Washington and Lee Law Review

Volume 76 | Issue 3 Article 5

11-7-2019

From Public Policy to Materiality: Non-Financial Reporting, Shareholder Engagement, and Rule 14a-8's Ordinary Business Exception

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I. Introduction

In 2017, shareholder proposals urging corporate boards to report on their climate-related risk made headlines when they earned majority support from investors at ExxonMobil, Occidental Petroleum, and PPL.[1] The key to this historic vote was the support of Blackrock, State Street, and Vanguard, which broke with management and cast their votes behind the proposals.[2] The 2018 proxy season saw several more climate-related proposals earn majority support, and in 2018 and 2019 record numbers of proposals were withdrawn after the companies agreed to respond to shareholders' requests.[3]

The highly visible 2017 proposal illustrates a number of key aspects of shareholder activism today. The first is the mainstreaming of shareholder activism from its origins in the civil rights and socially responsible investment movements to a point where the largest institutional investors are integrating "environmental, social, and governance" (ESG) or "non-financial" factors into their voting and investment policies.[4] Second, the

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1. *See* Steven Mufson, *Financial Firms Lead Shareholder Rebellion Against ExxonMobil Climate Change Policies*, WASH. POST (May 31, 2017), https://www.washingtonpost.com/news/energy-environment/wp/2017/05/31/exxonmobil-is-trying-to-fend-off-a-shareholder-rebellion-over-climate-change/ (last visited Sept. 23, 2019) (reporting support of over sixty percent of shareholders on the Exxon vote and over sixty-five percent at Occidental) (on file with the Washington and Lee Law Review); ExxonMobil Corp., Notice of 2017 Annual Meeting and Proxy Statement (Schedule 14A) (Apr. 13, 2017).

2. *See* Mufson, *supra* note 1 (discussing the leaders of the shareholder activism vote at ExxonMobil).

3. *See Five Takeaways From the 2019 Proxy Season*, ERNST & YOUNG (July 23, 2019), https://www.ey.com/en_us/board-matters/five-takeaways-from-the-2019-proxy-season (last visited Sept. 23, 2019) (explaining key takeaways from the 2019 proxy season) (on file with the Washington and Lee Law Review). *See also* Andrew Logan, *The Hidden Story of Climate Proposals in the 2018 Proxy Season*, CERES (May 29, 2018), https://www.ceres.org/news-center/blog/hidden-story-climate-proposals-2018-proxy-season (last visited Sept. 23, 2019) (reporting on responses to shareholder engagement around climate-related risk, transition planning, and reporting) (on file with the Washington and Lee Law Review).

4. *See Vanguard's Responsible Investment Policy*, VANGUARD, https://about.vanguard.com/investment-stewardship/principles-policies/ (last visited Sept. 23, 2019) (outlining how voting and investment policies integrate ESG risk assessment) (on file with the Washington and Lee Law Review); *2019 Proxy Voting and Engagement Guidelines: North America*, ST. STREET GLOBAL

proposal shows how the focus of shareholder activism around ESG matters has broadened beyond the civil rights, labor, and human rights issues that were its major target throughout much of the twentieth century. Climate change risk and corporate environmental impacts are now among the top subjects of shareholder proposals today.[5] Third, as explained below, mainstream investors like Blackrock and Vanguard are supporting ESG-oriented activism for economic reasons, not only or even necessarily because of commitments to a particular ethical or political position.[6] And finally, this proposal is one of many ESG proposals (about 20 percent of all environmental and social proposals in 2018) that seek greater corporate transparency about non-financial risks and impacts, either to better inform investor decision-making or to prompt changes in corporate practice.[7]

This Article focuses on the challenge of achieving corporate transparency for investment purposes and considers whether shareholder activism is the best way to achieve it. Many in the

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ADVISORS (Mar. 18, 2019), https://www.ssga.com/our-insights/viewpoints/2019-proxy-voting-and-engagement-guidelines-north-america.html (last visited Sept. 23, 2019) (on file with the Washington and Lee Law Review); *Proxy Voting Guidelines for U.S. Securities*, BLACKROCK (Jan. 2019), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf. Although the term "non-financial" properly refers to all information contained in corporate public filings outside of the financial statements, it includes, and is often used synonymously with, the term "ESG." *See* Richard Barker & Robert G. Eccles, *Should FASB and IASB Be Responsible for Setting Standards for Non-Financial Information?*, GREEN PAPER (Oct. 12, 2018) (using the two terms interchangeably).

5. These proposals account for nearly half of all shareholder proposals filed in 2019 as of the time of this writing. *See* Heidi Welsh et al., *Proxy Preview 2019*, HARV. L.S. CORP. GOV. (Apr. 1, 2019) (discussing the "environmental, social, and sustainability" shareholder resolutions proposed in early 2019). *See also* THE CONFERENCE BOARD, PROXY VOTING ANALYTICS (2015– 2018) 32 (2018) [hereinafter "PROXY VOTING ANALYTICS"] (reporting that these accounted for 38.7% of all proposals submitted to a shareholder vote in 2018).

6. *See infra* Part I (explaining evolving understandings of the materiality of non-financial ESG information).

7. *See* PROXY VOTING ANALYTICS, *supra* note 5, at 31, chart 7, 86, chart 24 (reporting that forty-two proposals in the first half of 2018 addressed either corporate reporting on environmental impact or sustainability reporting); Virginia Harper Ho & Stephen Kim Park, *Non-Financial Reporting in Comparative Perspective: Optimizing Private Ordering in Public Disclosure*, 41 U. PENN. J. INT'L L. __ (forthcoming 2019) (discussing the dual goals of disclosure).

business community appear to think so.[8] For example, in 2016, many corporations and law firms offered comments to the Securities and Exchange Commission (SEC) on the question of whether the agency should develop new ESG-related disclosure rules.[9] Nearly all took the position that shareholder engagement and other forms of shareholder activism were the best way to improve ESG disclosure and that the SEC should leave well enough alone.[10]

The SEC appears to agree. Several SEC commissioners have spoken openly about their opposition to new ESG disclosure reform,[11] and no such reforms have yet been proposed by the SEC. As a result, investors must rely on shareholder proposals like the ones submitted to ExxonMobil and its peers in order to obtain information that goes beyond what companies voluntarily disclose in their corporate sustainability reports or, to a limited extent, in

8. Leading business organizations and trade associations say they prefer private solutions over new disclosure regulation; however, many of these same business groups are also pressing for restrictions on the tools of shareholder activism. *See* Welsh et al., *supra* note 5 (discussing the Main Street Investors Coalition and the National Association of Manufacturing's efforts to limit shareholders' ability to file proposals). This conclusion is based on the author's own review of all of the unique comments submitted to the SEC in connection with its 2016 Regulation S-K Concept Release, which are available at www.sec.gov.

9. *See* William Thomas & Annise Maguire, *SEC Studying Change of Regulation S-K to Require ESG Disclosures*, WILLKIE FARR & GALLAGHER LLP (Nov. 7, 2016), https://www.willkie.com/~/media/Files/Publications/2016/11/SEC_Studying_Change_of_Regulation_SK_to_Require_ESG_Disclosures.pdf (discussing possible SEC changes).

