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SEC Staff Clarifies Guidance on Exclusion of Conflicting Shareholder Proposals and the Ordinary Business Operations Basis for Exclusion

Nov 10, 2015

Reading Time : **4 min**

By: William K. Wetmore

Conflicting Shareholder Proposals

Rule 14a-8(i)(9) allows a company to exclude a shareholder proposal submitted pursuant to Rule 14a-8 from its proxy statement if the proposal "directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting." In past responses to requests for no-action relief, the Division had stated that a shareholder proposal was excludable if including it, along with a management proposal, could present "alternative and conflicting decisions for the shareholders" and could create the potential for "inconsistent and ambiguous results." This approach to Rule 14a-8(i)(9) can be seen clearly in the Division's controversial grant of no-action relief to Whole Foods Market, Inc. ("Whole Foods") in December 2014 (the "Whole Foods Letter"). In the Whole Foods Letter, the Division agreed that Whole Foods could exclude a shareholder proposal seeking a proxy access bylaw, because management had also submitted a proxy access proposal, even though the management proposal would impose stricter ownership requirements for shareholder nominations than the shareholder proposal. The shareholder proposal would have allowed a shareholder or group of shareholders that collectively have held 3 percent or more of the company's shares for three years to include director nominees in the company's proxy statement, whereas the Whole Foods management proposal would have allowed a shareholder (but not a group of shareholders) that has held 9 percent or more of the company's shares for five years to include director nominees in the proxy statement.

Following the uproar caused by the Whole Foods Letter, SEC Chair Mary Jo White directed the Division to review its interpretation of Rule 14a-8(i)(9), and the grant of no-action relief provided by the Whole Foods Letter was withdrawn. The Division's review resulted in the revised interpretation found in SLB 14H. Under the new interpretive approach described in SLB 14H, the Division will concur in the exclusion of shareholder proposals pursuant to Rule 14a-8(i)(9) only if a direct conflict exists between the shareholder proposal and the management proposal such that a reasonable shareholder could not logically vote in favor of both proposals. For example, a direct conflict would exist between a shareholder proposal seeking the separation of the company's chairman and CEO and a management proposal seeking approval of a bylaw provision requiring the CEO to be the chairman at all times. However, proxy access proposals submitted by both a shareholder and management would not present a direct conflict solely because the proposals contained differing share ownership requirements. The Division concludes that a shareholder could logically vote for both proxy access proposals, because they seek the same general objective. Although the company's Board of Directors (the "Board") may have to consider the effects of both proposals if both are passed by shareholders, the Division stated that such a decision by the Board does not create the type of "direct conflict" Rule 14a-8(i)(9) was intended to address.

Ordinary Business Operations Basis for Exclusion

Rule 14a-8(i)(7) allows a company to exclude a shareholder proposal submitted pursuant to Rule 14a-8 from its proxy statement if the proposal "deals with a matter relating to the company's ordinary business operations." The Division issued clarifying guidance on this basis for exclusion inSLB 14H as a result of the 3rdCircuit's July 2015 decision in *Wal-Mart*. In that case, the Division had previously granted no-action relief to Wal-Mart Stores, Inc. ("Wal-Mart"), concurring in the exclusion of a proposal relating to Wal-Mart's ordinary business operations and the shareholder proponent sued to require the company to include the proposal in its proxy statement. The proposal sought oversight and reporting by Wal-Mart to cover policies and standards that would be applicable to determining whether or not the company should sell guns equipped with high-capacity magazines. The U.S. District Court for the District of Delaware concluded, *inter alia*, that, although the proposal could impact the core of Wal-Mart's business—decisions regarding which products to sell—the proposal was not excludable because it focused on sufficiently significant social policy issues that transcend day-to-day business matters.

The 3rdCircuit reversed the district court's ruling, with the majority opinion concluding that the proposal was excludable, because the proposal's subject matter intruded on Wal-Mart's decision making regarding the products it sells, and the social policy issues raised by the proposal's subject matter do not transcend the company's ordinary business operations. The majority opinion establishes a two-part test for the significant policy exception to Rule 14a-8(i)(7), asking first whether the proposal focuses on a significant policy issue and second, if the proposal does focus on a significant policy issue, asking whether the significant policy issue transcends the company's ordinary business operations.

The Division in SLB 14H rejects the majority's two-part test, stating that it is inconsistent with the SEC's statements on the ordinary business operations exclusion and past Division guidance. The Division instead agrees with the views expressed in the concurring opinion in *Wal-Mart* that whether a proposal focuses on an issue of social policy that is sufficiently significant is not separate and distinct from whether the proposal transcends a company's ordinary business, but rather, the significance and transcendence concepts are interrelated. According to the concurring opinion, to transcend ordinary business, a proposal could relate to the company's ordinary business as long as it focuses on a policy issue that, in some "transcendent" way, overcomes ordinary business in importance. The Division concludes that a proposal may transcend a company's ordinary business operations despite the fact that the significant policy issues raised by the proposal relate to the core of the company's business. If a proposal focuses on a significant policy issue, the Division will conclude that it transcends a company's ordinary business operations and is not excludable under Rule 14a-8(i)(7).

SLB 14H likely will have a significant impact on how companies respond to shareholder proposals in this proxy season, since the guidance makes it much more difficult to exclude a proposal under Rule 14a-8(i)(9), and companies face continued uncertainty with regard to Rule 14a-8(i)(7), since the Division in the no-action process appears to have broad discretion to determine which policy issues are significant and whether a proposal that implicates a company's ordinary business operations focuses on a significant policy issue.

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