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Memorandum

SEC's Division of Corporation Finance Issues Guidance on Rule 14a-8's "Directly Conflicting" and "Ordinary Business" Exclusions

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On October 22, 2015, the Division of Corporation Finance (the "Division") of the Securities and Exchange Commission ("SEC") issued Staff Legal Bulletin No. 14H ("SLB 14H"), which provides much awaited guidance on the Division's interpretation of Rule 14a-8(i)(9) – the provision that permits public companies to exclude a shareholder proposal "[i]f the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting."[1] The guidance clarifies the Division's reading of this provision following the Division's unexpected announcement early this year that it would not express any views regarding the application of Rule 14a-8(i)(9) during the 2015 proxy season. SLB 14H also expresses the Division's view regarding the scope of Rule 14a-8(i)(7), which allows companies to exclude shareholder proposals relating to their ordinary business operations.

The Division's Guidance Regarding Rule 14a-8(i)(9)

Unlike no-action letters granted prior to 2015 on the basis of Rule 14a-8(i)(9), which focused on the potential for inconsistent and ambiguous results and shareholder confusion, the Division's new approach centers "more specifically on the nature of the conflict between a management and shareholder proposal." In particular, under the Division's new approach, any assessment of whether a proposal is excludable under Rule 14a-8(i)(9) will focus on "whether there is a direct conflict between the management and shareholder proposals." As the Division explains, "a direct conflict would exist 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." Thus, if the two proposals are "in essence, mutually exclusive," the shareholder proposal would

[1] Division of Corporation Finance of the Securities and Exchange Commission, Staff Legal Bulletin No. 14H (CF) (Oct. 22, 2015) (quoting Rule 14a-8(i)(9) under the Securities Exchange Act of 1934, as amended).

be excludable; however, if a reasonable shareholder could logically vote for both proposals – although possibly preferring one proposal over the other – the shareholder proposal would need to be included in the company's proxy statement.

The Division provides several examples to illustrate its new definition of "directly conflicting" proposals. A management proposal seeking approval of a merger and a shareholder proposals requesting that shareholders vote against the merger, for instance, are "directly conflicting." The same goes for a shareholder proposal seeking a split of the chairman and CEO roles and a management proposal requesting approval of a bylaw amendment that requires that the roles be combined. On the other hand, the Division notes that a shareholder and management proposal, each of which seeks the adoption of proxy access but with different eligibility thresholds, are not "directly conflicting." The Division reasons that "both proposals generally seek a similar objective, to give shareholders the ability to include their nominees for director alongside management's nominees in the proxy statement, and the proposals do not present shareholders with conflicting decisions such that a reasonable shareholder could not logically vote in favor of both proposals." Similarly, under the new guidance, a shareholder proposal asking the compensation committee to implement a specific vesting policy for equity awards does not directly conflict with a management proposal seeking approval of an incentive compensation plan that provides the compensation committee the discretion to set the vesting provisions for equity awards. The Division believes that a reasonable shareholder could logically vote in favor of both of these proposals.

According to the Division, its new approach is better aligned with the intended purpose of Rule 14a-8(i)(9) – to prevent shareholders from using Rule 14a-8 to circumvent the SEC's rules that contain additional procedural and disclosure requirements for proxy solicitations. The Division believes that while, under its new policy, a board of directors "may have to consider the effects of both proposals if both the company and shareholder proposals are approved by shareholders," this decision does not rise to the level of a "direct conflict" that Rule 14a-8(i)(9) was designed to address.

The Division's Guidance Regarding Rule 14a-8(i)(7)

SLB 14H also addresses the scope and application of Rule 14a-8's "ordinary business" exclusion in light of the recent decision of the U.S. Court of Appeals for the Third Circuit in *Trinity Wall Street* v. *Wal-Mart Stores, Inc.*[2] The case involved a shareholder proposal requesting that Wal-Mart amend the charter of its Compensation, Nominating and Governance Committee to require the committee to oversee "the formulation and implementation of . . . policies and standards that determine whether or not the company should sell" certain categories of products, such as those that "especially endanger[] public safety and well-being."[3] After Wal-Mart obtained a no-action letter from the SEC staff on grounds that the proposal relates

[2] 729 F.3d 323 (3d Cir. 2015).

