Council of Institutional Investors®
The voice of corporate governance

Via Hand Delivery

June 20, 2019

William H. Hinman
Director
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street NE.
Washington, DC 20549

Re: Staff interpretation of the 14a-8(i)(7) ordinary business exclusion

Dear Mr. Hinman:

We are writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of $4 trillion. Our member funds include major long-term shareholders with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $35 trillion in assets under management.[1]

We are writing to express concern about evolving SEC Division of Corporation Finance staff (Staff) views on the "ordinary business" exclusion of shareholder proposals (Rule 14a-8(i)(7)).

The Securities and Exchange Commission (SEC or Commission) has indicated that it may consider a proposal to raise ordinary business matters (1) based on the proposal's subject matter, or (2) the degree to which the proposal seeks to "micromanage" a 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." Our concern relates to recent no-action letters from the Staff that rely on the second prong of this exclusion – the "micromanagement" or "too-complex-for-shareholders" grounds for omission. We note that the Staff discussed this prong in Staff Legal Bulletin No. 14J, in October 2018.[2]

In general, shareholders propose resolutions on matters on which there is disagreement, and there always will be some degree of complexity in any issue worthy of discussion in a shareholder

[1] For more information about the Council of Institutional Investors ("CII"), including its members, please visit CII's website at http://www.cii.org/members.
[2] "Shareholder Proposals: Staff Legal Bulletin No. 14J (CF), Oct. 23, 2018, at https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals.

proposal. Matters that are simple and obvious do not tend to be subjects of disagreement. That a proposal is debatable should not be deemed to render it too complex.

We are concerned that the Staff's "too-complex-for-shareholders" basis for omission risks (1) excluding many – or, eventually, most – proposals on subjects that shareholders care about, permitting only proposals that are "no-brainers"; or (2) haphazard SEC no-action guidance, with no clear understanding of what makes a subject "too complex" for shareholders to understand.

In fact, we think that at present both company management and investors are confused on what the Staff currently considers to be "micromanagement." The Staff's line-drawing in this area appears arbitrary. Bottom line: the Staff is substituting its judgement for that of shareholders on matters that should be debated and not excluded from the shareholder proposal process.

This is especially the case for a precatory proposal not binding on the company. The Commission for many years held that an advisory proposal does not unlawfully limit the discretion of the board or management, but recent Staff no-action decisions appear to contradict that position.

This year, the Staff agreed with omission of proposals to AbbVie and Johnson & Johnson that requested the companies to adopt policies providing that no performance metrics used for senior executive compensation be adjusted to exclude legal or compliance costs.[3] The Staff said the proposals "micromanage the company by seeking to impose specific methods for implementing complex policies," prohibiting "any adjustment of the broad categories of expenses covered by the proposal without regard to specific circumstances or the possibility of reasonable exceptions."

Well yes, each proposal does make a specific request, and the proponents no doubt are aware the proposal should not be excessively vague. This precatory proposal is not complicated, and shareholders are capable of understanding the proposal and its implications. Shareholders should be permitted to vote on whether they think this recommendation to the board is a good idea or not. The board is free to argue that the proposal is too sweeping, and that shareholders should oppose the proposal because it does not suggest the board create a policy that it would use flexibly, which evidently is the Staff's preferred position. But that is an argument for a company's board to make in the proxy statement, rather than for the Staff to use to preclude consideration of a valid proposal.

Investors have been highly concerned with use of non-GAAP metrics in executive pay targets, which is extensive and growing. CII in April petitioned the Commission to fix a loophole that permits companies to present non-GAAP metrics related to executive pay targets in the proxy statement Compensation Disclosure and Analysis (CD&A) in a manner that is unclear, avoids reconciliation, and would be deemed misleading by the SEC if presented in the same way in an

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[3] See SEC Staff response letter to AbbVie at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/ppers021519-14a8.pdf, and SEC Staff response letter to Johnson & Jonson at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/ppersetal021419-14a8.pdf

earnings release.[4] Underlying our request for better disclosure is rising concern among investors on how non-GAAP metrics are being used in setting executive pay targets.

Excluding certain costs, such as legal and compliance costs, can end up creating incentive plans that reward executives for value-destructive behavior. We would think that is an appropriate matter for shareholder concern. It is rational and reasonable for investors to ask the board to create a bright-line rule against use of non-GAAP metrics in general, or one that (as in these proposals) would oppose use of earnings or other financial metrics that specifically are adjusted to exclude legal and compliance cost. We understand that there would be valid arguments both for and against the proposal. But let both sides present their arguments.

If the Staff believes proposals on use of non-GAAP financial targets are inherently too complex for shareholders to understand, we would respectfully disagree. If the Staff is hinting that it might favor different wording, we are unsure what that would be. Perhaps the Staff prefers a proposal that requests the board *generally* use performance metrics for senior executive compensation that do not exclude legal and compliance costs, *unless specific circumstances indicate otherwise*. But we do not think that is the idea that proponents wished the board to consider, and we would view that proposal as less clear than the resolutions as submitted.

Similarly, we note Staff concurrence this year with omission of proposals at Devon Energy, ExxonMobil and J.B. Hunt Transport Services to report on greenhouse gas emission targets aligned with (or in the Hunt proposal "taking into account") goals of the Paris Agreement on climate change.[5] The Staff said that the proposal to J.B. Hunt "seeks to micromanage the company by probing too deeply in matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."