10. *See Comment of Shearman & Sterling LLP on Regulation S-K Concept Release to Brent J. Fields, Sec'y*, U.S. SEC. AND EXCH. COMM'N (Aug. 31, 2016), https://www.sec.gov/comments/s7-06-16/s70616-367.pdf (Certain areas of reform, most notably in the . . . ESG space, are better addressed by ongoing engagement with . . . investors, rather than through SEC mandates."). *See also infra* Part III.B.3 (explaining the sources of opposition to non-financial reporting reform).

11. *See* Hester M. Pierce, *Remarks Before the Council of Institutional Investors*, HARV. L. S. CORP. GOV. (Mar. 6, 2019) (rejecting calls to introduce ESG disclosure rules or to endorse ESG disclosure standards developed by private organizations); Jay Clayton, *Remarks to the SEC Investor Advisory Committee* (Dec. 13, 2018), https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-meeting-121318 (last visited Sept. 23, 2019) (same) (on file with the Washington and Lee Law Review). As this Article goes to press, the SEC is considering limited ESG disclosure proposals, but their ultimate success and form is unclear.

their public filings. In contrast, many investors, governments, and international organizations now urge the need for non-financial reporting reforms that will help investors understand the financial impact of corporate environmental and social performance.[12]

I argue that although shareholder activism is a powerful tool to change corporate practice, it is an inefficient substitute for non-financial disclosure reform under the federal securities laws—in fact, it has impeded it. Rule 14a-8 of the federal proxy rules, which establishes the process and conditions for shareholders to submit proposals to a shareholder vote, restricts shareholders' ability to push for better corporate disclosure and also forces shareholders to frame their proposals in a way that causes companies to discount the materiality of ESG information.[13] In particular, the interpretation of Rule 14a-8's "ordinary business exception," together with the rule's long use in shareholder activism around "public policy and social issues," are now discouraging support for new rulemaking that could improve investor and market access to material ESG information.

This Article begins by explaining the major shift in understandings of ESG materiality among investors that is driving their growing demand for ESG information and their support for many ESG-related shareholder proposals. It also explains why this demand for ESG information is not already met by the wealth of publicly available ESG information. Part III then examines the text and interpretations of Rule 14a-8's "ordinary business exception" and explains how the history of its application to environmental and social proposals has created barriers to potentially more effective disclosure reforms. This Article concludes by arguing for new interpretive guidance by the SEC that would recognize the potential materiality of ESG information and realign with the earliest of the SEC's own articulations of the ordinary business exception. These interpretations make clear that proposals may raise issues that are appropriate for a shareholder vote not only because of their "public policy" or "social" implications, but also because they implicate important and potentially material financial considerations.

12. *See infra* Part II (identifying some of these initiatives).

13. *See infra* Part III (explaining the history and application of Rule 14a-8).

II. Beyond Public Policy: Non-Financial Materiality and Demand for Disclosure Reform

Until relatively recently, investor demand for information on companies' environmental or workforce-related factors came largely from ethical, "social," or "responsible" investors, and the level of such investment as a percentage of the total assets under management (AUM) in the United States was relatively small.[14] Shareholder activists have therefore divided into several camps. In the first camp are "financial" investors, primarily hedge funds, who have tended to push for changes on corporate boards and, in the view of some, short-term profit.[15] Another camp consists of public pension funds, labor unions, religious orders, and individual "gadflies," whose activism has often aligned with particular values and interests.[16] In the middle, mainstream institutional investors like Vanguard and Fidelity have generally voted with management against environmental or social shareholder proposals, so while support for these proposals has grown over time, it remains relatively low.[17] Similarly, most investors did not historically

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14. *See* SIF FOUNDATION REPORT ON U.S. SUSTAINABLE, RESPONSIBLE, AND IMPACT INVESTING TRENDS: 2018—EXECUTIVE SUMMARY (2018), US SIF, https://www.ussif.org/trends (last visited Sept. 23, 2019) (reporting that in 1995, only USD $639 billion were invested using responsible investment strategies, as compared to over USD $10 trillion in 2018) (on file with the Washington and Lee Law Review).

15. On the role of hedge funds as catalysts of shareholder activism, see generally Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013) (describing hedge funds as "activist arbitrageurs"). *See also* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 681–88 (2010) (highlighting investor short-termism as a contributing factor to the 2008 financial crisis). In the past five years, hedge funds have been responsible for between two and four percent of all shareholder proposals. PROXY VOTING ANALYTICS, *supra* note 5, at 30, chart 6.

16. *See* PROXY VOTING ANALYTICS, *supra* note 5, at 30, chart 6 (reporting that labor unions, pension funds, nonprofit organizations, and individuals remain important sponsors of most shareholder proposals).

17. In general, ESG proposals, including those seeking greater corporate transparency, fail to achieve majority support; average levels of support reached only 25.7% in 2018, with less than seven percent receiving majority support. PROXY VOTING ANALYTICS, *supra* note 5, at 16, 66, chart 21. In comparison, governance-related proposals achieved an average 37.5% support in 2018. *Id.* at 18. An indication of mainstream investors' historical lack of support for

incorporate non-financial information into investment analysis, and "responsible" investment strategies were largely focused on ethical or social screening strategies that excluded certain firms or sectors from investment portfolios.[18]

Over the past decade or so, a striking shift has occurred in how investors, governments, and many companies think about ESG materiality, which has driven higher demand for investment-grade ESG information among investors. The 2017 ExxonMobil proposal itself illustrates this point:

> Item 12–Report on Impacts of Climate Change Policies: RESOLVED: Shareholders request that, beginning in 2018, ExxonMobil publish an annual assessment of the long-term portfolio impacts of technological advances and global climate change policies, at reasonable cost and omitting proprietary information. The assessment can be incorporated into existing reporting and should analyze the impacts on ExxonMobil's oil and gas reserves and resources under a scenario in which reduction in demand results from carbon restrictions and related rules or commitments adopted by governments consistent with the globally agreed upon 2 degree target [established by the Paris Climate Accord]. This reporting should assess the resilience of the company's full portfolio of reserves

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environmental and workforce-related proposals is Vanguard's 2016 Voting Guidelines, which state as follows:

> The Board generally believes that these are "ordinary business matters" that are primarily the responsibility of management and should be evaluated and approved solely by the corporation's board of directors. Often, proposals may address concerns with which the Board philosophically agrees, but absent a compelling economic impact on shareholder value (e.g., proposals to require expensing of stock options), the funds will typically abstain from voting on these proposals.

Vanguard Voting Guidelines (2016), https://pcg.law.harvard.edu/wp-content/uploads/2016/09/5-Vanguards-proxy-voting-guidelines-_-Vanguard.pdf.

18. *See* Lloyd Kurtz, *Socially Responsible Investment and Shareholder Activism*, *in* THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 249, 251, 262–65 (Andrew Crane et al., eds. 2008) (describing screening and relative weighting investment strategies and observing that responsible investment includes not only "value-based" or ethical investors, but also "value-seeking" and "value-enhancing" investors who see ESG strategies as enhancing economic value).

