Three Key SEC Developments Affecting ESG: Acting Chairman Uyeda's Climate Rule Statement, SLB 14M and Schedule 13D/G CDIs

In recent years, environmental, social and governance, or "ESG", considerations have become a key component of corporate strategies and in investor engagement. Particularly when coupled with the anti-ESG backlash, ESG continues to be one of the leading topics in the financial, corporate and regulatory landscape. Under the leadership of former Chair Gary Gensler, the U.S. Securities and Exchange Commission (the "SEC") pushed through a wave of regulatory and policy actions relating to ESG matters. The direction of ESG-related policies by regulators, however, has historically shifted with political changes and the recent transition to the second Trump administration is no exception.

The SEC's new leadership has already begun the process of dismantling the pro-ESG legacy of the prior administration. Since the change in presidency, the SEC has signaled plans to roll back the rule requiring mandatory federal-level climate disclosures as well as published updated staff guidance making shareholder engagement with companies on ESG policies more challenging. These early actions preview that the SEC will likely refocus on historical financial considerations in the coming years and generally act to reverse the pro-ESG actions taken by the prior SEC.

CLIMATE RELATED DISCLOSURES

With the change in presidential administration, we and many other commentators anticipated that the Enhancement and Standardization of Climate-Related Disclosures for Investors rule (the "Climate Rule") would be rescinded or, at a minimum, not go into effect as adopted. On February 11, 2025, SEC Acting Chairman Mark Uyeda took the first step in this direction and issued a statement indicating that the SEC would be pausing its legal defense of the Climate Rules.

The final Climate Rule, discussed in more detail here, was adopted (by a 3-2 vote) on March 6, 2024, and called for publicly traded companies to disclose a variety of information regarding their climate-related risks and impacts, including certain greenhouse gas emissions data. In response to the staggering number of comments received, the SEC scaled back the final Climate Rule somewhat from what was initially proposed in 2022. For example, the SEC dropped the requirement that public companies report certain indirect emissions from their supply chains and customer use of their products.

Even so, the final Climate Rule faced a host of challenges in court almost as soon as it was finalized and approved. These lawsuits were subsequently consolidated as *State of Iowa v. SEC* in the U.S. Court of Appeals for the Eighth Circuit, and shortly thereafter, the SEC exercised its discretion to stay the implementation of the Climate Rule pending the Eighth Circuit's review.

The Climate Rule is being challenged on three key grounds: (1) the SEC lacks the statutory authority to enact the Climate Rule; (2) the Climate Rule did not meet the procedural requirements of the Administrative Procedure Act, including failing to properly assess the rule's economic impact, meaning the SEC acted unreasonably in adopting the rule; and (3) the Climate Rule violated the First Amendment by requiring public company disclosure on matters of political debate.

In his recent statement, Acting Chairman Uyeda noted that the positions taken in the SEC's briefs defending its adoption of the Climate Rule were not reflective of his views. He noted, among other things, that both he and Commissioner Hester Peirce voted against the final Climate Rule, found the Climate Rule to be "deeply flawed", and believed that the SEC has neither the authority nor the expertise to enforce such a rule on climate matters.

Acting Chairman Uyeda stated that these concerns, together with "the recent change in the composition of the Commission, and the recent Presidential Memorandum regarding a Regulatory Freeze, bear on the conduct of [the Eighth Circuit] litigation". As such, Acting Chairman Uyeda directed the SEC staff to request that the Eighth Circuit not schedule the case for argument so that the SEC could have time to "deliberate and determine the appropriate next steps". The SEC filed a letter with the court on February 11, 2025 in which it committed to submitting a status report within 45 days (*i.e.*, March 28, 2025).

While Acting Chairman Uyeda's statement does not necessarily have a practical impact on the legality of the Climate Rule itself, it sends an affirmative signal that the current SEC is not supportive of the Climate Rule and we believe it indicates the SEC is actively considering the most effective path to roll back the Climate Rule. Combined with the Trump Administration's deregulatory climate agenda and focus on unwinding the Biden Administration's ESG policies, it is all but certain that the "next steps" taken by the SEC will include a rollback of the Climate Rule in some form. This could include opening a notice-and-comment process to rescind the Climate Rule and/or to adopt high-level, principles-based climate disclosure requirements, or letting the challenge in the Eighth Circuit proceed and withdrawing opposition to certain grounds proposed by the plaintiffs.

