue. The board's findings that this was not a significant issue for the company for purposes of Rule 14a-8(i)(5) was not met by a response by the proponent. *Dunkin Brands Group, Inc*. (February 22, 2018).

the Staff rejected certain exclusion requests under Rule 14a-8(i)(7) or Rule 14a-8(i)(5) expressly because the no-action request failed to include a Board of Directors opinion (*Verizon Communications Inc.* March 7 and 8, 2018) and *General Motors Company* (April 18, 2018).

Instead, boards of directors attempted to redirect their findings to avoid asserting insignificance. In mid-November, Apple Inc. filed the first letters from any company responding to the bulletin, on proposals requesting a human rights committee, sustainability metrics linked to executive compensation, a report on freedom of expression and setting net zero greenhouse gas goals. Notably, in the description of findings by Apple's Board of Directors, the board was unable to assert that the issues behind the proposals were not "significant" for the company. Instead, the board claimed that it had complex policies in place to address the subject matter and therefore the proposals were not appropriate for shareholder deliberation.[33]

As the season evolved, it became clear that it is difficult for most companies to successfully assert that the issues raised in proposals are "insignificant" to their companies. A number of such assertions by companies were rejected by the Staff based on the lack of compelling analysis demonstrating insignificance to the company and its shareholders.

Lack of Clarity in the Bulletin About Degree of Substantive Analysis Required

The Staff Legal Bulletin is ambiguous in its description of how the board should address the subject matter of a proposal, including the merits. The bulletin only states that the board section of a no-action request should include "a discussion that reflects the board's analysis of the proposal's significance to the company."

It is not surprising therefore, that most of the Board findings lacked specific analysis of the merits or substance of proposals. Even where the board findings have asserted "insignificance" or "irrelevance," they have seldom gone into a direct analysis of the substance of the proposal.

Reviewing the no-action correspondence at the end of the season, it became apparent that the submissions from boards of directors were variable. Some boards submitted relatively detailed substantive discussions; but others appear to follow a checklist script provided by a corporate secretary or external counsel describing the minimum requirements that might be implied under the Bulletin. Some of these

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[33] While two of the Apple proposals were resolved under other rules, two of the proposals were resolved by the Staff based on the board findings. The Staff declined to exclude the proposal to establish a board human rights committee related to ordinary business, noting that "We are unable to conclude, based on the information presented in your correspondence…that this particular proposal is not sufficiently significant to the Company's business operations such that exclusion would be appropriate. As your letter states, "the Board and management firmly believe that human rights are an integral component of the Company's business operations." Further, the board's analysis does not explain why this particular proposal would not raise a significant issue for the Company.

However, a second proposal that asked the company to set a target date to eliminate its carbon footprint did not meet the same fate. The staff allowed the proposal to be excluded based on micromanagement, noting, "In our view, the Proposal seeks to micromanage the 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."

"checklist" responses omitted any substantive discussion of the specifics of the proposal, and merely described the board process in a way that was opaque to both investors and the Staff.

The Staff found numerous instances where board findings were submitted, but failed to provide adequate explanation, counterargument or data to demonstrate the insignificance of the proposal to the company. *Entergy Corporation* (March 14, 2018) distributed energy strategy for climate change, *Goldman Sachs* (March 12, 2018) lobbying disclosure, and *AmerisourceBergen Corporation* (January 11, 2018) opioids crisis.[34]

Proponents were left with a sense that the Bulletin had caused boards of directors to overreach in asserting that their companies were exceptional – that proposals which have long been found to represent a significant issue were insignificant to their companies. In the course of the process, substantial resources were wasted by both proponents and companies revisiting long-standing precedents. In practice, where there has been long-standing acceptance of proposals supported by staff decisions at numerous companies there is and should be a high burden of persuasion on the board to claim an exclusion.

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CONFLICTING PROPOSALS

Rule 14a-8(i)(9) provides that a proposal may be excluded when it "directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting." During the 2018 season, the Staff interpreted this provision in favor of allowing seven companies to exclude proposals to lower the number of shareholders required to call a special meeting by substituting – after the fact – a management proposal that merely ratified the company's existing higher threshold.

