

Shareholder advocates say new SEC policy to prompt litigation, less transparency

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By Esther Whieldon
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Debbie Hall of Sanford, N.C., holds a sign protesting coal ash ponds outside Duke Energy's headquarters before the company's shareholders meeting in 2015. Duke is among a number of companies that have come under pressure from shareholders to report on their environmental performance and strategies.

Source: Associated Press

Shareholder advocates worry the U.S. Securities and Exchange Commission's plan to be more selective in weighing in on corporations' requests to block shareholder resolutions could tip the scales in favor of companies, prompt more litigation and generally make the process less transparent.

"Without the agency's routine written guidance, investors and companies will be in the position of having to guess the SEC's position, with negative consequences for the entire process," Josh Zinner, CEO of the Interfaith Center on Corporate Responsibility, said in a statement.

But SEC staff contends the move will enable the agency to proffer the kind of in-depth guidance for which shareholders, companies and trade groups have pressed.

The agency's Corporate Finance Division on Sept. 6 announced that beginning with the 2019-2020 proxy season, staff

will end its default practice of writing and publishing its rulings on corporations' requests to block shareholder resolutions. Moreover, the agency may opt not to weigh in at all on some requests, allowing the companies and shareholders to potentially fight it out in court instead.

SEC's Corporate Finance Division in announcing the new policy said that following the recent proxy and shareholder proposal season, "the division considered whether additional guidance or changes to its process of administering [the SEC's shareholder resolution rules] were warranted. As a result of that consideration, the staff focused on how it could most efficiently and effectively provide guidance where appropriate."

The move comes as the SEC is considering broader reforms to the shareholder resolution process, such as raising the minimum threshold of money and time a shareholder must have invested in a corporation before proposing a resolution.

In the meantime, SEC staff has come under fire in recent years over legal guidance it issued followed by a series of decisions that effectively allowed companies to exclude a number of climate change-related and other environmental or social resolutions. Stakeholders on both sides of the table pressed the agency to provide more guidance on its rules regarding shareholder resolutions.

"The SEC corporate finance staff has wavered back and forth on climate change-related proposals," said George Mason University Associate Professor J.W. Verret, who serves on the SEC's Investor Advisory Committee and previously served as chief economist and general counsel to the U.S. House Financial Services Committee. "That wavering back and forth is a symptom of a broken system," he said in an interview.

Verret contended broader reforms to the shareholder resolution process are needed. When the number of requests from companies "engulf the commission's ability to respond, maybe there's something wrong with how you define" what resolutions can be blocked from getting a vote, he added. If the definitions were a "more specific, a little more clear, then we wouldn't have this problem."

Shareholder advocates view the proxy process as a key tool for pushing companies to pay attention to emerging issues. But companies and their trade groups have pushed for reforms to the process amid an uptick in environmental and social shareholder proposals. The groups argue that some investors have shifted the focus of the shareholder proposal process from improving business performance and financial returns to advancing social or political causes.

SEC aims to offer stakeholders more clarity on rules

In a Sept. 9 interview, an SEC staffer who spoke on background said the decision to give staff more flexibility in the no-action letter process was prompted by a number of factors. First, the 35-day federal government shutdown in late 2018 and early 2019, which is the time of the year when most companies submit no-action letter requests, left staffers scrambling when they returned to work to address the requests before the companies' held their annual meetings. The furlough effectively meant staff lost one month out of the three or four months they usually need to address the requests, which prompted staff to reexamine the process.

The second reason for the change was that companies, investors and trade groups have for some time pressed the SEC to provide more detailed answers in their responses to no-action letter requests, the staffer said. By having the flexibility on whether to respond to requests, staff aims to free up its ability to discuss particular issues in greater length and detail.

"We're trying to focus our resources on where we think we can provide more value," the staffer said. Moreover, "most people will get responses, it may just be in a different form than what they've gotten in the past."

But the division does not currently have a sense of how often it may opt not to weigh in or issue a written response. Going forward, staff expects to indicate in some way online whether it agreed, disagreed or expressed no view on a company's petition and to include a link to any written letter, to the extent one may exist.

The staffer said another reason staff wants to not have to respond to every decision is because sometimes shareholder resolutions fall outside of staff's area of expertise, such as when a significant policy issue is raised. Given that a policy-related proposal to one company can mean something very different to another, staff has urged the boards of companies to weigh in more on their perspective to help staff understand the issue better.

Potential for more litigation

In the past, the agency has posted online its response to all companies' no-action letter requests. The nonbinding letters effectively indicate whether staff supports a company's argument that a particular resolution does not fall within the rules and therefore can be excluded from the annual shareholder meeting. The no-action letters also include the full record of correspondence from the company's lawyers and shareholders.

But because staff's responses are advisory in nature, a company's decision to exclude the resolution from the proxy materials, even with the SEC's blessing, could be subject to litigation. For instance, New York City Comptroller Scott Stringer in 2018 took TransDigm Group Inc. to court to force the aerospace and defense company to hold a vote on a resolution that would have it set goals for managing greenhouse gas emissions. TransDigm in January 2019 settled with the comptroller and agreed to allow a vote on the measure at its annual meeting.

A number of shareholder advocates and related groups worry the SEC's new practice will force them to take companies to court.

"Without clear written guidance from the SEC, investors and companies will face uncertainty, increased costs, and companies could even face increased lawsuits from shareholders," Ceres CEO and President Mindy Lubber said in a statement.

While larger institutions such as pension funds may be willing to pursue a case in court, smaller shareholders such as individuals may not have the financial capacity or appetite for litigation in the face of radio silence from the SEC, said Tim Smith, Director of ESG Shareowner Engagement at Walden Asset Management. And yet, those shareholders may still have some options, he said.

Shareholders can continue to negotiate with the company to either include the resolution in the meeting or pledge to take some further action related to the proposal outside of the process, Smith said. The resolution proponents could also urge other shareholders to vote against the reelection of that company's board members or they could also attend the annual meeting in person and file a floor resolution. Lastly, investors can lodge an aggressive public campaign against companies, he said.

As for overall ramifications for the broader shareholder resolution process, Lubber and Sanford Lewis, a lawyer and director of the Shareholder Rights Group, said the true impact will not be clear until the agency begins to apply the new policy.

"Through implementation, [SEC staff] may be able to show over the next year that there's no immediate problem, that they're very judicious in how they implement the language and that would certainly be good and would be a relief," Lewis said in an interview. At the same time, "looking at the policy as written gives us huge concern about the potential for that approach to be abused and also to undermine the integrity of the overall process."

Lewis is also worried that when the SEC opts to not weigh in on a no-action letter request, the move could make companies feel emboldened to exclude the measure. "Until this policy, we had an assurance that at a minimum, the SEC would back up shareholders if their proposal was compliant with the rules. Now, it seems like even if a proposal is compliant, the SEC might essentially signal selective enforcement," he said.

The SEC in its announcement indicated the parties involved should not assume a lack of a decision is a ruling against the applicable company.

"If the staff declines to state a view on any particular request, the interested parties should not interpret that position as indicating that the proposal must be included," the announcement said. "In such circumstances, the staff is not taking a position on the merits of the arguments made, and the company may have a valid legal basis to exclude the proposal."

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