Given the current SEC's posture towards the Climate Rule, it seems unlikely that, as currently constructed, the rule will go into effect for public companies. However, it is important to note that companies may still be required to comply with other climate-related disclosure laws, including the EU's Corporate Sustainability Reporting Directive and California's SB 253 and SB 261 (discussed in more detail here).

SHAREHOLDER PROPOSALS – NEW STAFF LEGAL BULLETIN 14M

In a separate development, on February 12, 2025, the staff of the SEC's Division of Corporation Finance (the "Staff") published Staff Legal Bulletin No. 14M ("SLB 14M") to update the Staff's guidance on the "economic relevance" (Rule 14a-8(i)(5)) and "ordinary business" (Rule 14a-8(i)(7)) grounds for exclusion of shareholder proposals pursuant to Rule 14a-8. The Staff also rescinded Staff Legal Bulletin No. 14L ("SLB 14L"), which it had issued in November 2021. As discussed in a prior Cravath memo, SLB 14L had significantly narrowed the economic relevance and ordinary business exceptions by limiting the ability of companies to exclude shareholder proposals on matters with a "broad social impact". SLB 14M rejects this approach in favor of a company-specific framework, which we anticipate will result in giving more companies greater flexibility to exclude ESG-related proposals from their proxy materials.

Economic Relevance Exception

Rule 14a-8(i)(5) permits a company to exclude a shareholder proposal from its proxy materials that "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business." The bulk of the analysis centers on the last piece — whether or not the proposal is "significantly related to the company's business."

The updated guidance in SLB 14M reflects a more measured, company-specific approach to the Rule 14a-8(i)(5) analysis. Under SLB 14M, "proposals that raise issues of social or ethical significance may be excludable, notwithstanding their importance in the abstract, based on the application and analysis of each of the factors of Rule 14a-8(i)(5) in determining the proposal's relevance to the company's business." Given that the availability of the exclusion depends on whether the matter raised is not "otherwise significantly related to the company", SLB 14M affirms that the analysis will depend on "the particular circumstances of the company to which the proposal is submitted". Accordingly, a "proponent could continue to raise social or ethical issues in its arguments" but they "would need to tie those matters to a significant effect on the company's business." In particular, "[t]he mere possibility of reputational or economic harm alone will not demonstrate that a proposal is 'otherwise significantly related to the company's business,' and the staff will consider the proposal in light of the 'total mix' of information about the issuer."

Ordinary Business Exception

Rule 14a-8(i)(7) permits a company to exclude a shareholder proposal from its proxy materials that "deals with a matter relating to the company's ordinary business operations", and its availability rests on two key considerations: (1) whether a proposal raises matters that 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," or (2) the degree to which the proposal "micromanages" the company.

With respect to the first consideration, prior guidance provided that the Staff was to consider whether a shareholder's proposal "raises issues with broad societal impact, such that they transcend the ordinary business of the company", thus making it appropriate to include on the proxy ballot for a shareholder vote. SLB 14M rejects the blanket approach of the previous framework, and rather than focusing on whether particular categories of issues are universally 'significant', the updated guidance directs the Staff to consider whether the policy issue raised by a shareholder's proposal is significant as it relates to the subject company such that the policy issue in question transcends that company's ordinary business operations. While under the previous framework, pro-ESG proposals could escape exclusion by pointing to their importance on a broad scale, the same proposals may face a tougher challenge under this updated guidance.

The second consideration focuses on the means by which a proposal seeks to address the subject matter raised, rather than the subject matter itself. As such, a proposal may be excluded on "micromanagement" grounds regardless of whether it raises a significant social policy that transcends ordinary business operations. SLB 14M reinstates a broader definition of micromanagement and calls for a consideration of whether a shareholder proposal "involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies" (*e.g.*, a proposal that seeks an intricately detailed study or report from a company). Further, the Staff may consider the underlying substance of the matters addressed by the study or report in making their determination. For example, if the substance of a report sought by a shareholder proposal relates to the imposition or assumption of specific timeframes or methods for implementing complex policies, it may constitute micromanagement. Shareholder proponents seeking to put forth ESG-related proposals in particular may face increased challenges under the new guidance, and will have to carefully tailor any targets or methods included in their proposal to avoid exclusion.

