

# INSIGHTS

THE CORPORATE & SECURITIES LAW ADVISOR

Volume 27 Number 12, December 2013

## CORPORATE GOVERNANCE

### The SEC and Sustainability Shareholder Proposals

*The SEC recently has encouraged “sustainability” shareholder proposals under Rule 14a-8. It is important for manufacturers to adapt to this new environment.*

**By Patrick Daugherty and Daniel Pieringer**

Concern about the environmental impact of manufacturing is growing. The long-term success of a manufacturer may depend, in part, on its strategies for sustainability. But these strategies are not created and perpetuated in a vacuum. Increased shareholder activism regarding sustainability has the potential to affect any public company’s approach, and recent changes in how the SEC looks at shareholder proposals on this issue are giving shareholder activists a bigger voice. Manufacturers need to consider taking appropriate steps to adapt to the new environment.

#### Rule 14a-8 Background

Public companies answer to their shareholders in numerous ways. One way in which shareholders

---

Patrick Daugherty is a partner, and Daniel Pieringer is an associate, at Foley & Lardner LLP in Chicago, IL. The authors acknowledge editorial assistance from their colleagues Steve Cade and Aubrey Refuerzo at Foley & Lardner.

request company action is by making proposals in accordance with Rule 14a-8 adopted under the Securities Exchange Act of 1934. Under Rule 14a-8, a shareholder that satisfies the rule’s prerequisites can submit a “recommendation or requirement that the company and/or its board of directors take action” for inclusion in the company’s proxy materials.<sup>1</sup>

Not every proposal, however, results in a shareholder vote. By objecting to the SEC, companies can exclude proposals on one or more of the grounds stated in Rule 14a-8. Companies can exclude recommendations that are “vague and indefinite,”<sup>2</sup> for example, or that arise from “personal grievance[s].”<sup>3</sup> The most common ground for exclusion allows a company to keep a proposal out of its proxy materials if the proposal “deals with a matter relating to the company’s ordinary business operations.”<sup>4</sup>

#### Sustainability Proposals

Shareholder proposals cover a broad scope of topics, ranging from diversity to poison pills to voting processes. Increasingly, they deal with “sustainability,” which suggests acting responsibly and adhering to environmental, social, and economic policies so as to create a sustainable future. In 2012, overall shareholder proposal submissions grew by more than 6 percent over the year earlier, and the trend is continuing.<sup>5</sup> Environmental and

---

social policy proposals were the largest category, with almost 40 percent of all proposals.<sup>6</sup> Thirty-five percent of the environmental and social policy proposals sought enhanced disclosure and company action regarding environmental sustainability.<sup>7</sup> Furthermore, sustainability proposals are getting increased voting support among shareholders. Environmental and social policy proposals received about 20 percent support from shareholders in the 2013 proxy season, or twice the level of support they received in 2005.<sup>8</sup>

---

***More shareholder sustainability proposals are making it into proxy statements.***

---

Historically, companies were able to exclude most of these proposals from their proxy materials by claiming that the proposals dealt with the company's ordinary business operations. The Staff granted a company's request to exclude a proposal whenever the company could show that it called for an "evaluation of risk."<sup>9</sup> According to the then-Staff's analysis, such an evaluation amounted to ordinary business operations, so exclusion was typically granted.<sup>10</sup> While the Staff clarified in a 1976 release that proposals dealing with significant policy issues could not be excluded,<sup>11</sup> "evaluation of risk" proposals did not fall in that category.

Those days, however, are over. In 2009, the Staff changed its analysis of proposals requiring an evaluation of risk.<sup>12</sup> A Staff Legal Bulletin issued that year stated that the Staff's position before 2009 resulted in "the unwarranted exclusion" of proposals that relate to evaluation of risk but that focus on significant policy issues.<sup>13</sup> Instead, the Staff would look at the subject matter of the risk and whether that subject matter involves a matter of ordinary business to the company.<sup>14</sup>

The pre-2009 analysis allowing companies to exclude proposals calling for risk assessment

made it easy to exclude sustainability proposals because, as the Staff noted, "most corporate decisions involve some evaluation of risk."<sup>15</sup> The new analysis raised the bar significantly. If the subject matter "transcends day-to-day business matters and raises policy issues so significant that it would be appropriate for a shareholder vote," then it generally will not be excluded under Rule 14a-8(i)(7) as long as there is a "sufficient nexus" between the nature of the proposal and the company.<sup>16</sup>