This power to call a Special Meeting is typically of interest to shareholders when there is a major governance issue at the company that must be attended to before the next annual meeting. Typical examples include efforts by shareholders to elect a director with particular expertise, to dismiss certain members of the board, or to make amendments to bylaws.[35] In these instances, as well as in many others, shareholders need and deserve the right to call a Special Meeting to discuss items of import.

As a result of broad support by investors of proposals previously filed on Special Meetings, a majority of S&P 500 companies allow a group of investors to call a Special

[34] For example, in *AmerisourceBergen* where the company's board findings vaguely stated that the governance committee discussed various questions and then:

> "Upon completion of the discussion, the Governance Committee determined that, based on its understanding of the SEC Staff's views and the Governance Committee's consideration of the Company's business, there is not a sufficient nexus between the Proposal's focus on the abuse of opioid medications and the Company's core operations as a distributor of pharmaceutical products to hospitals, pharmacies and other customers, and between the Company's business of providing services and distributing pharmaceutical products, on the one hand, and opioid use, abuse and dependency, on the other." *AmerisourceBergen Corporation* (January 11, 2018).

[35] http://www.theactivistinvestor.com/The_Activist_Investor/Special_Meetings.html

Meeting;[36] however, many of these Special Meeting bylaws require 25 percent or more of the company's share ownership to request a Special Meeting. In contrast, many institutional investors, believe that 10 percent is a more appropriate threshold recognizing that this still represents a large number of shares and share owners in most instances.

During the 2018 season, shareholders filed proposals at 68 companies to lower the requisite number of shareholders required to call a Special Meeting.[37]

A principal group of shareholders with corporate governance concerns have been instrumental in addressing this issue at numerous companies.[38] At some companies, such as United Natural Foods, Inc. and Allergan, PLC, there was no right of shareholders to call a Special Meeting prior to the proposals filed by shareholders. Prompted by shareholder support for the proposals, in 2013 at Allergan and 2014 at United Natural Foods, the companies adopted bylaws that allow 25 percent of shareholders to call a Special Meeting. These efforts have had a broad impact on corporate governance throughout the marketplace. According to Institutional Shareholder Services Inc. (ISS):

> Since 2010, shareholders have voted on 183 proposals to adopt the right to call a special meeting, and 48 of these proposals received the support of majority of votes cast, with an average support rate of 43% of votes cast.

ISS also notes:

> Since 2008, the percentage of S&P 500 firms giving shareholders the right to call a special meeting has increased from 41% to 67%.[39]

In the 2018 proxy season, average support for these proposals to lower the thresholds has been roughly 41percent support, while seven proposals received majority votes.[40] Despite, or perhaps because of, the sweeping success of these Special Meeting proposals, a number of companies sought SEC support in 2018 for exclusion of the proposals. The most frequently used method of blocking votes on these proposals was to attempt to substitute a management proposal that would ratify the existing 25 percent threshold, and to claim that the existence of the management proposal represented a "conflicting" proposal, such that the shareholder proposal could be excluded.

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[36] https://corpgov.law.harvard.edu/2016/09/02/special-meeting-proposals-2/

"As of June 30, 2016, 295 companies in the S&P 500 already provided their shareholders with the right to call a special meeting outside of the usual annual meeting, as compared with 286 companies at this time last year. Among companies in the Russell 3000, approximately 1,300 provide their shareholders with the right to call special meetings."

[37] https://www.issgovernance.com/file/publications/early-look-us-proxy-season-trends.pdf?elqTrackId=7846f924a48945b3a09d4b10a6fcbde9&elq=5b1e2a2f47614e91be34274828a71922&elqaid=1192&elqat=1&elqCampaignId

[38] John Chevedden, James McRitchie, Myra Young, and Kenneth Steiner.

[39] https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf?elqTrackId=607d7315a2944ad5ba8c985c962ab84d&elq=f2c0137114f44df4b9287db6d4e4fb5d&elqaid=1083&elqat=1&elqCampaignId= (15).

[40] Webinar, Latham and Watkins, "2018 Proxy Season: Lessons Learned and Coming Attractions". June 19, 2018.