> and resources through 2040 and beyond, *and address the financial risks associated with such a scenario.*[19]

Similarly, Blackrock's public statement explaining its 2017 vote frames the reasons for seeking information on climate-related risk in *economic* terms. It states: "[w]e will continue our dialogue over time with Exxon and other companies on a range of issues *of economic relevance,* including but not limited to climate-related risks, and regardless of whether the companies have received a shareholder proposal."[20] Essentially, investors have identified climate-related risk and other ESG factors as important to their investment and voting decisions—in other words, within the definition of materiality that has been established by the Supreme Court under the federal securities laws.[21]

Survey evidence confirms that the vast majority of institutional investors now believe that companies should disclose material ESG information to investors, but that critical ESG information gaps exist.[22] In addition, investors with over $70

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19. EXXONMOBIL, *supra* note 1 (emphasis added).

20. *BlackRock Vote Bulletin*, BLACKROCK (May 2017), https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2017.pdf (explaining BlackRock's vote in favor of the ExxonMobil climate change shareholder proposal) (emphasis added).

21. Under the standard set by the Supreme Court in *TSC v. Northway*, 426 U.S. 438, 449 (1976), information is material if there "is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote" or "that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information" available to the investor in reaching a voting or investment decision.

22. *See* Kiran Vasantham et al., *Institutional Investor Survey 2019* 15–16 (2019), https://www.morrowsodali.com/uploads/insights/attachments/ae189c6414e1ef6b0eed5b7372ecb385.pdf (finding that eighty percent support the integration of non-financial disclosure with existing mandatory disclosures and that a similar percentage support more extensive ESG disclosure). *See also* PWC, SUSTAINABILITY GOES MAINSTREAM: INSIGHTS INTO INVESTOR VIEWS 6–9 (2014), https://www.pwc.com/us/en/pwc-investor-resource-institute/publications/assets/pwc-sustainability-goes-mainstream-investor-views.pdf (finding that approximately eighty percent of surveyed investors, accounting for over fifty percent of U.S. institutional assets, integrate sustainability information into investment analysis but that an equal percentage were dissatisfied with its comparability); *Tomorrow's Investment Rules 2.0*, ERNST & YOUNG (2015), http://www.ey.com/Publication/vwLUAssets/investor_survey/$FILE/CCaSS_Institutional_InvestorSurvey2015.pdf (discussing how investors are looking for more nonfinancial reporting); *Is Your Non-Financial Performance Revealing the True Value of Your Business to Investors?*, ERNST & YOUNG (2017), http://www.ey.com/gl/en/services/assurance/climate-change-and-sustainability-

trillion in assets under management have now voluntarily committed to integrate ESG information into their investment decisions.[23] More than $12 trillion AUM in the U.S. is now managed by investors who engage in ESG-related shareholder activism, invest in "sustainable, responsible, and impact" (SRI)-invested funds, or incorporate ESG criteria into investment analysis.[24] This figure represents a thirty-eight percent increase since 2016 and over one-fourth of all assets under management in the U.S.[25]

Indeed, many governments, stock exchanges, and international organizations have already acknowledged the materiality of ESG information. For example, the International Organization of Securities Commissions' (IOSCO) 2019 Statement on Disclosure of ESG Matters by Issuers states that "ESG matters . . . may have a material short-term and long-term impact on the business operations of the issuers [and] on risks and returns for investors and their investment and voting decisions."[26] The London Stock Exchange's ESG reporting guidance also observes that ESG-related information "has moved from a 'peripheral' to a 'core' part of investment analysis, across all sectors."[27] Even the U.S. Department of Labor has acknowledged that "[e]nvironmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment, [making them] *proper components of the [pension fund] fiduciary's primary analysis of the economic merits* of competing investment choices."[28] Outside the U.S., consideration of ESG factors in

services/ey-non-financial-performance-may-influence-investors (last visited Sept. 23, 2019) (finding that forty percent of surveyed investors were dissatisfied with the quality of non-financial disclosure) (on file with the Washington and Lee Law Review).

23. *See Annual Report 2018*, at 6, UNPRI (2019), https://www.unpri.org/annual-report-2018 (last visited Sept. 23, 2019) (reporting that current signatories represent over $90 trillion in assets under management) (on file with the Washington and Lee Law Review).

24. USSIF, *supra* note 14, at 1.

25. *Id.*

26. *2019 Statement on Disclosure of ESG Matters by Issuer*, IOSCO (2019), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD619.pdf.

27. *Your Guide to ESG Reporting*, LONDON STOCK EXCHANGE GROUP (2017), https://www.lseg.com/esg (last visited Sept. 23, 2019) (on file with the Washington and Lee Law Review).

28. Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA

shareholder engagement and throughout the investment chain is mandatory for institutional investors in Europe under the 2017 amendments to its Shareholder Rights Directive.[29] In sum, investors are now as likely to assess a portfolio company's environmental or social practices because of their financial materiality as they are to do so for ethical or public policy reasons.

However, as I have discussed in other work, the level of ESG disclosure contained in corporate annual reports and other public filings, on the one hand, and the quality of voluntary sustainability reporting, on the other, are not sufficient to meet rising demand for investment-grade information.[30] Public filings largely depend on issuer judgments on the materiality of ESG information to investors, which can lead to under-reporting.[31] Although over eighty percent of public companies now produce voluntary sustainability reports, these are not based on consistent reporting frameworks and do not align with the materiality standards of federal securities law.[32] They also lack the reliability and comparability that investment analysis requires.[33]

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in Considering Economically Targeted Investments, 80 Fed. Reg. 65,135, 65,136 (Oct. 26, 2015), codified at 29 C.F.R. pt. 2509.2015-0 I (2015) (emphasis added).

29. Directive (EU) 2017/828, of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards to the Encouragement of Long-Term Shareholder Engagement, 2015 O.J. (L 132), 1, 1–25, http://data.europa.eu/eli/dir/2017/828/oj.

30. *See* Virginia Harper Ho, *Nonfinancial Disclosure and The Costs of Private Ordering*, 55 AM. BUS. L. J. 407, 446–52 (2018) (discussing nonfinancial disclosure).

31. *See The State of Disclosure 2016: An Analysis of the Effectiveness of Sustainability Disclosure in SEC Filings*, SASB (2016), at 5–8, https://library.sasb.org/state-of-disclosure-annual-report-2/ (last visited Sept. 23, 2019) (analyzing disclosure limitations in over 700 filings, including 597 10-K filers and 116 20-F filers, across 434 disclosure topics) (on file with the Washington and Lee Law Review).

32. *See* IRRC INSTITUTE AND SUSTAINABLE INVESTMENTS INSTITUTE (SI2), STATE OF INTEGRATED AND SUSTAINABILITY REPORTING 27–32 (2018) (analyzing sustainability reporting trends in the United States).

33. *See* Harper Ho, *supra* note 30, at 428–30 (discussing these limits); Stephen Kim Park, *Targeted Social Transparency as Global Corporate Strategy*, 35 NW. J. INT'L L. & BUS. 87, 93 (2014) ("[M]arket competition and CSR commitments do not provide sufficient incentives to firms to voluntarily disclose thereby leading to the systemic underreporting of useful information regarding the social impacts of business activities.").

In its review of this reporting landscape, the Task Force on Climate-Related Financial Disclosure (TCFD) of the G20's Financial Stability Board therefore concluded that available sources of climate-related non-financial information leave critical gaps, making assessments of the financial impacts of non-financial risk difficult for investors and governments alike.[34] Similarly, when the SEC last sought comment on investor views, eighty percent supported revisions to how ESG issues are disclosed in the annual reports, including the SEC's Investor Advisory Committee.[35] The observed deficiencies of current non-financial reporting have prompted several investor petitions for new rulemaking to the SEC,[36] as well as renewed efforts by shareholders to obtain non-financial information and encourage better voluntary reporting practices through shareholder activism.

