

SEC policy shift expected to increase power of shareholders moving for action on ESG

Takeaways

- Policies that thwarted shareholder ESG proposals reversed
- New policies protecting socially responsible initiatives are being implemented
- Broad-scope issues like climate change may be included alongside core business activity
- Concept of shareholder micromanagement narrowed

With proxy season in full swing, the U.S. Security and Exchange Commission's new view of shareholder proposals could significantly bolster environmental, social and governance (ESG) causes that shareholders want to promote.

SEC's newer approach to reviewing shareholder proposals will make it harder for companies to block shareholder initiatives, including ones to reduce carbon emissions and promote social responsibility.

It is important for businesses to understand this SEC policy shift, even as they continue to learn about the proposed climate disclosure rule, which we discussed ([Scope 3 emissions](#) and for [Scope 1 and 2 emissions](#)) last month.

Earlier policy discouraged activism

SEC rule 14a-8 (17 C.F.R. § 240.14a-8) relates to shareholder proposals. Under rule 14a-8, a company must include shareholder proposals on its proxy statement for consideration at annual and special meetings. Under certain circumstances, however, rule 14a-8 provides that a company may exclude a shareholder proposal from the proxy statement. Two common exclusions that companies rely on to exclude shareholder proposals are the ordinary business exclusion in section 240.14a-8(i)(7) and the economic relevance exclusion in section 240.14a-8(i)(5).

Under the Trump administration, the SEC issued a series of bulletins relating to the interpretation of the ordinary business and economic relevance exclusions. The guidance in the bulletins effectively imposed restrictions on shareholder proposals aimed at influencing corporate strategies related to broad social issues like climate change and corporate responsibility. The SEC at the time said the restrictions were intended to safeguard against shareholder micromanagement and ensure that proposals were economically relevant to the company's business. Therefore, the SEC focused on the nexus between the policy issue raised in the proposal and the company.

Overall, these interpretations of the ordinary business and economic relevance exclusions complicated shareholder efforts to advance proposals related to ESG issues, including climate change. The interpretations also effectively shut down shareholder proposals related to emissions targets, which were seen as too prescriptive (i.e., micromanagement).





The SEC will consider more proposals that relate to broad societal issues (including ESG) as significant to a company even if they're not necessarily related to the company's business.

Updated SEC policy reverses exclusions, hits definitions

On November 3, 2021, the SEC issued a legal bulletin (November Bulletin) that rescinded the Trump-era policies on the ordinary business and economic relevance exclusions summarized above.

Ordinary course exclusion and micromanagement

Regarding the ordinary business exclusion, the November Bulletin said the prior policy put “undue emphasis ... on evaluating the significance of a policy issue to a particular company at the expense of whether the proposal focuses on a significant social policy.” According to the SEC, this led to inconsistencies in the agency's exclusion determinations.

The November Bulletin thus provides that the SEC's policy on the ordinary business exclusion will focus on the social policy significance of the issues in the shareholder proposal. Staff have been instructed to consider whether the shareholder proposal raises issues associated with broad social impact. If yes, the SEC may no longer readily dismiss the shareholder proposal under the ordinary course exclusion.

Additionally, the November Bulletin reverses the prior interpretation of micromanagement under the ordinary business exclusion. Previously, the SEC broadly construed the micromanagement concept and considered basically any limit or prescription on company or board discretion as micromanagement. This allowed the prior SEC to more readily dismiss shareholder exclusions based on perceived micromanagement. The current SEC's interpretation of micromanagement focuses on the level of granularity sought in the proposal and the extent to which it inappropriately limits the discretion of the board or management. Essentially, this approach appears to signal that the SEC intends to narrow the application of the micromanagement concept.

Economic relevance exclusion

The economic relevance exclusion under section 240.14a-8(j)(5) allows a company to exclude a shareholder 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.” The SEC previously narrowly construed this language. However, the November Bulletin states that shareholder proposals that raise broad social or ethical issues now may not necessarily be excluded even if the relevant business falls below the 5-percent threshold in the exclusion.

Recent SEC action

SEC action under the new policy already appears to be impacting objections to shareholder proposals. An energy company recently objected to a shareholder proposal that the company report on how it is responding to the risk of stranded assets and natural gas infrastructure given climate change. The company generally argued that its existing reports and climate disclosures covered the shareholder's request. The SEC disagreed and rejected the company's objection, stating that the company's existing materials and disclosures did not substantially cover the shareholder proposal. As a result, the proposal will be considered at the company's upcoming annual meeting.

Overview

- The November Bulletin reverses prior SEC policy, which limited the ability of shareholders to advance proposals concerning ESG matters like climate change and emissions targets. The SEC will now consider proposals that relate to broad societal issues (including ESG) as significant to a company even if not necessarily related to the company's business.
- Policy changes reflected in the November Bulletin narrow the application of the micromanagement concept and suggest that the SEC may not exclude a shareholder proposal that includes emissions targets for greenhouse gases generated by the company's operations and products.





- The SEC’s policy changes ahead of the 2022 proxy season may result in the advancement of more proposals that could influence company policies on ESG issues. There are already reports for the 2022 proxy season of the SEC allowing climate-based resolutions to proceed to shareholder votes over company objections.
- The SEC’s policy changes may embolden “activist shareholders” to advance proposals with more detailed or aggressive ESG milestones.

About the authors

Ben H. Patton concentrates his practice on environmental and safety regulatory and compliance matters. He routinely counsels companies in connection with major industrial accidents, internal investigations and root cause analysis, workplace culture, compliance assurance, crisis response, whistleblowers, process safety incidents, and workplace injuries and fatalities. Ben also advises companies on government agency investigations and enforcement, environmental litigation, and responses to regulatory rulemakings.

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