Board analysis

In earlier Rule 14a-8 Staff legal bulletins leading up to SLB 14L, the Staff had encouraged companies seeking to exclude shareholder proposals under Rules 14a-8(i)(5) and 14a-8(i)(7) to include in their Rule 14a-8 no-action requests discussions of their boards of directors' analyses of the particular policy issues raised and the significance thereof to the companies. The Staff had indicated in SLB 14L that it would no longer request that companies provide discussions of their boards' analyses, as the Staff would no longer be taking a company-specific approach to evaluating the significance of a policy issue under Rule 14a-8(i)(7). In SLB 14M, the Staff has confirmed that it will still not require board analyses but now notes that is based on the Staff's experience that companies' no-action requests often failed to include information relevant to the Staff's determination and generally did not influence the outcome of the Staff's decisions. As such, the Staff continues to not expect a company's no-action request to include such board analysis, even though the Staff has rescinded SLB 14L.

2022 Proposed Rulemaking

As discussed in more detail previously, the SEC proposed amendments in 2022 to narrow the "substantial implementation", "duplication" and "resubmission" exclusions under Rule 14a-8(i)(10), Rule 14a-8(i)(11), and Rule 14a-8(i)(12). SLB 14M confirms that these proposed amendments have not been adopted and that the pre-2022 precedents applying these rules remain applicable. The SEC will not adopt the 2022 proposed amendments, though different rulemaking related to Rule 14a-8 is possible.

Timing

Recognizing that SLB 14M has been issued during the middle of the current proxy season, the Staff included a "Frequently Asked Questions" section to address a number of questions regarding timing and the implementation of the bulletin. Notably, the FAQs state that the new guidance in SLB 14M will be applied to no-action requests in the current season. Pending no-action requests will not need to be resubmitted, but if a company wishes to raise new legal arguments in light of the updated guidance in SLB 14M, they can submit such arguments as supplemental correspondence.

Relatedly, if a company believes that a new no-action request would be viable based on the updated guidance, but the deadline to submit a request has passed, SLB 14M notes that the Staff may permit a company to submit its request after the deadline under Rule 14a-8(j) "if the company demonstrates good cause for missing the deadline", which we note might include the lack of the Staff's updated guidance at the time of the original deadline. The Staff will consider the publication of SLB 14M to be "good cause" within the meaning of Rule 14a-8(j) so long as it relates to legal arguments made by the new request.

Finally, the FAQs note that the Staff will aim to meet print deadlines for definitive proxy statements in responding to no-action requests, but given the volume and timing of new requests and supplemental correspondence they expect to receive, the Staff may not be able to respond before a company's print deadline. As such, SLB 14M instructs companies that they "should endeavor to submit any new requests as soon as possible".

UPDATED CDIS ON SCHEDULE 13G ELIGIBILITY

On February 11, 2025, the Staff also updated its Compliance and Disclosure Interpretations ("CDIs") regarding the filing of Schedules 13D and 13G, revising Question 103.11 and issuing new Question 103.12. The updated CDIs address how certain interactions with an issuer's management might impact a shareholder's Schedule 13G eligibility.

Background

Generally, a shareholder may report its beneficial ownership of equity securities using Schedule 13G if, among other things, they certify that such securities were not acquired or held "with the purpose or effect of changing or influencing control of the issuer". Alternatively, shareholders who demonstrate this "control intent" (*i.e.*, "active investors") are required to file their reports using the more burdensome and disclosure-intensive Schedule 13D. The updated CDIs present a more expansive view as to what activities might suggest a disqualifying control intent.