As a result, more shareholder sustainability proposals are making it into proxy statements. In a no-action letter released by the Staff on January 15, 2010, PPG Industries, Inc., which manufactures paints, coatings, glass, and optical products, was not allowed to exclude a proposal requesting a report on "how the company ensures that it responsibly discloses its environmental impacts in all of the communities in which it operates."<sup>17</sup> Later that year, Chesapeake Energy Corporation, America's second-largest producer of natural gas, was required to include in its proxy materials a proposal requesting a sustainability report because the proposal "focused primarily on sustainability."<sup>18</sup> In 2012, the Staff denied Cleco Corporation's request to exclude a proposal requesting a sustainability report from the energy services company. That proposal narrowly missed adoption, with 45.6 percent of the shareholder vote favoring the proposal.<sup>19</sup>

Proponents of proposals requesting disclosure about matters relating to climate change have been particularly successful in avoiding exclusion. Earlier this year, PNC Financial Services Group was unable to exclude, under Rule 14a-8(i)(7), a proposal requesting the company's "assessment of the greenhouse gas emissions resulting from its lending portfolio and its exposure to climate change risk in its lending, investing, and financing activities."<sup>20</sup> Although PNC is not itself a manufacturer, this decision and the other recent ones like it mark a significant shift—one that has had and will continue to have an impact on manufacturers.<sup>21</sup>

---

Despite the apparent transition toward requiring that more shareholder proposals be put to a vote, some proposals dealing generally with sustainability still are excluded. For instance, the Staff allowed FLIR Systems, Inc., a thermal imaging systems manufacturer, to exclude a proposal requesting a report on the company's strategies on energy use management because the proposal focused not on sustainability but rather on "FLIR's strategies for managing its energy expenses."<sup>22</sup> This decision indicates that, while sustainability is considered a significant policy issue by the Staff, cost reduction is not. Similarly, a proposal requesting a report on an energy utility's use of renewable energy was excluded due to its focus on the company's "choice of technologies," and another proposal requesting a summary of plans to eliminate the release of mercury from a global manufacturer's industrial and consumer products was excluded due to its focus on "product development."<sup>23</sup>

### **Adapting to the Current Environment**

Given the current landscape, manufacturers face more, and more expensive, demands from activist shareholders than they faced before, but management is not without recourse.

One way to respond to shareholder proposals in this area is to address shareholder concerns proactively. While traditionally the "ordinary business operations" rationale has been the most common ground for exclusion, a company also can exclude a proposal under Rule 14a-8(i)(10) on the basis that it has "substantially implemented" the proposal's objectives.<sup>24</sup> The question of whether a company has substantially implemented a proposal depends upon whether its particular policies, practices, and procedures compare favorably with the guidelines of the proposal.<sup>25</sup> If shareholders want something a company reasonably can provide, then the company prudently might get out in front of the official requests, satisfying the shareholders and saving the company time and money.

Relative to this approach, one option is to open a dialogue with shareholders before they make formal proposals. If a company receives a letter expressing concern about environmental sustainability from a shareholder or advocacy group that focuses on this area, the company should consider meeting with the proponent.<sup>26</sup> When companies open a dialogue about the issues that matter to shareholders, the ensuing process can result in a mutually agreeable resolution before a formal shareholder proposal is submitted.

---

***One option is to open a dialogue with shareholders before they make formal proposals.***

---

Finally, if a company does receive a formal shareholder proposal, the company should consider the following two courses of action. First, a company can explore procedural grounds on which to exclude the proposal. Sometimes a proposal fails simply because the shareholder that made the proposal does not own enough stock, or has not owned the stock for the requisite period of time, to qualify and take advantage of the shareholder rights provided by Rule 14a-8.<sup>27</sup> In such a case, the company can ask the Staff to exclude the proposal, and at least postpone the issue.

If the proposal cannot be excluded on procedural grounds, however, or if the shareholder cures the procedural problem, there remains the option to negotiate. Engaging in a dialogue with the shareholder after a formal proposal has been received can be better than adding the proposal to the company's proxy materials because the decision can be made, more or less, on consensual terms, without turning shareholders into adversaries by filing an exclusion request with the SEC.