We entirely disagree that shareholders as a group would be unable to express a coherent view on these proposals that should be considered by these companies' boards. While climate change and greenhouse gas emissions do pose complicated questions, investors have devoted considerable attention to the issue, arguably one of the preeminent public policy matters of our time involving material risks and opportunities for public companies.

There are multiple efforts by investors to promote disclosure on carbon emissions and a clean energy transition. To take just one: More than 300 investors with more than $33 trillion in assets under management have signed onto Climate Action 100+, which seeks to promote company actions consistent with the Paris Agreement. We also would suggest that the Paris Agreement is defining the world's response to climate change, and it is more than reasonable to argue that missing the Paris goals creates huge risk for investors.

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[4] See Council of Institutional Investors, Petition for Rulemaking Regarding Disclosures on Use of Non-GAAP Financials in Proxy Statement CD&As, April 29, 2019, at https://www.sec.gov/rules/petitions/2019/petn4-745.pdf.
[5] See SEC Staff response letter to Devon at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/georgegundrecon040119-14a8.pdf; to Exxon at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/nyscrf040219-14a8.pdf; and to Hunt at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/trilliumasset021419-14a8.pdf.

A March 8 letter to the Staff from investors with $9.5 trillion in assets under management strongly urged the Staff to permit the Exxon shareholder proposal to go to a vote. The investors noted that a 2017 proposal asking for analysis related to the 2ºC scenario as stated in the Paris Agreement was supported by holders of 62.3% of Exxon shares. The investors said that "the issues of climate change and GHG emissions have become increasingly urgent as their impact on our portfolios and on society becomes more tangible."

With regard to the each of the Devon and Exxon proposals, the Staff said that, "by imposing this requirement, the Proposal would micromanage the Company by seeking to impose specific methods for implementing complex policies in place of the ongoing judgments of management as overseen by its board of directors."[6] The Staff used the word "impose" twice in this sentence, but that doubling-down does not obviate the fact that the precatory recommendation would not impose anything on the company, other than for management to place the item on its proxy card and include the proposal and supporting statement in the proxy statement. These are requests to the boards on a major public policy issue, not directives.

Nor, for that matter, do the proposals require "specific methods." The proposals thread the needle between vagueness and recommending overly specific policies. They do not suggest specific goals or a timetable, but rather frame a general structure, well understood by investors, for disclosure of goals.

We would agree with comments submitted to the Staff by an attorney for the proponents of the proposal to Exxon:

> The Proposal does not involve intricate or unreasonable details or methods. The request to develop short-, medium- and long-term goals does not impose a specific time frame or otherwise direct the minutia of the business, but is framed based on reasonable methods that have long been acceptable in Staff decisions. The Proposal is framed on broad parameters through which investors, board, and management can reasonably assess whether the scale and pace of Company efforts are aligned with the temperature increase containment goals.[7]

In our view, the recent Staff no-action letters appear to disregard elements stated by the Commission in 1998 in its "Final Rule: Amendments to Rules on Shareholder Proposals."[8] In that rulemaking, the SEC wrote:

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[6] "This requirement," as stated by the Staff, is "to require the company to adopt targets aligned with the goals established by the Paris Climate Agreement."
[7] Sanford J. Lewis, Letter Re: Shareholder Proposal to Exxon Mobil Corporation, March 8, 2019, at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/nyscrf040219-14a8.pdf (see 17th page of Staff's decision and attached compilation of correspondence).
[8] See SEC, Final Rule: Amendments to Rules on Shareholder Proposals (May 21, 1998), at https://www.sec.gov/rules/final/34-40018.htm

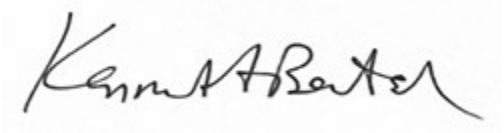
> Some commenters [on the proposed rule change] thought that the examples cited seemed to imply that all proposals seeking detail, or seeking to promote time-frames or methods, necessarily amount to 'ordinary business.' We did not intend such an implication. Timing questions, for instance, could involve significant policy where large differences are at stake, and proposals may seek a reasonable level of detail without running afoul of these considerations.

We would submit that the Devon, Exxon and Hunt proposals request a reasonable level of detail, necessary to make the proposals substantive and not excessively vague. Moreover, there clearly are "large differences" at stake in the proposals. For example, Exxon had not established goals for reducing companywide greenhouse gas emissions consistent with the Paris goals on any timeframe.

In 1998, the Commission described the underlying policy of the ordinary business exclusion as "to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting….Certain tasks are so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight."[9] We would submit that the Devon, Exxon and Hunt proposals provide a completely practical way for shareholders to express a collective view on a critical matter on which boards should consider the views of shareholders. The wording of each proposal appears fully appropriate to us.

CII urges the Staff to revisit its approach to Rule 14a-8(i)(7) so that it is more consistent with the language and intent of the underlying rule. We would be happy to answer any questions, and would welcome the opportunity to meet to discuss CII's concerns.

Sincerely,



Kenneth A. Bertsch
Executive Director

Jeffrey P. Mahoney
General Counsel

cc: Chairman Jay Clayton
Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Peirce
Commissioner Elad L. Roisman

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[9] *Id.*