Question 103.11

Revised Question 103.11 discusses the relationship between an exemption from the Hart-Scott-Rodino ("HSR") Act's notification and waiting period provisions and eligibility to report beneficial ownership on Schedule 13G. The HSR Act provides an exemption from notification where the securities were acquired "solely for the purpose of investment" and the acquiror had "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer".

Consistent with prior guidance, the Staff indicates that a shareholder's inability to rely on the HSR Act exemption is not, by itself, enough to disqualify the shareholder from reporting on Schedule 13G. The Staff maintains that the analysis centers around whether a shareholder acquired or holds its securities "with the purpose or effect of changing or influencing control of the issuer" and that this determination will take into account all relevant facts and circumstances. Notably, the revised CDI states that the determination of Schedule 13G eligibility "will be informed by the meaning of 'control' as defined in Exchange Act Rule 12b-2".

The prior version of Question 103.11 went on to include several examples of shareholder engagements with an issuer that could reflect a disqualifying control intent and cause a shareholder to lose their eligibility to report on Schedule 13G. Those examples, with substantial revisions, have been moved to the new Question 103.12.

Question 103.12

Mirroring the prior guidance in Question 103.11, the new CDI 103.12 notes that certain types of shareholder engagement are generally dispositive in determining whether Schedule 13G is unavailable, including specifically calling for the sale of the company or a significant amount of the company's assets, the restructuring of the company, or the election of director nominees other than the company's nominees.

The CDI goes on to note that in addition to the subject matter of the engagement, the context in which shareholder engages the issuer is also highly relevant in determining whether the shareholder is holding their securities with a disqualifying purpose or effect of "influencing" control of the issuer. As the base case, a shareholder who merely "discusses" their views on a topic and how these views may influence their voting decisions, without more, would generally not be disqualified from reporting on Schedule 13G. Once the shareholder goes beyond mere discussion, and attempts to "exert pressure" on management or the board to implement a particular measure or policy in line with those views, the shareholder is arguably seeking to influence control over the issuer.

The CDI provides two such examples of this "discussion-plus-pressure", noting that Schedule 13G may be unavailable to a shareholder who:

- recommends that the issuer remove its staggered board, switch to a majority voting standard in uncontested director elections, eliminate its poison pill plan, change its executive compensation practices, or undertake specific actions on a social, environmental, or political policy ***and***, as a means of pressuring the issuer to adopt the shareholder's position, explicitly or implicitly conditions its support of one or more of the issuer's director nominees at the next shareholder meeting where directors will be elected on the issuer's adoption of the shareholder's recommendation; or
- discusses with management its voting policy on a particular topic and how the issuer fails to meet the shareholder's expectations on such topic, and, to apply pressure on the company, states or implies during any such discussions that it will not support one or more of the issuer's director nominees at the next shareholder meeting where directors will be elected unless the company makes changes to align with the shareholder's expectations.

Takeaway

While the prior guidance provided that shareholder engagement "without more" was not disqualifying, the new CDIs indicate that simply conditioning support of an issuer's director nominees on the adoption of a shareholder's policy recommendation could constitute disqualifying conduct for purposes of filing on Schedule 13G rather than the more burdensome Schedule 13D. The updated CDIs appear to implicate the large asset managers and other institutional investors who typically engage with issuers on ESG-related policies or act as "swing-votes" on shareholder proposals brought by smaller activist investors. The new guidance indicates a view by the Staff that these institutional investors, who have in recent years leveraged their voting guidelines and significant voting power to influence corporate action in the ESG space, may no longer be entitled to the presumption that they are passive investors eligible to report their holdings on Schedule 13G. Notably, the new CDIs will not affect smaller ESG and anti-ESG investors, who are unlikely to even approach the requisite 5% beneficial ownership of the subject equity securities and thus need to give no consideration to Schedule 13D versus 13G filing eligibility.

In the immediate wake of the new CDIs, it was reported that certain large asset managers and institutional investors that currently file on Schedule 13G with a large number of companies have suspended shareholder engagement meetings. While we believe it should be possible for shareholder engagement meetings to resume once large asset managers have established compliance policies and procedures to reflect the "discussion-plus-pressure" framework in the CDIs, it is not clear exactly how the new CDIs will affect the shareholder engagement process in the medium- to long term.

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