III. Shareholder Activism and Non-Financial Reporting

In response to rising investor demand for ESG information, leading business organizations, such as the U.S. Chamber of Commerce, have maintained that voluntary disclosure by companies is sufficient, and that shareholder activism is the best way to promote better corporate reporting practice if it is in fact

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34. TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, at iii, 1 (2017).

35. SASB, *supra* note 31, at 4; Comment of SEC Investor Advisory Committee on Regulation S-K Concept Release to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n (June 15, 2016), https://www.sec.gov/comments/s7-06-16/s70616-22.pdf. Symposium keynote speaker Lisa Fairfax serves on the board of the IAC.

36. *See* Cynthia Williams & Jill Fisch, Request for rulemaking petition on environmental, social and governance (ESG) disclosure (Oct. 1, 2018), No. 4-730, https:/www.sec.gov/rules/petitions/2018/petn4-730.pdf (explaining a request for the SEC to engage in notice and comment rule-making to develop a better framework for companies' long-term risks and performance). *See also* Human Capital Management Rulemaking petition to require issuers to disclose iformation about their human capital management policies, practices, and performance (July 6, 2017), No. 4-711, https://www.sec.gov/rules/petitions/2017/petn4-711.pdf (requesting "that the Commission adopt new rules, or amend existing rules, to require issuers to disclosure information about their human capital management policies, practices and performance.").

necessary.[37] They therefore oppose new disclosure rules that could expand reporting obligations for listed firms. Indeed, prior SEC disclosure-related rulemaking that was intended to drive greater corporate accountability for human rights practices has been met with stiff opposition from the business community and the courts, even when done at Congress' direction.[38]

This Symposium highlights the powerful contributions shareholder activism has made to the civil rights movement. Shareholder activism also led the battle against apartheid in South Africa and has brought about more recent changes to corporate governance norms and practice. However, confidence in shareholder activism as an adequate substitute for disclosure reform is nonetheless misplaced. First, the mechanisms of shareholder activism are unwieldy if the goal is to advance the core purposes of the mandatory reporting regime that has been developed under federal securities law. Second, the history and success of Rule 14a-8 have in fact undermined support for more effective regulatory solutions from Congress, the SEC, or stock exchanges. This Part explains these obstacles, drawing on the history of Rule 14a-8 and its interpretation over time by the SEC and the courts.

A. The Practical Limits of Shareholder Activism

At the outset, shareholder engagement is a costly, impractical, and inefficient tool for achieving the goals of the federal disclosure regime: to protect investors from fraud; to promote "fair, efficient, and transparent markets;" and to reduce systemic risk to the economy as a whole.[39] Most obviously, shareholder proposals are

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37. *See Corporate Sustainability Reporting: Past, Present, Future*, U.S. CHAMBER OF COM. FOUND. (Nov. 2018), at 8, https://www.uschamberfoundation.org/sites/default/files/Corporate%20Sustainability%20Reporting%20Past%20Present%20Future.pdf (summarizing the Chamber of Commerce's opinion on self-reporting).

38. *See*, *e.g.*, Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518 (D.C. Cir. 2015) (challenging conflict mineral disclosure rules).

39. OBJECTIVES AND PRINCIPLES OF SEC. REG. 3, IOSCO (2017), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD561.pdf. *See also* Business and Financial Disclosure Required by Regulation S-K: Concept Release, 81 Fed. Reg. 23,916, 23,921 (Apr. 22, 2016) (articulating similar goals as the core of the SEC's mission).

by law advisory, and the board is free to disregard even a majority vote.[40] Shareholder proposals also target only a relative handful of public companies each year, mostly large-capitalization companies in the S&P 500.[41] For example, between 2015 and 2018, only forty to sixty proposals on environmental or sustainability reporting went to a vote each year at Russell 3000 companies.[42] Although successful shareholder proposals at firms that are highly visible industry leaders often have spillover effects on other firms, the *ad hoc*, campaign-like nature of shareholder activism is better suited to raising companies' awareness of investor concerns, not to standardizing how companies report on non-financial risks and impacts associated with their business. Finally, a growing number of environmental and social proposals do succeed in getting a response from management before a vote occurs,[43] but those that go to a vote routinely garner relatively low levels of shareholder support and are therefore even easier for boards to ignore.[44]

Most critically, the purpose of the proxy rules under Section 14 of the Securities Exchange Act of 1934 (the "Exchange Act") is to promote shareholder democracy as a check on corporate management, and to prevent fraud.[45] High shareholder support for

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40. *See* 17 C.F.R. § 240.14a-8(i)(1) (permitting exclusion of proposals that would be improper under state law); Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, 41 Fed. Reg. 52,994, 52,998 (1976) [hereinafter 1976 Release] ("[P]roposals that merely recommend or request that the board take certain action [are] not contrary to the typical state statute, since such proposals are merely advisory in nature and would not be binding on the board even if adopted by a majority.").

41. PROXY VOTING ANALYTICS, *supra* note 5, at 26.

42. *Id.* at 86, chart 24.

43. *See id.* at 15 (finding that the rate of withdrawn proposals doubled in 2018 over 2017). Withdrawal of a proposal by the proponent often indicates that a successful response was obtained without the need for a formal vote. *See* Paula Tkac, *One Proxy at a Time: Pursuing Social Change Through Shareholder Proposals*, 91 ECON. REV.: FED. RES. BANK OF ATLANTA, Aug. 2006, at 1, 13 (2006) ("[W]ithdrawal can be viewed as indicating some level of success."); Rob Bauer et al., *Who Withdraws Shareholder Proposals and Does It Matter? An Analysis of Sponsor Identity and Pay Practices*, 23 CORP. GOV.: INT'L REV. 472, 474 (2015) ("[I]f negotiations are successful, the proposal is withdrawn.").

44. *See supra* note 17 and accompanying text (discussing historical average levels of shareholder support for environmental and social proposals).

45. *See* Roosevelt v. E.I. Du Pont de Nemours & Co., 958 F.2d 416, 421–22 (D.C. Cir. 1992) (reviewing the purpose of Section 14(a) of the Exchange Act). *See also* 1976 Release, *supra* note 40, at 52,995 (emphasizing the rule's goal to

a proposal may signal that the topic is indeed material to investors, but that is not a prerequisite for the proposal to be in included in the corporate proxy. As the legislative history of Rule 14a-8 discussed below makes clear, shareholder activism is intended as a megaphone for investors, not primarily as a conduit of information to the market.[46] Rule 14a-8 is therefore designed to address much broader goals than those that drive the federal disclosure regime, but it is for the same reason not well-suited to fixing the core problems of comparability and standardization that currently plague voluntary ESG reporting.

