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Securities Law ALERT ■

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SEC Provides Guidance on Exclusion of Shareholder Proposals

On October 22, 2015, the staff of the Division of Corporation Finance (the "Division") of the U.S. Securities and Exchange Commission (SEC) released the highly anticipated Staff Legal Bulletin No. 14H (SLB 14H) concerning certain shareholder proposals submitted under Rule 14a-8 of the Exchange Act of 1934, as amended.[1] Specifically, SLB 14H addresses the scope and application of the "directly conflicts" exclusion under Rule 14a-8(i)(9) and the "ordinary business" exclusion under Rule 14a-8(i)(7). The guidance under SLB 14H significantly narrows the application of Rule 14a-8(i)(9) and confirms the Division's historical interpretation of Rule 14a-8(i)(7).

Exclusions Under Rule 14a-8(i)(9)

Rule 14a-8(i)(9) allows a company to exclude a shareholder proposal from its proxy materials if it "directly conflicts" with a management proposal. Questions arose earlier this year regarding the Division's interpretation of the exclusion under Rule 14a-8(i)(9) in connection with conflicting management and shareholder proxy access proposals. In light of these questions, the SEC announced that it would not express any views on the application of Rule 14a-8(i)(9) during the 2015 proxy season, and Chair Mary Jo White directed the Division to review the proper scope and application of Rule 14a-8(i)(9).

The Division's review

As part of reviewing the scope and application of Rule 14a-8(i)(9), the Division reviewed the history of the exclusion. The Division noted that the rule was intended to prevent shareholders from using Rule 14a-8 to circumvent the SEC's proxy rules governing solicitations. Based on this intended purpose, the Division states in the new guidance that any assessment of whether a proposal is excludable under Rule 14a-8(i)(9) should focus on whether there is a direct conflict between the management and shareholder proposals. In this regard, a "direct conflict" would arise when "a reasonable shareholder could not logically vote in favor of both proposals."

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1 http://www.sec.gov/interps/legal/cfslb14h.htm.

No-action requests going forward under Rule 14a-8(i)(9)

In considering future no-action requests under Rule 14a-8(i)(9), the Division staff will focus on whether such a reasonable shareholder could logically vote in favor of each proposal. However, the staff stressed that it will not view proposals as "directly conflicting" if a reasonable shareholder, although preferring one proposal over the other, could indeed logically still vote in favor of both.

For example, the Division notes in SLB14H that if a company does not permit shareholder nominees to be included in its proxy materials, "a shareholder proposal that would permit a shareholder or group of shareholders holding at least 3% of the company's outstanding stock for at least 3 years to nominate up to 20% of the directors would not be excludable if a management proposal would allow shareholders holding at least 5% of the company's stock for at least 5 years to nominate for inclusion in the company's proxy statement 10% of the directors."

The Division concedes that while this formulation may pose a "higher burden for some companies seeking to exclude a proposal" than had previously been the case, the Division believes that this current interpretation is "most consistent with the history of the rule and more appropriately focuses on whether a reasonable shareholder could vote favorably on both proposals or whether they are, in essence, mutually exclusive proposals."

In light of this guidance, instances of competing management and shareholder proposals being contained in the same proxy statement are likely to increase, and it will be difficult for companies to exclude shareholder proposals under Rule 14a-8(i)(9) even if management intends to include its own competing proposal.

Exclusions Under Rule 14a-8(i)(7)

***The Third Circuit opinion in* Trinity Wall Street v. Wal-Mart Stores, Inc.**

Rule 14a-8(i)(7) allows the exclusion of a shareholder proposal if it "deals with a matter relating to the company's ordinary business operations." In July 2015, the Third Circuit released its opinion in *Trinity Wall Street v. Wal-Mart Stores, Inc.*[2] in which the court addressed the application of Rule 14a-8(i)(7) to Trinity's shareholder proposal requesting that Wal-Mart's board provide oversight concerning the formulation, implementation and public reporting of policies and standards that determine whether or not Wal-Mart should sell a product that endangers public safety, namely assault rifles with high capacity magazines, that could impair its reputation or may be considered offensive to family and community values. The three-judge panel concluded that Wal-Mart could exclude Trinity's shareholder proposal from its proxy materials under Rule 14a-8(i)(7) because it related to "ordinary business operations." Notably, this conclusion is the same as the one reached by the staff when the Division granted Wal-Mart no-action relief in March 2014 to exclude Trinity's proposal from its 2014 proxy materials.

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2 792 F.3d 323 (3d Cir. 2015).

In addressing whether the "significant social policy exception" to the ordinary business exclusion applied, the majority opinion in *Trinity* employed a new two-part test that departed from the SEC's previous statements and Division practice. The majority's two-part test 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." In order to "transcend" a company's ordinary business, the majority found that the significant policy issue must be "divorced from how a company approaches the nitty-gritty of its core business." By contrast, the concurring judge in *Trinity* analyzed Rule 14a-8(i)(7) in line with the approach previously articulated and applied by the SEC. In doing so, the concurring judge noted 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. Rather, a proposal is sufficiently significant 'because' it transcends day-to-day business matters." Further, the concurring judge noted that the SEC "treats the significance and transcendence concepts as interrelated, rather than independent."

The Division confirms its approach under Rule 14a-8(i)(7)

Given the split between the majority opinion and the concurring judge in *Trinity*, the Division noted its concern that the new analytical approach introduced by the Third Circuit goes beyond the SEC's prior statements regarding the exclusion and could result in shareholder proposals being improperly excluded.

As a result, the Division announced in SLB 14H that it intends to continue to apply Rule 14a-8(i)(7) as articulated by the SEC and consistent with the Division's prior application of the exclusion, as endorsed by the concurring judge in *Trinity*, when considering no-action requests that raise Rule 14a-8(i)(7) as a basis for exclusion.

Looking Forward

The new guidance has been issued in time for the start of the 2016 proxy season. Companies should review the new guidance when determining whether it is proper to exclude a shareholder proposal from its proxy materials under Rule 14a-8.

If you have any questions or would like additional information on how to best prepare for these new standards, please contact your Alston & Bird securities attorney.

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