[3] *Id*. at 329.

to the company's ordinary business operations, the shareholder proponent filed suit in federal court. The district court concluded that the proposal was *not* excludable under Rule 14a-8(i)(7); on appeal, however, the Third Circuit reversed. In assessing whether the proposal pertains to ordinary business matters, the Third Circuit looked to the underlying subject matter of the proposal. Emphasizing substance over form, the court found that although the proposal requested the development of a policy, its underlying subject matter is its ultimate consequence – in this instance, a potential change in the way the company decides which products to sell. As a "retailer's approach to its product offerings is the bread and butter of its business," the court concluded that the proposal relates to the company's day-to-day business matters and is, therefore, excludable.[4]

The Third Circuit's opinion proceeded to address the "significant social policy exception" under Rule 14a-8(i)(7). As the Division has explained in the past, when "a proposal's underlying subject matter transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote, the proposal generally will not be excludable under Rule 14a-8(i)(7)."[5] The Third Circuit formulated a two-step analysis to determine whether a shareholder proposal relating to a company's ordinary business operations must nonetheless be included in the company's proxy materials under this exception. The court first asked whether the shareholder proposal raises a significant social policy issue. Even if it does, the court then inquired whether that issue transcends the company's ordinary business operations. While finding that the shareholder proposal in the case before it raised a significant social policy issue, the court held that such issue does not transcend Wal-Mart's business operations, since, in the case of retailers that sell a variety of products, "a policy issue is rarely transcendent if it treads on the meat of management's responsibility: crafting a product mix that satisfies consumer demand."[6]

In SLB 14H, the Division endorsed the Third Circuit's approach to determining whether a shareholder proposal relates to a company's ordinary business operations, reiterating the SEC's existing position that the analysis "should focus on the underlying subject matter of a proposal's request for board or committee review regardless of how the proposal is framed."[7] The Division voiced its concern, however, regarding the court's two-step process for assessing the applicability of the significant social policy exception and its potential to "lead to the unwarranted exclusion of shareholder proposals." In the Division's view, "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

[4] *Id*. at 344.

[5] Division of Corporation Finance of the Securities and Exchange Commission, Staff Legal Bulletin No. 14E (Oct. 27, 2009).

[6] *Trinity Wall Street*, 729 F.3d at 347.

[7] SLB 14H (citing Securities and Exchange Commission, Release No. 34-20091 (Aug. 16, 1983)).

would be appropriate for a shareholder vote.'"[8] Unlike the Third Circuit majority, the Division believes that "a proposal may transcend a company's ordinary business operations even if the significant social policy issue relates to the 'nitty-gritty of its core business.'"[9] SLB 14H clarifies that, in considering future no-action requests, the Division will continue to apply the principle that "proposals that focus on a significant policy issue transcend a company's business operations and are not excludable under Rule 14a-8(i)(7)."

Implications of the Division's Guidance

The Division's guidance on "directly conflicting" proposals alleviates the uncertainty generated by the Division's announcement, issued in the heat of last year's proxy season, that it would not opine on no-action requests based on Rule 14a-8(i)(9). As a practical matter, the Division's guidance is likely to result in many fewer no-action requests premised on Rule 14a-8(i)(9) than in previous years, when the Division's staff regularly granted relief with regard to shareholder proposals containing different eligibility thresholds than those in their management-sponsored counterparts. Going forward – much like in 2015 – an issuer receiving a shareholder proposal seeking proxy access or the right to call special meetings, for example, will generally not be able to exclude the proposal under Rule 14a-8(i)(9). It will, however, have the option of including the shareholder proposal with a statement of opposition or in addition to a management-sponsored proposal. As of a result of SLB 14H, therefore, the novel phenomenon of dueling proposals is likely to continue.

With regard to the "ordinary business" exclusion, SLB 14H affirms that a shareholder proposal that, at its core, relates to the company's ordinary business operations is excludable even when phrased as a request for board or committee oversight. The Division's guidance, however, articulates a view of the significant social policy exception that is considerably broader than that adopted by the Third Circuit. Interestingly, with regard to the shareholder proposal submitted to Wal-Mart, the Division's staff and the Third Circuit reached the same conclusion despite their meaningfully different approaches to the significant policy exception; however, the position articulated by the Division in SLB 14H accords its staff the flexibility to conclude that the significant social policy exception is applicable even where the policy issue clearly pertains to the company's day-to-day business operations. The concern with the Division's approach – which was a key impetus behind the Third Circuit's transcendence requirement – is that it may allow shareholders to circumvent the "ordinary business" exclusion by submitting proposals relating to the company's day-to-day business operations but couched as raising "significant" social policy issues.

[8] *Id*. (quoting Securities and Exchange Commission, Release No. 34-40018 (May 21, 1998)).

[9] *Id*. (quoting *Trinity Wall Street*, 729 F.3d at 347).

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at (212) 455-3815 or yafit.cohn@stblaw.com, or any other member of the Firm's Public Company Advisory Practice.

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