B. The Ordinary Business Exception and Anti-Materiality

Beyond the practical limits of Rule 14a-8, the SEC's interpretation of the rule itself and the very success of social activists in the past have perhaps ironically become barriers to any future rule-making that could help standardize how material ESG information is disclosed. This is problematic, because corporate transparency around material ESG factors is essential to both market efficiency and corporations' accountability to their shareholders, as well as other stakeholders. In addition, as I have argued elsewhere, disclosure reform is a more efficient solution to the under-reporting of material ESG information.[47] The core issue concerns one of the provisions of Rule 14a-8 known as the "ordinary business exception," which has a direct effect on whether many shareholder proposals go to a vote. This Part introduces the history of this provision and explains how its scope and implementation have affected how companies view the materiality of ESG issues.

advance shareholder democracy).

46. *See Roosevelt*, 958 F.2d. at 421–22 ("Congress did not narrowly train section 14(a) on the interest of stockholders in receiving information necessary to the intelligent exercise of their [voting] rights under state law" but to "give true vitality to the concept of corporate democracy."). Indeed, Regulation FD (for "fair disclosure") restricts the disclosure of material non-public information that is not simultaneously disclosed to the public. 17 C.F.R. § 243 (1939).

47. *See generally* Harper Ho, *supra* note 30.

1. The Purpose and History of Rule 14a-8 and the Ordinary Business Exception

Shareholders' ability to exercise voice in corporate governance rests largely on their ability to submit shareholder proposals to the corporation for inclusion in the corporate proxy under Rule 14a-8.[48] Although the proxy rules were introduced in 1935,[49] the SEC did not adopt a rule requiring shareholder proposals to be included in the corporate proxy until 1942.[50] The legislative history of Rule 14a-8 indicates that its purpose was to facilitate shareholder participation in corporate governance and to serve as a check on potential managerial abuse in the proxy solicitation process.[51]

Rule 14a-8 now allows corporations to exclude a proposal from the corporate proxy if it fails to comply with the procedural rules of Rule 14a-8 or if there is a substantive basis for exclusion under Rule 14a-8(i).[52] If a company is uncertain about whether it can rely on an exclusion, it can petition the SEC for "no-action" review of the issue or seek a court's determination of the issue.[53] The

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48. *See* Bauer et al., *supra* note 43, at 474–76 (discussing how shareholder proposals can initiate direct engagement or follow an unsuccessful engagement).

49. *See generally* Exchange Act Release No. 378 (Sept. 24, 1935).

50. *See* Exchange Act Release No. 3347 (Dec. 18, 1942) [hereinafter "1942 Release"] (adopting the rule that initially became Rule 14a-7). *See also* LISA FAIRFAX, SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION 65 (2011) (discussing this history); Kevin W. Waite, *The Ordinary Business Operations Exception to the Shareholder Proposal Rule: A Return to Predictability*, 64 FORDHAM L. REV. 1253, 1254 (1995) (same).

51. *See* Waite, *supra* note 50, at 1260 n.42–44 (citing this legislative history). Rule 14a-8 was originally adopted as Rule 14a-7.

52. *See* 17 C.F.R. § 240.14a-8 (listing reasons a company may exclude a shareholder proposal).

53. The SEC issues interpretations and guidance relating to these exceptions, but companies may also petition the SEC for "no-action relief" by stating the exception on which they tend to rely and seeking an opinion from SEC staff that it will take "no action" to enforce Rule 14a-8 against the company if it excludes the proposal from its corporate proxy. SEC no-action letters are non-binding. *See* Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 884–86 (S.D.N.Y. 1983) (discussing the degree of deference courts afford to no-action letters given their non-binding nature). Alternatively, shareholders and companies may litigate the question of whether a proposal is excludable or not, and courts may take positions that differ from those of the SEC staff. *See, e.g.*, *infra* note 74 and accompanying text (discussing *Trinity Wall Street v. Wal-Mart Stores, Inc.*,792 F.3d 323 (2015), which parted

substantive grounds for excluding proposals from the corporate proxy found in modern Rule 14a-8(i) did not exist in the initial version of the shareholder proposal rule, though it did contain some procedural conditions.[54] Prior to 1976, the rule simply required companies to include any proposal that was "a proper subject for action by the security holders."[55] From 1942 to 1976, the SEC determined what was a "proper subject" of a shareholder proposal with reference to state corporate law.[56] However, because state law generally provides only that "the business and affairs of the corporation shall be managed by the board of directors"[57] and because state courts offered little guidance on what might be a "proper purpose" for shareholder consideration, SEC staff began to develop their own interpretative guidance.[58]

Perhaps the most important of these substantive bases for exclusion is the "ordinary business exception,"[59] which allows the company to exclude a shareholder proposal from the corporate proxy if "the proposal deals with a matter relating to the company's ordinary business operations."[60] This provision, which was first introduced in 1954,[61] is one of the most widely used grounds for exclusion and is among the most heavily litigated of the Rule 14a-8 exceptions.[62]

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course from the SEC's interpretation of Rule 14a-8(i)(7)).

54. *See* FAIRFAX, *supra* note 50, at 65–66 (discussing this history).

55. 1942 Release, *supra* note 50.

56. Waite, *supra* note 50, at 1261 n.51 (citations omitted).

57. *See, e.g.*, Del. Gen. Corp. L. § 141(a) (2018).

58. *See* Apache Corp. v. NYCERS, 621 F. Supp. 2d 444, 449 n.4 (2009) (observing the lack of state law guidance on this question).

59. In 2018, the ordinary business exception was one of the most common grounds for exclusion that companies raised in their requests for no-action review (thirty-three percent of all no-action requests); around sixty percent succeeded, down from nearly seventy-five percent in 2017. *See* Ron Mueller et al., *Shareholder Developments in the 2018 Proxy Season,* GIBSON DUNN & CRUTCHER LLP (July 12, 2018), at 11, https://www.gibsondunn.com/wp-content/uploads/2018/07/shareholder-proposal-developments-during-the-2018-proxy-season.pdf (discussing statistics on the usage of the ordinary business exception in 2018).

60. 17 C.F.R. § 240.14a-18(i)(7).

61. *See* Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4979 (Jan. 6, 1954) [hereinafter "1954 Release"] (discussing the introduction of the ordinary business exception).

62. *See* FAIRFAX, *supra* note 50, at 72 (discussing in detail the ordinary

As the SEC explained in its 1998 interpretative release ("1998 Release"), the ordinary business exception rests on two underlying policy goals. The first is "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."[63] As a result, the SEC considers whether the "subject matter of the proposal [concerns] tasks [that] are so fundamental to management's ability to run a company . . . that they could not . . . be subject to direct shareholder oversight."[64] For example, proposals involving "the management of the workforce, such as the hiring, promotion, and termination of employees," generally relate to ordinary business matters and are therefore excludable.[65] Second, the proposal cannot "micro-manage" by engaging with complex matters on which shareholders collectively "would not be in a position to make an informed judgment."[66]

Because most shareholder proposals and the vast majority of those dealing with environmental or social concerns necessarily relate to some aspect of the company's operations,[67] the ordinary business exception is also one of the most important substantive bases for the exclusion of environmental and social proposals.[68] Table 1 gives an indication of how often common environmental and social topics have been raised in shareholder proposals that have been challenged by the company under the ordinary business

business exception).

63. *See* Exchange Act Release No. 34-40018 (May 21, 1998) [hereinafter "1998 Release"]. *See also* SEC Staff Leg. Bulletin 14J (Oct. 23, 2018) (discussing the rule's origin and intent); SEC Staff Leg. Bulletin 14I (Nov. 1, 2017) (same).

