March 4, 2025

A New Chapter for the SEC: A Philosophical Shift on Shareholder Engagement, Shareholder Proposals, and ESG

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Only a short time has elapsed since President Trump named Mark T. Uyeda as Acting Chair of the Securities and Exchange Commission ("SEC") on January 21, 2025. Already, however, the regulatory climate has shifted significantly for public companies and their investors. More changes can be expected under the leadership of President Trump's nominee for SEC Chair, Paul S. Atkins.

Some of the first regulatory actions were directed at shareholder engagement and the proxy season. These developments are discussed in this memorandum. Other initiatives are likely to affect periodic reporting and, potentially, capital-raising and will be discussed in a subsequent memorandum.

The initiatives discussed here strengthen the role of the corporate board of directors and management in dealing with shareholders. They also essentially reject the idea that environmental and social concerns are the business of the boardroom. This of course reflects the political winds of change, but the intent might be politically neutral, stemming more from a philosophy of corporate governance than an attempt to stifle activism on a single political side. As Acting Chair Uyeda said in a June 21, 2023 address to the Society for Corporate Governance, "Shareholder meetings were not intended under state corporate law to be political battlegrounds or debating societies."

Shareholder Engagement

On February 10, 2025, the SEC shifted its stance on shareholder engagement on environmental, social, and governance topics by reversing its prior administrative interpretation of whether such engagement could be deemed to influence the control of the issuer.

Large asset managers and other institutional investors generally rely on the ability to file ownership reports with the SEC on the abbreviated Schedule 13G rather than on the more onerous Schedule 13D, which must be used by investors who intend to influence the control of the issuer. Historically, institutional investors have felt free to engage with management on environmental, social, and governance matters, without triggering Schedule 13D reporting. Their ability to do so was enshrined in the response to Question 103.11 of the SEC's "Compliance and Disclosure Interpretations" (or "C&DIs," as they are affectionately called) relating to Schedule 13D and 13G reporting. On February 10, 2025, this interpretation was amended, and a new interpretation was added, to provide that such discussions could well be seen as having an intent to influence control, depending on the circumstances.

Under the new interpretation, shareholders may continue to discuss social and governance issues with management and indicate how such views may inform their voting decisions without losing Schedule 13G eligibility. Once they go beyond that and pressure management to implement specific measures or policies, however, they may lose that eligibility and become subject to Schedule 13D reporting, something no asset manager would want. The problem is how to draw the line between a discussion of positions and the exertion of pressure to implement proposals. The new C&DIs indicate that pressure need not be explicit if it can be inferred from the totality of the circumstances.

Changes in the SEC's C&DIs rarely generate headline news. The amendment to Question 103.11, however, caused institutional investors to rethink their shareholder engagement process coming into proxy season, and both BlackRock and Vanguard were reported to have pulled back from all shareholder engagement while they studied the possible impact on their practices. As of now, BlackRock has resumed engagement, possibly concluding that the new interpretations require little change to its actual practices. In a statement, BlackRock indicated that it begins each engagement by emphasizing its role as a passive investor.

While shareholder engagement will no doubt continue in the future, institutional holders may become more cautious in their discussions for fear that their actions will be scrutinized and that they might possibly lose Schedule 13G eligibility. This could be true not only in their advocacy on social issues, but also on governance issues and executive compensation, where shareholders have traditionally tried to influence the management of the companies in which they invest. This in turn could have an impact on the balance of power between shareholders, on the one hand, and management and other corporate insiders, on the other hand, and could make it easier for companies to pursue governance and compensation practices that are disfavored in the governance community.

Shareholder Proposals

Continuing to reverse course on shareholder involvement with social and governance issues, on February 12, 2025, the SEC adopted interpretations that make it easier for a company to exclude shareholder proposals from its proxy statement if the proposals are not closely related to the company's business.

Rule 14a-8 under the Securities Exchange Act of 1934, as amended, is the regulation that sets forth when a corporation must include a shareholder proposal in its proxy statement as well as the grounds on which a shareholder proposal may be excluded. Among other things, a company may argue for exclusion if a proposal involves its "ordinary business" rather than shareholder concerns (Rule 14a-8(i)(7)). A company might also argue that a proposal is not economically relevant because it relates to less than 5% of the company's total assets or net earnings and is not otherwise relevant to the company's business (Rule 14a-8(i)(5)).

Under Staff Legal Bulletin 14L, adopted in November 2021, the SEC took the view that proposals raising significant public policy questions could not be excluded on ordinary business grounds, even if the public policy issues were not closely related to the business of the company. In addition, issues of broad social or ethical concern that had some relation to the company's business could not be excluded as economically irrelevant, even if less than 5% of the business was involved. These two positions were reversed, and Staff Legal Bulletin 14L was rescinded, by the SEC's new leadership with the adoption of new Staff Legal Bulletin 14M on February 12, 2025.

Under new Staff Legal Bulletin 14M, a proposal involving public policy concerns may still be excluded on the grounds that it involves the ordinary business of the company, unless there is a close nexus between the public policy issues and the company's business. In addition, the raising of broad social or ethical concerns will not influence whether a proposal will be considered relevant to the company's business. Instead, in each case, the SEC would look to the specific facts and circumstances of the company and the proposal, in the light of other SEC precedent.

The new Staff Legal Bulletin is a largely welcome development, which could curb both "ESG" and "anti-ESG" proposals. Understandably, management of the larger public companies that typically receive shareholder proposals complain that their proxy statements should not be required to provide a forum for the proponents of social and political positions that are not directly relevant to the companies' business.

Shareholder proposals rarely garner significant support, but gaining even a small percentage of the vote may influence corporate behavior over the long term. Making it easier for corporations to exclude proposals relating to social issues may therefore limit the attention given to those issues in the boardroom. Together with the shareholder engagement interpretation, the new Staff Legal Bulletin strengthens the hand of management in corporate governance while limiting shareholder influence on environmental and social issues.

A Philosophical Shift

The SEC's recent actions on shareholder engagement and shareholder proposals reflect a consistent and essentially conservative philosophy of corporate governance, in which boards have ultimate authority to determine what is in the best interests of shareholders and do not need to look to the interests of other stakeholders or to social and environmental concerns when making decisions. In this view, governance is primarily a question of state corporation law rather than federal securities laws, and federal securities regulators should apply only a light hand in influencing corporate behavior. This view is reportedly shared by Paul Atkins. Thus, it would seem likely that further actions of the SEC will reflect this perspective. But in the current political environment, with the Trump administration attempting to assert control over independent agencies such as the SEC, nothing can be certain.

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