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Client Alert

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SEC Issues Guidance Limiting Exclusion of Shareholder Proposals

On October 22, 2015, the Staff of the Securities and Exchange Commission (the "Staff") issued Staff Legal Bulletin No. 14H (the "Bulletin"), which provides guidance on how the Staff will evaluate arguments for excluding Rule 14a-8 shareholder proposals from reporting companies' proxy materials. The Bulletin significantly narrowed the "conflicting proposals" exclusion under Rule 14a-8(i)(9) and confirmed the Staff's historical interpretation of the "ordinary business" exclusion under Rule 14a-8(i)(7).

Conflicting Proposal Exclusion Under Rule 14a-8(i)(9)

Rule 14a-8(i)(9) permits exclusion of a shareholder proposal from a company's proxy materials if "the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting." The Staff's interpretation of the Rule 14a-8(i)(9) exclusion was called into question ahead of the 2015 proxy season after a prominent shareholder proponent submitted a "proxy access" proposal to Whole Foods Market, Inc. ("Whole Foods").

The shareholder proposal called for the company to include in its proxy materials director nominations by an individual or group of shareholders that have continuously held more than 3% of Whole Foods' shares for a period of at least three years. Whole Foods' board responded with its own proxy access proposal that would allow any shareholder, but not a group of them, who has continuously held more than 9% of Whole Foods' shares for a period of at least five years to include director nominations in the company's proxy materials. In January 2015, the Staff withdrew the no-action letter previously granted to Whole Foods on the grounds that the proposals directly conflicted within the meaning of Rule 14a-8(i)(9) and initiated a review on the exclusion for the 2015 proxy season.

The Staff recently announced the results of its review, indicating that a company may only rely on Rule 14a-8(i)(9) if "a reasonable shareholder could not logically vote in favor of both proposals, *i.e.*, a vote for one

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proposal is tantamount to a vote against the other proposal." The Bulletin provides several examples to illustrate the new standard. Whereas a management proposal seeking approval of a merger would directly conflict with a shareholder proposal seeking a vote against the merger, dueling proposals like the two at Whole Foods would not directly conflict.

Looking forward, this higher standard will likely increase the number of competing shareholder and management proposals and decrease the number of no-action requests based on the Rule 14a-8(i)(9) exclusion. The Staff noted that companies concerned with potential shareholder confusion arising from the inclusion of two proposals on the same topic in their proxy materials may explain the differences between the proposals. In addition, where the Staff determines that a binding shareholder proposal and a management proposal 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).

Ordinary Business Proposal Exclusion Under Rule 14a-8(i)(7)

Rule 14a-8(i)(7) permits exclusion of a shareholder proposal from a company's proxy materials if it "deals with a matter relating to the company's ordinary business operations." However, the Staff generally will not exclude a proposal that presents a significant policy issue. The Bulletin expressed the Staff's views on the scope and application of the significant policy exception to Rule 14a-8(i)(7) in light of the Third Circuit's July 2015 opinion in *Trinity Wall Street v. Wal-Mart Stores, Inc.*[1]

Although both the Staff (in no-action relief granted in March 2014) and the Third Circuit agreed that Wal-Mart could exclude Trinity's proposal, which called for increased board oversight of Wal-Mart's decisions on the sale of guns and other potentially offensive or dangerous products, the Bulletin seeks to differentiate the Staff's approach from the standard employed in the majority opinion. According to the Third Circuit's majority opinion, in order to qualify for the significant policy exception and avoid exclusion under Rule 14a-8(i)(7), the shareholder proposal must pass a two-part test: it must focus on a "significant policy issue" and the subject matter of the proposal must "transcend" the company's ordinary business. The concurring judge on the three-member panel rejected the majority's two-part test, suggesting instead that if a policy issue met the test for "significance," it should also be deemed to "transcend" ordinary business operations. Moreover, the concurring judge noted that the Staff has traditionally treated the "significance and transcendence concepts as interrelated, rather than independent."

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

In the Bulletin, the Staff confirmed the concurring opinion's approach and expressed its concern that the two-part test advocated by the majority in the Third Circuit, where Delaware corporations reside, could justify "unwarranted exclusion" of investor proposals. Specifically, the Staff said that future applications of the Rule 14a-8(i)(7) exclusion would be "consistent with the [SEC's] prior application of the exclusion, as endorsed by the concurring judge."

Although Trinity has filed a petition asking the U.S. Supreme Court to review the appellate ruling, given the current status, we would advise companies against relying on the Third Circuit's majority opinion as a basis for excluding shareholder proposals under Rule 14a-8(i)(7).

A copy of the Bulletin is available here. For more information, please contact the Olshan attorney with whom you regularly work or any of the attorneys listed below.

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