64. 1998 Release, *supra* note 63.

65. *Id. See also* SEC Staff Leg. Bulletin 14J, *supra* note 63 (citing Staff Legal Bulletin No. 14A (Jul. 12, 2002)).

66. 1998 Release, *supra* note 63 (citing 1976 Release, *supra* note 40, at 52,997).

67. The SEC and the courts have both observed that most proposals can be swept into the ordinary business exception, absent the SEC's broader interpretive gloss. *See* 1976 Release, *supra* note 40, at 52,997 (announcing the "significant policy" exception to address this). *See also* Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 890 (S.D.N.Y. 1983) (referencing the 1976 Release).

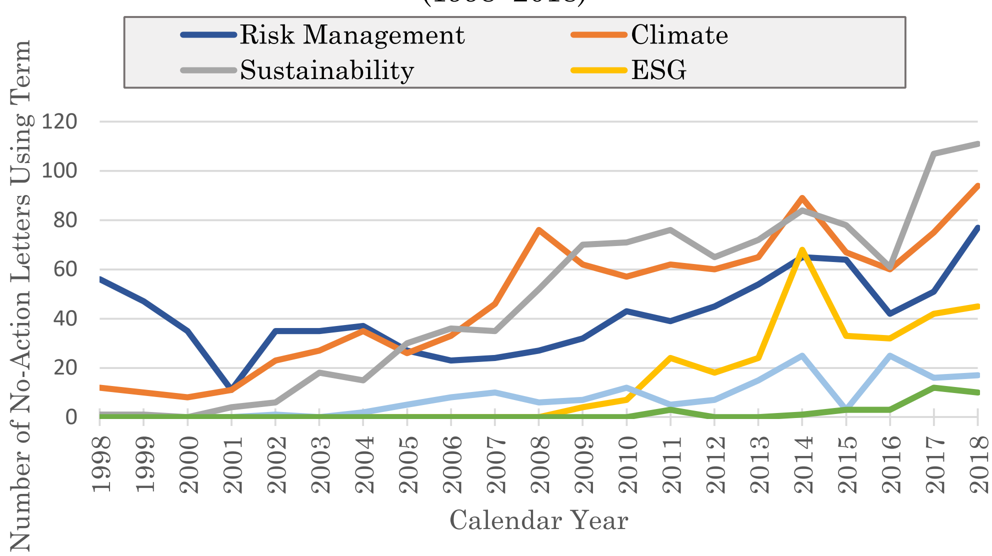
68. *See supra* note 59 (explaining in detail the usage of the ordinary business exception).

exception over the past 20 years.[69] Because corporations rely heavily on the ordinary business exception when considering ESG proposals, companies' experiences with ESG-related activism has largely defined their views of these issues.

2. "Transcending" the Ordinary Business of the Company is Equated with "Policy" or "Social" Issues

Since 1976, the SEC's interpretation of the ordinary business exception has expanded shareholders' ability to bring proposals to a vote by allowing them to speak to the "ordinary business" of a company so long as the subject of the proposal also implicates a "significant policy issue." As I explain in Part IV, the provenance

Table 1, Frequency of Terms in SEC No-Action Letters (1998–2018)



69. Table 1 does not fully capture all aspects of shareholder engagement with companies around environmental and social issues, nor does it capture proposals that are withdrawn or are automatically included in the corporate proxy. Proposals relating to "risk" are not shown but were approximately double the level of proposals for "risk management" over this period. These results are based on a search of the SEC No-Action Letter database on Bloomberg Law.

of the SEC's 1976 interpretive release ("1976 Release")[70] clearly indicates an intention that this exception encompass matters that are financially significant as well. However, the more common formulation defines "significant" in terms of "social or policy" issues, and this history now presents a significant obstacle to non-financial reporting reform because it appears that shareholder proposals advance issues that are not material. As explained above, investors advocating for non-financial reporting reform routinely assert that certain ESG matters are financially material to the firm and its investors, making better corporate reporting essential.[71] However, if the same investors seek improved disclosure via a shareholder proposal, they must raise their petition in the very different language of politics, shareholder democracy, and social movements.

Concerned that proposals "which have significant policy, economic, or other implications inherent in them" were being excluded under the ordinary business exception and undermining shareholder democracy, the 1976 Release adopted a new framework for determining whether a proposal should be excluded under the "ordinary business exception."[72] The SEC concluded that a company may only exclude proposals "relating to the conduct of the ordinary business of the issuer" that "are mundane in nature and do not involve any substantial policy or other considerations."[73] In essence, the SEC created an exception for proposals raising important policy issues. As the SEC elaborated in the 1998 Release, proposals relating to the "ordinary business" of the company may be excluded unless the proposal "focuses on policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a

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70. *See supra* note 40 (explaining 1976 Release).

71. For ESG matters that may not be material to a given firm, disclosure reform that is intended to change corporate conduct rather than simply elicit better information may also be within the SEC's authority to regulate in the public interest or to address sources of systemic risk. *See* Harper Ho, *supra* note 30, at 440, 445–46 (presenting these arguments).

72. 1976 Release, *supra* note 40.

73. *Id.* at 52,998. The 1998 Release defines the scope of ordinary business to mean proposals "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." 1998 Release, *supra* note 63.

shareholder vote."[74] In 1998, the SEC also clarified its current two-part approach, adding that proposals raising a "sufficiently significant" issue can only be excluded if they "see[k] to micro-manage the company."[75]

Of course, interpreting which issues are both of relevance to the company and yet "sufficiently significant" to transcend "ordinary business" is a highly subjective and therefore difficult task for the SEC and the courts.[76] The SEC has at times identified certain issues as "significant" in its interpretive guidance. For example, in 2009, the SEC relaxed its interpretation of Rule 14a-8(i)(7) in the wake of the financial crisis to state that "the board's role in the oversight of a company's management of risk is a significant policy matter."[77] On rare occasions, it has attempted to set bright-line rules for which proposals are not significant enough.[78] Since 2017, the SEC has also required corporations relying on this exception to discuss in their no-action request the

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74. SEC Staff Leg. Bulletin 14I, *supra* note 63 (citing 1998 Release, *supra* note 63). The 1998 Release stated disjunctively the requirement that the proposal "transcend" ordinary business *and* raise a "significant policy or other issue." *Id.* This prompted the Third Circuit to adopt a bifurcated test in *Trinity Wall Street v. Wal-Mart Stores, Inc.*, 729 F.3d 323 (3rd Cir. 2015), in which the court stated that for a proposal to avoid exclusion, "a shareholder must do more than focus its proposal on a significant policy issue; the subject matter of its proposal must 'transcend' the company's ordinary business." In 2015, the SEC rejected this interpretation and expressed concern that distinguishing the two concepts would "lead to the unwarranted exclusion of shareholder proposals." SEC Staff Leg. Bulletin 14H (Oct. 22, 2015). Instead, it reaffirmed its own position that proposals that raise a significant policy issue will therefore "transcend a company's ordinary business." *Id.*

75. 1998 Release, *supra* note 63; Apache Corp. v. NYCERS, 621 F. Supp. 2d 444, 451 (2009).