Negotiating to an agreed-upon result, thereby mooting the proposal, is a common result in this particular area of shareholder activism. An increasing number of proposals are being

---

withdrawn based on negotiation. Environmental and social policy proposals have the highest percentage of proposals withdrawn in connection with direct dialogues between the company and its shareholders.<sup>28</sup>

## Conclusion

As companies realize that there is market value in transparency, they are becoming more willing to provide disclosure on matters dealing with sustainability.<sup>29</sup> This is a realization that can benefit manufacturers in the near term as shareholder activism continues to increase and the SEC continues to favor inclusion of sustainability shareholder proposals. Companies should be ready to meet the movement head-on. By being aware of these developments and being open to dialogue about shareholder sustainability concerns, manufacturers can save time and money, maintain strong relationships with their shareholders, and position themselves well for long-term, sustainable success.

## Notes

1. Rule 14a-8.
2. Rule 14a-8(i)(3); SEC Staff Legal Bulletin No. 14B (Sept. 15, 2004), available at <http://www.sec.gov/interps/legal/cfslb14b.htm>.
3. Rule 14a-8(i)(4).
4. Rule 14a-8(i)(7).
5. Gibson, Dunn & Crutcher LLP, Shareholder Proposal Developments During the 2013 Proxy Season, available at <http://www.gibsondunn.com/publications/Documents/Shareholder-Proposal-Developments-2013-Proxy-Season.pdf>.
6. Ernst & Young, Taking Flight: Environmental Sustainability Proposals Gain More Attention (2013), available at [http://www.ey.com/Publication/vwLUAssets/Environmental\\_sustainability\\_proposals\\_gain\\_more\\_attention/\\$FILE/EnvironmentalSustainabilityGainAttention.pdf](http://www.ey.com/Publication/vwLUAssets/Environmental_sustainability_proposals_gain_more_attention/$FILE/EnvironmentalSustainabilityGainAttention.pdf).
7. *Id.*
8. *Id.*
9. SEC Staff Legal Bulletin No. 14E (Oct. 27, 2009), available at <http://www.sec.gov/interps/legal/cfslb14e.htm>.
10. *Id.*
11. SEC Release No. 34-12999 (Nov. 22, 1976).
12. SEC Staff Legal Bulletin No. 14E (Oct. 27, 2009), available at <http://www.sec.gov/interps/legal/cfslb14e.htm>.
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*
17. PPG Industries, Inc., SEC No-Action Letter (Jan. 15, 2010), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2010/missionaryoblates011510-14a8.pdf>.
18. Chesapeake Energy Corp., SEC No-Action Letter (April 2, 2010), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2010/calstrs040210-14a8.pdf>.
19. Cleco Corp., SEC No-Action Letter (Jan. 26, 2012), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/greencentury012612-14a8.pdf>; Betty Moy Huber, Davis Polk & Wardwell LLP, Sustainability Disclosure in Public Company Annual Reports and Proxy Statements—State of Play and the Future (July 2013).
20. The PNC Financial Services Group, Inc., SEC No-Action Letter (Feb. 13, 2013), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/bostoncommon021313-14a8.pdf>.
21. PNC styles itself as the “green” bank. It is unclear whether the PNC no-action process outcome will be extended to financial institutions generally.
22. FLIR Systems, Inc., SEC No-Action Letter (Feb. 6, 2013), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/calpers020613-14a8.pdf>.
23. FirstEnergy Corp., SEC No-Action Letter (March 8, 2013), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/stateofnewyorkoffice030813-14a8.pdf>; Danaher Corp., SEC No-Action Letter (March 8, 2013), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/trinityhealth030813-14a8.pdf>.
24. Rule 14a-8(i)(10).
25. Texaco, Inc., SEC No-Action Letter (March 28, 1991).
26. “As You Sow” and the “Rainforest Action Network” are two examples of prominent and active corporate social responsibility advocacy groups.
27. Bank of America Corp., SEC No-Action Letter (Jan. 16, 2013), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/edwardstewart011613-14a8.pdf>.
28. Ernst & Young, Taking Flight: Environmental Sustainability Proposals Gain More Attention (2013), available at [http://www.ey.com/Publication/vwLUAssets/Environmental\\_sustainability\\_proposals\\_gain\\_more\\_attention/\\$FILE/EnvironmentalSustainabilityGainAttention.pdf](http://www.ey.com/Publication/vwLUAssets/Environmental_sustainability_proposals_gain_more_attention/$FILE/EnvironmentalSustainabilityGainAttention.pdf).
29. *Id.*

Copyright © 2013 CCH Incorporated. All Rights Reserved.  
Reprinted from *Insights* December 2013, Volume 27, Number 12, pages 11–13,  
with permission from Aspen Publishers, a Wolters Kluwer business, New York, NY,  
1-800-638-8437, [www.aspenpublishers.com](http://www.aspenpublishers.com).

