Securities Regulation and Compliance Alert

Four Times Square
New York, NY 10036
212.735.3000

SEC Staff Issues New Shareholder Proposals Guidance

The Division of Corporation Finance of the U.S. Securities and Exchange Commission (Staff) recently published Staff Legal Bulletin No. 14H (SLB), which provides important new guidance for companies that may receive shareholder proposals during the upcoming proxy season. The SLB establishes a new standard for excluding a shareholder proposal under Rule 14a-8(i)(9), which allows the exclusion of a shareholder proposal that directly conflicts with a management proposal, and reaffirms the Staff's historical approach for determining whether a shareholder proposal could be omitted under the Rule 14a-8(i)(7) ordinary business exclusion.

Rule 14a-8(i)(9) Conflicting Proposals

Rule 14a-8(i)(9) permits a company to exclude a proposal if "the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting." Historically, the Staff permitted companies to exclude a shareholder proposal under this basis if presenting the shareholder proposal with a management proposal in the same proxy materials would present "alternative and conflicting decisions for shareholders" and create the potential for "inconsistent and ambiguous results."

In January 2015, at SEC Chair Mary Jo White's direction, the Staff initiated a review to determine the proper scope and application of the Rule 14a-8(i)(9) exclusion. As a result of this review, the SLB establishes a new, heightened standard for exclusion under Rule 14a-8(i)(9). Under this new standard, a direct conflict exists between a shareholder proposal and a management proposal only if "a reasonable shareholder could not logically vote in favor of both proposals, *i.e.*, a vote for one proposal is tantamount to a vote against the other proposal." The SLB provides several examples to illustrate this new standard:

- a management proposal seeking approval of a merger *would directly conflict* with a shareholder proposal seeking a shareholder vote against the merger;
- a shareholder proposal asking for the separation of the company's chairman and CEO *would directly conflict* with a management proposal seeking approval of a bylaw provision requiring the CEO to be the chair at all times;
- where a company does not allow proxy access, a shareholder proposal permitting a shareholder holding at least 3 percent of the company's outstanding stock for at least three years to nominate up to 20 percent of the directors *would not directly conflict* with a management proposal allowing shareholders holding at least 5 percent of the company's stock for at least five years to nominate for inclusion in the company's

proxy statement 10 percent of the directors because both proposals generally seek the "similar objective" of allowing proxy access; and

- a shareholder proposal asking the compensation committee to implement a policy that equity awards would have no less than four-year annual vesting *would not directly conflict* with a management proposal to approve an incentive plan that gives the compensation committee discretion to set the vesting provisions for equity awards because a reasonable shareholder could logically vote for a compensation plan that gives the compensation committee the discretion to determine the vesting of awards while also seeking implementation of a specific vesting policy for future awards.

To the extent that companies are concerned about potential shareholder confusion arising from the inclusion of two proposals on the same topic in the proxy materials, the Staff noted that companies have the ability to explain the differences between the proposals in their proxy materials.

In the case of a binding shareholder proposal and a management proposal that directly conflict, the Staff will give the shareholder proponent an opportunity to revise the proposal from binding to nonbinding in order to avoid exclusion under Rule 14a-8(i)(9). Lastly, the SLB reminds companies that the Staff may not agree that a company has met its burden of demonstrating that a shareholder proposal is excludable if a copy of management's proposal is not included with the no-action request.

Overall, the SLB places a much greater burden on companies seeking to exclude a shareholder proposal under Rule 14a-8(i)(9). Among other things, companies may need to demonstrate to the Staff that the shareholder proposal and the management proposal do not seek a "similar objective" and that they cannot both be implemented if approved. For companies that do not currently provide proxy access, the SLB appears to foreclose the possibility of excluding a shareholder proposal on proxy access under Rule 14a-8(i)(9) based on the argument that the ownership thresholds in management's proposal differ from those in the shareholder proposal. Companies also may need to finalize a management proposal earlier than has typically been the case so that they can submit the precise management proposal with their Rule 14a-8(i)(9) no-action request. Lastly, companies may need to include additional explanatory disclosure in their proxy materials if a management proposal and a shareholder proposal on the same topic are included in the proxy materials.

Trinity Wall Street vs. Wal-Mart **and the Rule 14a-8(i)(7) Ordinary Business Exclusion**

The SLB provides the Staff's views on the scope and application of the Rule 14a-8(i)(7) ordinary business exclusion in light of the recent *Trinity Wall Street v. Wal-Mart Stores, Inc.* decision by the U.S. Court of Appeals for the Third Circuit.[1] In concluding that the shareholder proposal submitted to Wal-Mart was excludable under Rule 14a-8(i)(7) because it related to the company's decisions on which products to sell, the Third Circuit majority opinion established a new two-part test for determining whether the significant policy exception to the ordinary business exclusion applied. It concluded that "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." The majority found that to transcend a company's ordinary business, the significant policy issue must be "divorced from how a company approaches the nitty-gritty of its core business."[2]

The Staff noted in the SLB that the two-part test of the Third Circuit majority opinion differs from the Commission's statements on the ordinary business exclusion and its historical practice. The Staff reiterated the Commission's view that proposals focusing on a significant policy issue are not excludable under the ordinary business exception "because the proposals would transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote." In the Staff's view, a proposal may transcend a company's ordinary business operations even if the significant policy issue relates to the "nitty-gritty of its core business." Therefore, proposals that focus on a significant policy issue transcend a company's ordinary business operations and are not excludable under Rule 14a-8(i)(7). The Staff stated that it will apply Rule 14a-8(i)(7) in this manner when considering Rule 14a-8(i)(7) no-action requests. In light of this SLB guidance, companies should not expect any change in the Staff's no-action positions on Rule 14a-8(i)(7) as a result of the *Trinity Wall Street v. Wal-Mart Stores, Inc*. decision.

A copy of the SLB is available here.

[1] 792 F.3d 323 (3d Cir. 2015).

[2] Additional information and analysis of the *Trinity Wall Street v. Wal-Mart Stores, Inc.* decision can be found here: https://www.skadden.com/insights/appeals-court-ruling-wal-mart-broadens-ordinary-business-exception-shareholder-proposal-rule

Contacts in the Securites Regulation Group

Brian V. Breheny
Washington, D.C.
202.371.7180
brian.breheny@skadden.com

Marc S. Gerber
Washington, D.C.
202.371.7233
marc.gerber@skadden.com

Richard J. Grossman
New York
212.735.2116
richard.grossman@skadden.com

Josh LaGrange
Palo Alto
650.470.4575
josh.lagrange@skadden.com

Ted Yu
Washington, D.C.
202.371.7592
ted.yu@skadden.com

Hagen J. Ganem
Washington, D.C.
202.371.7503
hagen.ganem@skadden.com

Caroline S. Kim
Washington, D.C.
202.371.7555
caroline.kim@skadden.com