76. It is important to note that shareholder proposals cannot raise issues wholly unconnected with the company; there must be a "sufficient nexus . . . between the nature of the proposal and the company" in order for the significant policy exception to apply. SEC Staff Leg. Bulletin No. 14E (Oct. 27, 2009). *See also* SEC Staff Leg. Bulletin No. 14H at n. 32 (Oct. 23, 2015) (same).

77. SEC Staff Leg. Bulletin No. 14E (Oct. 27, 2009).

78. In general, the SEC rejects bright-line tests for the "significance" of a given issue. However, in 1992, the SEC's Cracker Barrel No-Action letter adopted a bright-line test that would consider all employment-related proposals excludable, other than those involving executives. Cracker Barrel Old Country Store, SEC No-Action Letter (Oct. 13, 1992), *aff'd by Commission*, Cracker Barrel Old Country Store, Inc. (Jan. 15, 1993). In its 1998 Release, the SEC abandoned this bright-line test in favor of a case-by-case approach to employment matters. 1998 Release, *supra* note 63.

board's assessment of whether the matter is in fact "sufficiently significant."[79] Regardless, the SEC's most common formulation of this exception omits any mention of economic importance to the company or its shareholders, which is a touchstone of materiality under the federal securities laws. Instead, it requires that shareholders seeking to prevent proposals related to corporate operations from being excluded must frame them as raising a "significant policy issue."

This common short-hand entrenches the view that environmental and social risks and other factors are not economically material to the firm and its investors, but are instead a smokescreen for the social or political agendas of niche investors and related interest groups. Companies opposed to such proposals are therefore even more likely to view them as immaterial and as an inappropriate subject of future disclosure reform. As the International Integrated Reporting Council has noted, "the use of terminology such as 'sustainability or public policy issues . . . marginalizes such information and impedes its effective integration into the core investor document."[80]

At the same time, the second part of the two-part test—the prohibition on "micro-management"—also prevents shareholder proposals from being an effective alternative to ESG disclosure reform. First, the more prescriptive a proposal, the more likely it is to be found to "micromanage" the company's approach to its workforce, environmental concerns, or how it manages its existing public reporting obligations. However, the problems with the current state of ESG disclosure are not a lack of information that could be resolved by broad requests for sustainability reporting, for example, but a lack of standardization, which requires consistency across disclosing companies and greater particularity in the content and form of disclosure.

A proposal will be considered micromanagement if it "involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies."[81] Although the SEC adopts a

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79. SEC Staff Leg. Bulletin 14I, *supra* note 63.

80. *Comment of International Integrated Reporting Council on Regulation S-K Concept Release to Brent J. Fields, Sec'y*, U.S. SEC. AND EXCH. COMM'N (Aug. 31, 2016), https://www.sec.gov/comments/s7-06-16/s70616-197.pdf.

81. *See* SEC Staff Leg. Bulletin 14J (Oct. 2, 2018) (citing 1998 Release, *supra* note 63, and Apple, Inc., SEC No-Action Letter, Dec. 5, 2016 (finding excludable

presumption of inclusion, proposals urging the company to use certain performance indicators or adopt particular reporting standards may therefore raise micro-management concerns. For example, in 2018, the SEC, in a surprising departure from past practice, concluded that a resolution asking EOG Resources to adopt greenhouse gas emission goals sought to micromanage the company and could therefore be excluded.[82] In addition, the general requirement that shareholder proposals be non-binding on the board in deference to the board's role under state corporate law also means that the more prescriptive a proposal, the more likely it is to be excluded from the corporate proxy under Rule 14a-8(i)(1). For these reasons, shareholder proposals are a poor substitute for the adoption of ESG disclosure rules and principles that would apply to all companies' public filings.

Finally, corporate issuers' perceptions of the economic importance of ESG issues have been diminished by the "democracy" in shareholder democracy. This Symposium has highlighted the tremendous role shareholder activism has played in the civil rights movement and beyond. However, the fact that the typical proponent of such proposals has historically been an individual, responsible investment fund, labor union, or religious order has reinforced corporations' fears of expansive and politically motivated regulation when it comes to disclosure reform.

3. Rejection of ESG Materiality and Opposition to Non-Financial Disclosure Reform

Since the SEC has directed shareholders to frame proposals related to corporate operations or their impact in terms of "social" or "policy" issues for over forty years, it is perhaps not surprising that many companies now view the potential integration of ESG disclosure into mandatory public filings as a politicization of the SEC's mission and ESG issues themselves as largely "social" or

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a proposal asking the company to prepare a plan to "reach net-zero greenhouse gas emissions by 2030")).

82. EOG Resources, Inc., SEC No-Action Letter (Feb. 26, 2018), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2018/trilliummiller022618-14a8.pdf. The proposal requested that EOG "adopt company-wide, quantitative, timebound targets for reducing greenhouse gas emissions and issue a report discussing its plans and progress towards achieving these targets." *Id.*

"political," rather than potentially "economic" or "material." The Business Roundtable, a staunch opponent of any new federal reporting requirements, is opposed to ESG-related shareholder activism itself on these grounds, arguing that "[s]hareholders should not use their investments in U.S. public companies for purposes that are not in keeping with the purposes of for-profit public enterprises, including but not limited to the advancement of personal or social agendas unrelated and/or immaterial to the company's business strategy."[83]

Despite the evidence that the vast majority of institutional investors want better ESG disclosure, the U.S. Chamber of Commerce's 2017 position paper on corporate disclosure reform also questions the value of ESG information and even the rationality of investors who seek to use it. It states: "[a]n investor that bases its voting and investment decisions on promoting social or political goals is not a 'reasonable' investor when it comes to what materiality means under the federal securities laws."[84] And in 2016, ExxonMobil explained its own resistance to ESG shareholder proposals in similar terms: "[t]he concept of 'reasonable investor' should govern the SEC's consideration of disclosure requirements, which necessarily should exclude disclosures promoted by narrowly-focused special interest groups. The SEC should avoid promoting political, social, and public policy objectives, or attempting to drive related corporate behavior advocated by special interest groups."[85]

Comments from business organizations, issuers, and the legal community to the SEC on the wisdom of revising the federal disclosure regime to require more specific ESG disclosures have adopted a more strident tone. For example, the National Mining Association, which led a successful legal battle against conflict mineral disclosure rules, argues that:

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83. BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE 2 (2016), https://s3.amazonaws.com/brt.org/principles-of-corporate-goverance-2016.pdf.

84. *Essential Information: Modernizing Our Corporate Disclosure System*, CTR. CAP. MKT. COMPETITIVENESS, U.S. CHAMBER OF COM., (2017), at 1, 8, https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-ChamberEssential-Information_Materiality-Report-W_FINAL-1.pdf.

85. David S. Rosenthal, ExxonMobil Corp., Comment Letter Concept Release on Bus. and Fin. Disclosure Required on Regulation S-K (Aug. 9. 2016), https://www.sec.gov/comments/s-7-06-16/s70616-355.pdf.

