

SEC's Division of Corporation Finance Issues Staff Legal Bulletin 14M, Rescinds Staff Legal Bulletin 14L

February 13, 2025

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Yesterday, the Staff of the Division of Corporation Finance ("CF Staff") of the Securities and Exchange Commission (the "SEC" or the "Commission") issued Staff Legal Bulletin 14M ("SLB 14M"). SLB 14M, among other things, rescinded Staff Legal Bulletin 14L ("SLB 14L") issued in November 2021 and provided CF Staff's current views as to the application of Exchange Act Rules 14a-8(i)(5) and 14a-8(i)(7).

As discussed in this alert, SLB 14M provides that CF Staff will once again take a company-specific approach to evaluating the significance of a policy issue raised by a shareholder proposal when applying Rules 14a-8(i)(5) and 14a-8(i)(7), rather than recognizing certain issues as universally significant irrespective of its significance to the company. In addition, SLB 14M reinstates CF Staff guidance on the micromanagement consideration of Rule 14a-8(i)(7), which prior guidance was issued during the term of Chair Jay Clayton. Companies that have already submitted a no-action request this proxy season should consider submitting supplemental correspondence if SLB 14M provides a basis for a new or stronger legal argument. CF Staff will also permit companies to submit a new no-action request related to legal arguments based on SLB 14M, even if the submission deadline in Rule 14a-8(j) has passed.

BACKGROUND

Rule 14a-8(i)(5) is one of the substantive bases for exclusion of a shareholder proposal in Rule 14a-8. Often referred to as the “economic relevance” exclusion, Rule 14a-8(i)(5) permits a company to exclude a proposal that “relates to operations which account for less than 5 percent of the company’s total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company’s business.”

Rule 14a-8(i)(7), another substantive basis for exclusion, permits a company to exclude a proposal that “deals with a matter relating to the company’s ordinary business operations.” The Commission has stated that the policy underlying the “ordinary business” exclusion rests on two central considerations. The first relates to the proposal’s subject matter and the second relates to the degree to which the proposal “micromanages” the company.

As to the subject matter consideration, shareholder proposals relate to a company’s ordinary business operations if they raise matters that are so fundamental to management’s ability to run a company on a day-to-day basis that they could not practically be subject to direct shareholder oversight. However, a proposal that relates to a company’s ordinary business operations but also focuses on a significant policy issue is not excludable under this consideration as the proposal would transcend day-to-day business matters and thus be appropriate for a shareholder vote.

As to the micromanagement consideration, the exclusion analysis rests on an evaluation of the manner in which the proposal seeks to implement the subject matter of the proposal, rather than the subject matter itself. A proposal that micromanages a company is excludable under this consideration even when the proposal focuses on a significant policy issue.

SLB 14L

SLB 14L, issued during the term of SEC Chair Gary Gensler, rescinded Staff Legal Bulletin 14I (“SLB 14I”), Staff Legal Bulletin 14J (“SLB 14J”) and Staff Legal Bulletin 14K (“SLB 14K”), which were issued during the term of Chair Jay Clayton.

As to Rule 14a-8(i)(5), the “economic relevance” exclusion, SLB 14L provided that proposals raising issues of broad social or ethical concern related to the company’s business could not be excluded, even if economically insignificant to the company. In addition, CF Staff would no longer expect a board analysis for its consideration of a no-action request under this rule.

As to Rule 14a-8(i)(7), the “ordinary business” exclusion, and the subject matter consideration, SLB 14L provided that CF Staff would no longer focus on determining the nexus between a policy issue and the particular company, but would instead focus on the societal significance of the issue. Thus, it was no longer relevant whether the policy

issue was significant for the company receiving the proposal. In addition, CF Staff would no longer expect a board analysis for its consideration of a no-action request under this rule.

As to Rule 14a-8(i)(7) and the micromanagement consideration, SLB 14L narrowed the exclusion. In SLB 14L, CF Staff provided that they would take a “measured approach” to evaluating micromanagement arguments, focusing on the level of granularity sought by the proposal and whether it inappropriately limited management’s discretion. In making this determination, CF Staff would also consider the robustness of public discussions and analysis on the topic, the availability of data and investor sophistication generally. For example, SLB 14L provided that climate change proposals suggesting targets or timelines could not be excluded so long as management had discretion on how to achieve such goals.

The issuance of SLB 14L is viewed as a cause of a major reduction in no-action requests during 2022 and 2023, and a historically low rate of successful no-action requests (38% in 2022 compared to an average of 68% from 2015-2021), though these numbers have since returned to more typical levels.

SLB 14M

As noted above, SLB 14M rescinds SLB 14L and provides CF Staff’s current views as to the application of Rules 14a-8(i)(5) and 14a-8(i)(7).

As to Rule 14a-8(i)(5), SLB 14M generally restates the guidance previously provided in SLB 14I; thus CF Staff will again focus on a proposal’s significance to the company’s business. As a result, a proposal that raises issues of social or ethical significance may again be excludable if the proposal is not significantly related to the company’s business, and the analysis is dependent upon the particular circumstances of the company receiving the proposal.

As to Rule 14a-8(i)(7), SLB 14M generally restates the guidance previously provided in SLB 14J and SLB 14K, including by reinstating the guidance on the micromanagement consideration contained in these two SLBs. Regarding the subject matter consideration of this rule, CF Staff will again take a company-specific approach in evaluating the significance of a policy issue, rather than focusing solely on whether a proposal raises a policy issue with broad social impact. Thus, CF Staff’s analysis will again focus on a proposal’s significance to the company’s business when it otherwise relates to operations that account for less than 5% of its total assets, net earnings and gross sales.

As to the micromanagement consideration, a proposal will again be excludable if it probes too deeply into matters of a complex nature by involving intricate details or imposing time frames or methods for implementing complex policies.

One major difference between SLB 14M and SLBs 14I, 14J and 14K is that SLB 14M makes clear that CF Staff does not expect a no-action request to include a discussion of the board’s analysis of the policy issue raised and

its significance to the company (though such an analysis will be accepted if the company believes it will help CF Staff analyze the no-action request).

SLB 14M also includes some frequently asked questions. Of note, it provides that:

- (i) the guidance the CF Staff will consider when assessing the no-action request will be based on the guidance in place at the time it issues a response,
- (ii) previously submitted requests are not required to be resubmitted, but if a company wishes to raise new legal arguments in light of SLB 14M, the arguments should be submitted as supplemental correspondence, and
- (iii) a company may submit a new no-action request even if the deadline prescribed in Rule 14a-8(j) has passed, provided that the legal arguments made in the new request relate to the new guidance in SLB 14M.

Finally, SLB 14M largely restates portions of SLB 14L related to procedural exclusions for proposals under Rule 14a-8(d), including guidance related to the use of images in shareholder proposals, proof of ownership letters and the use of email for communications between proponents and companies. In a departure from SLB 14L, however, SLB 14M clarifies that Rule 14a-8 does not require a company to send a second deficiency notice to a proponent for purposes of identifying defects in a proof of ownership letter received by the company after the company sends an initial, adequate deficiency notice.

If you have any questions regarding this client alert, or would like assistance in responding to a shareholder proposal, please contact any of the following attorneys or the Willkie attorney with whom you regularly work.

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