The "conflicting proposal" rule does not exist to provide an avenue for management to develop after-the-fact "counterproposals" solely for the purpose of excluding properly submitted shareholder proposals.[41] During the 2018 season, Staff seemingly surrendered to this form of company gamesmanship by excluding shareholder proposals. Although two early decisions in the season simply allowed companies to exclude the proposals,[42] six later decisions added a requirement that the company include information in the proxy noting:

> Accordingly, we will not recommend enforcement action to the Commission if the Company omits the Proposal from its proxy materials in reliance on rule 14a-8(i)(9), provided that the Company's proxy statement discloses, consistent with rule 14a-9:
>
> - that the Company has omitted a shareholder proposal to lower the ownership threshold for calling a special meeting,
> - that the Company believes a vote in favor of ratification is tantamount to a vote against a proposal lowering the threshold,
> - the impact on the special meeting threshold, if any, if ratification is not received, and the Company's expected course of action, if ratification is not received.[43]

This new approach[44] of allowing after-the-fact company ratifications to displace properly submitted shareholder proposals (even with a modicum of disclosure regarding the proposal displaced) has directly undermined the established ownership right of shareholders to file proposals for inclusion in the proxy. Ratification of the status quo in lieu of a shareholder's proposal, besides being unnecessary, means that shareholders only ever hear management's side of an issue, and undermines the ability of shareholders to request specific reforms. Voting on watered down ratification proposals eliminates the possibility of robust debate on the merits of an issue. As a precedent it invites additional corporate gamesmanship, which is highly problematic.

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[41] *Cypress Semiconductor Corp*. (March 11, 1998) denying exclusion under 14a-8(c)(9): "[S]taff notes that it appears that the Company prepared its proposal on the same subject matter in *or* significant part in response to the Mercy Health Services proposal." *Genzyme Corporation* (March 20, 2007) denying exclusion under 14a-8(i)(9). "[W]e note your representation that you decided to submit the company proposal on the same subject matter to shareholders, in part, in response to your receipt of the AFL-CIO Reserve Fund proposal."

[42] *AES Corporation* (December 19, 2017), *CF Industries Holdings, Inc*. (January 30, 2018).

[43] *eBay Inc.* (February 26, 2018), *Capital One Financial Corporation* (February 21, 2018), *ITT Inc.* (February 22, 2018), *Skyworks Solutions, Inc.* (March 23, 2018), *JPMorgan Chase & Co.* (February 26, 2018), *NetApp, Inc.* (June 26, 2018).

[44] Examples of prior Staff decisions declining to apply the rule to exclude a proposal based on a company's attempt to game the system include *Cypress Semiconductor Corp*. (March 11, 1998) denying exclusion under 14a-8(c)(9): "[S]taff notes that it appears that the Company prepared its proposal on the same subject matter in or significant part in response to the Mercy Health Services proposal." *Genzyme Corporation* (March 20, 2007) denying exclusion under 14a-8(i)(9). "[W]e note your representation that you decided to submit the company proposal on the same subject matter to shareholders, in part, in response to your receipt of the AFL-CIO Reserve Fund proposal."

Former Securities and Exchange Commission chair Mary Jo White noted that this gamesmanship was a possibility that the Staff should be attentive to preventing:

> In impartially administering the rule, we must always consider whether our response would produce an unintended or unfair result. Gamesmanship has no place in the process.[45]

From a shareholder rights perspective, the only time when a shareholder proposal potentially "conflicts" with a management proposal would be when two binding proposals are on the proxy, such that there would be a genuine legal conflict – i.e., where the two proposals, if both approved, would mandate legally contradictory requirements.

In contrast, most shareholder proposals are not binding but only advisory in nature, which obviates the possibility of legal conflict. In contrast, the rulings allowing companies to ratify existing policy have the effect of giving companies an assured way to block any corporate governance proposal submitted by shareholders.

This new approach of allowing company ratifications of the status quo to displace properly submitted shareholder proposals has negated shareholder rights.

There has been some discussion about whether it might possibly be confusing to have two proposals on a similar or the same topic with different outcomes, such as the management proposal to ratify the existing threshold and the shareholder's proposal to lower the threshold. There is nothing inherently confusing in the inclusion of these two proposals, as the company is free to explain how it will interpret and resolve any apparent conflict between a show of support on both proposals, should that occur.

The 2018 season included an illuminating demonstration of how this can work. At Spirit AeroSystems Holdings, Inc., a company that builds fuselages for the Boeing 737, a management proposal to ratify the existing 25 percent Special Meeting threshold appeared on the proxy alongside a shareholder proposal to lower the threshold to 10 percent. Shareholders demonstrated a decidedly strong preference to lower the threshold with 65 percent supporting the proposal to lower the threshold, while only 42 percent supported the ratification proposal.[46] It is clear that shareholders were not confused by these two proposals appearing side-by-side, so Staff should not succumb to management protestations to this effect.