> Activists . . . are now . . . under the guise of transparency and good governance, seeking to have the Commission adopt reporting requirements that exceed traditional reporting contours. The net result is the politicization of the Commission to achieve a social or political goal that has been outside their grasp by traditional means . . . advancing a special interest focus.[86]

The Maryland Bar Association's comments to the SEC on the question of ESG disclosure reform were even more strongly worded: "[a]s securities lawyers, this perversion of the federal securities laws truly offends us. We urge the Commission not to make this situation worse."[87]

As these remarks suggest, there is sustained opposition to non-financial reporting reform because it is seen as an attempt to achieve "social" or "political" objectives. While the implication is that such efforts are "impermissible," the federal proxy rules were in fact intended to advance the public interest[88] and the anti-fraud and investor protection goals of the federal securities laws are premised on the power of disclosure to prevent harmful corporate practices that would be difficult to eradicate otherwise. Nonetheless, it is clear that opposition by companies, trade associations, and members of the corporate and securities bars to potential ESG disclosure reform is being fueled in part by the spillover effects of shareholder activism, and in particular, by how the SEC has defined the ordinary business exception.

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86. Bruce Warzman, Nat. Mining Ass'n, Comment Letter on Concept Release on Bus. and Fin. Disclosure Required by Regulation S-K (July 21, 2016), https://www.sec.gov/comments/s7-06-16/s70616-260.pdf.

87. Penny Somer-Greit & Gregory T. Lawrence, Comm. on Sec. Law of the Bus. Law Section of the Md. State Bar Ass'n, Comment Letter on Concept Release on Business and Financial Disclosure Required by Regulation S-K (July 21, 2016), https://www.sec.gov/comments/s7-06-16/s70616-257.pdf.

88. The Securities Act of 1933 and the Securities Exchange Act of 1934 authorize the SEC to require disclosure when "necessary or appropriate in the public interest or for the protection of investors." Securities Act of 1933, 15 U.S.C. §§ 77g(a)(10), 77s(a) (2012); Securities Exchange Act of 1934, 15 U.S.C. §§ 78c(b), 78*l*, 78m(a), 78n(a), 78o(d), 78w(a) (2012). *See also* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 375–82 (2013) (asserting that this "publicness" is a defining feature of securities law); Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012, 1017–31 (2013) (same).

IV. Reframing the Ordinary Business Exception

Since 1976, shareholders' ability to raise "significant" issues about corporate activities has expanded the space for the use of shareholder proposals and engagement with corporate management, changing corporate norms, shining light on troubling corporate practices, and focusing corporations on what matters to investors. Indeed, shareholder proposals have already raised the profile of ESG issues for companies and among more mainstream investors. But as the materiality of ESG factors becomes more widely recognized, it is essential that the SEC's implementation of the proxy rules—the mechanisms of investor self-help—do not impede more efficient ESG disclosure reform through direct rule-making.

This Article does not argue for the elimination of the ordinary business exception, nor does it advocate fundamental changes to the shareholder proxy rules. Of course, future revisions to the rules governing the informational content of proxy statements could improve investor access to decision-useful, non-financial information. But this Article's key concern is not with the text of Rule 14a-8 itself. Instead, its focus is the framing effects and communicative impact of the SEC's *interpretation* of the ordinary business exception.

The basic proposal here is therefore quite simple—that the SEC carefully consider the language it uses to define "substantial" matters so that it acknowledges the potential *economic* significance or materiality of ESG issues in no-action letters, future staff guidance, policy statements, and interpretations. By acknowledging the economic significance of non-financial issues, the SEC can weaken the false perception that non-financial matters are not material to investors. Such a shift would also prevent the incongruity of proponents defending material ESG issues from exclusion on ordinary business grounds by asserting their social and political, rather than economic, importance.

As it happens, implementing this modest proposal would require only that the SEC revive its use of the language of the 1976 Release, which in fact identified matters "beyond the realm of an issuer's ordinary business operations" as those with "significant policy, *economic* or other implications."[89] In the 1976 Release, the SEC also clearly recognized that many shareholder concerns might be "significant" for *both* economic and public policy reasons.[90] Indeed, the SEC made its case for allowing some "ordinary business" proposals to reach a shareholder vote by citing an example that raised both economic and public policy (i.e. safety) considerations: the decision of whether to construct a nuclear power plant.[91] In keeping with its original formulation, the SEC should clarify that its standard allows companies to exclude proposals only if they do not raise "significant policy *or economic*" issues, instead of describing the exception as one for proposals "that raise significant social policy issues."[92]

This is not to say that all ESG proposals raise material economic concerns, nor does this Article anticipate that the adoption of ESG-related disclosure reforms by the SEC would eliminate the need for ESG shareholder proposals, even those concerning information disclosure. Such proposals will still be essential, helping investors to raise contested topics and helping companies gauge investor interest in issues that may not be material, or may not ultimately merit a corporate or agency response.[93] Many of these topics may be areas of emerging risk for companies, while others may never become economically material. This is often true, for example, where investors raise concerns about corporate impacts on remote or diffuse stakeholders, such as victims of human rights abuses, or environmental exploitation. In these cases, shareholder activism remains an essential vehicle for communicating investors' views, raising the profile of issues they care about, and leveraging companies' reputational interests to spur changes in how companies do business, perhaps more powerfully than could be achieved via regulation. Still, reframing

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89. 1976 Release, *supra* note 40, at 52,998 (emphasis added).

90. *Id.*

91. *Id.*

92. 1998 Release, *supra* note 63 (emphasis added).

93. As of the time of this writing, the SEC is considering reforms urged by several business organizations that could impose higher ownership thresholds and other limitations on shareholders' ability to file proposals, outcomes that would undercut the many positive contributions of shareholder activism highlighted here. *See* Welsh et al., *supra* note 8 (discussing proposals to introduce such limits).

how investors, companies, and the SEC's own staff articulate and approach the ordinary business exception could change how corporate boards and their advisors understand ESG materiality and the growing demands of investors for ESG transparency.

V. Conclusion

Shareholder activism has already pushed many changes in corporate practice, ranging from corporate governance issues like proxy access, to environmental and social concerns, such as climate change mitigation, diversity, and sustainability reporting, all of which have potentially significant financial implications.[94] Shareholder activism has also begun to shift corporate norms around ESG materiality, and many proposals seek some form of information disclosure from corporate boards. However, shareholder activism cannot substitute for disclosure reform, which is a more efficient way to reduce ESG information gaps and standardize how this information reaches investors.

This Article therefore argues that the SEC should reframe how it defines "significant" to acknowledge the potential economic significance of non-financial matters that may be the subject of a shareholder proposal or no-action request. As we have seen, this interpretive stance is in fact faithful to the SEC's early articulations of the ordinary business exception. By acknowledging the economic relevance of ESG issues, the SEC can reduce issuer misperceptions that investor attention to sustainability or ESG issues flows only from a political or social agenda. Simply by changing its rhetoric, the SEC could reaffirm Congress' intent to create a broad forum for shareholder voice, and at the same time remove a subtle, but powerful ideological barrier to future disclosure reforms.

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94. *See, e.g.*, Kosmas Papdopoulos, *The Long View: The Role of Shareholder Proposals in Shaping U.S. Corporate Governance (2000–2018)*, HARV. L.S.F. ON CORP. GOVERNANCE AND FIN. REG. (Feb. 6, 2019), https://corpgov.law.harvard.edu/2019/02/06/the-long-view-the-role-of-shareholder-proposals-in-shaping-u-s-corporate-governance-2000-2018/ (last visited Sept. 23, 2019) (tracing the corporate governance reforms that companies have adopted in response to shareholder proposals) (on file with the Washington and Lee Law Review).