In summary, the efforts underway and interpretations this season undermine the Rule's original intent, and allow the worst form of gamesmanship to supplant the shareholder right to file proposals on corporate governance.

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[45] https://www.sec.gov/news/speech/observations-on-shareholders-2015.html

[46] Shareholders voted 65 percent supported 10 percent threshold votes for: 63,795,634 votes against 33,500,429

42 percent supported 25 percent threshold votes for: 41,316, 966 votes against: 56,002,609

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RECOMMENDATIONS

Restoring Shareholder Rights

The 2018 micromanagement and "conflicting proposals" rulings undermined shareholder rights and threatened to disrupt long-standing, productive relationships between investors and companies on environmental and social issues, and between small and large investors on corporate governance.

SEC guidance could reduce the need for proponents to file proposals just to find out what Staff decisions mean, and help eliminate costly "kitchen sink" arguments in no-action correspondence by companies and proponents.

1. Confirm that proposals requesting action are not considered micromanagement unless they attempt to direct the minutiae of the company's operations. Continue to recognize that investors have a practical ability to request both disclosure and action on long term business strategy on ESG matters, including goal setting and increasing the scale, pace and rigor of responses to significant policy issues.

   Delineate clear limits on the new micromanagement doctrine of excluding proposals that seek specific methods for addressing complex policies. The fact that a company has complex policies in place is not a basis for exclusion of proposals. Complex policies can also be ineffectual policies. The correct path for evaluating the adequacy of company activities as a basis for exclusion is under Rule 14a-8(i)(10) (substantial implementation) not under Rule 14a-8(i)(7).

2. Prevent the abuse of Rule 14a-8(i)(9). The rule should be limited to instances where two binding proposals could not both be legally enacted simultaneously without creating a legal conflict. Advisory proposals as a general proposition, cannot conflict with management proposals. Of particular concern is recent gamesmanship by companies in which they introduced "conflicting proposals" that merely ratified the "status quo". There should be a rebuttable presumption against a "conflict" when management seeks ratification of an existing policy.

Reducing Inefficiencies and Uncertainties

Staff Legal Bulletin 14I increased uncertainty and encouraged boards of directors to waste resources asserting that their firms were exceptions to the general understanding of significance of many categories of proposals and policy issues. It encouraged all parties to make "kitchen sink" arguments that drove up companies' and investors legal costs.

3. Provide additional detail in staff no-action decisions, concisely applying the decision-making rule to the facts and language of the proposal to clarify the decisive issues in each decision for both proponents and companies. This practice could eliminate guesswork and reduce the need for proponents to file proposals to seek clarification of the decisions, and for "kitchen sink" arguments in no-action correspondence by companies and proponents.

4. Identify categories of proposals in which Board of Directors "findings" tend to be less relevant to determination of significance for purposes of Rule 14a-8(i)(7) and Rule 14a-8(i)(5). We would recommend that these include instances where the Board of Directors is in no better position than proponents or the Staff to assess significance to shareholders, such as where a proponent has documented that:

- The company's externalities can impose portfolio-wide impacts;
- The company's activities may pose systemic risks;
- The company has material gaps in its ESG disclosure.

5. Identify the categories of proposals that the Staff views as "governance" proposals that are exempt from relevance and significance challenges.

6. Clarify the adequacy of board submissions. Clarify the need for the board section of a no-action request to include analysis of the substance and significance of the proposal, as well as documentation regarding the content of the board process. The Staff should encourage boards to include appropriate specifics relative to their "findings," including backup data, minutes and records of board discussion, identifying any personnel or experts consulted by the board on the issue, or references to material reviewed or evaluated to reach their conclusion.

CONCLUSION

For the reasons outlined above, the members of the Shareholder Rights Group respectfully submit that these six recommendations are prudent and fully aligned with the Commission's mandate to protect and serve investors and the capital markets.

The Shareholder Rights Group welcomes the opportunity to further discuss these findings and recommendations with policymakers, including SEC Commissioners and Staff, as well as fellow investors, corporate counsel, and boards.

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