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## SEC Issues Staff Legal Bulletin Outlining the Scope of the “Directly Conflicts” Exclusion under Rule 14a-8 and Providing Guidance on the Staff’s Interpretation of the Ordinary Business Exclusion

On October 22, 2015, the SEC’s Division of Corporation Finance (the Division) issued Staff Legal Bulletin No. 14H (the SLB) in which it provides guidance on two key issues surrounding the exclusion of shareholder proposals under Rule 14a-8: (i) the scope and application of Rule 14a-8(i)(9), regarding shareholder proposals that conflict with a company’s own proposal and (ii) the scope and application of Rule 14a-8(i)(7), regarding shareholder proposals that deal with matters relating to a company’s ordinary business operations. In each case these rules and interpretations also apply to registered investment companies.

*Directly Conflicting Proposals.* Rule 14a-8(i)(9) states that a company may exclude a shareholder proposal if such proposal directly conflicts with one of the company’s own proposals to be submitted to shareholders at the same meeting. In January 2015, SEC Chair Mary Jo White announced that the Division would express no view on the application of Rule 14a-8(i)(9) during the 2015 proxy season. That edict followed the staff’s issuance of a no-action letter to Whole Foods Market, Inc. (Whole Foods), which sought to exclude from its proxy materials a shareholder proposal to allow shareholders or a group of shareholders that, for the preceding three years, had continuously held at least 3% of Whole Food’s voting shares to nominate up to 20% of the company’s Board of Directors. In arguing the proposal was excludable under Rule 14a-8(i)(9), Whole Foods advised the staff that it too was submitting a proxy access proposal at the upcoming shareholder meeting, and that its proposal featured different terms. The staff agreed the proposal was conflicting and therefore excludable, and granted the company’s no-action request. This opened the door for companies that wished to follow the Whole Foods model, and a number of issuers soon attempted to exclude shareholder proposals on proxy access by offering their own access proposals with more company-favorable terms. Ultimately, this led Chair White to suspend the application of Rule 14a-8(i)(9) and call for further review of the rule.

In the SLB, SEC staff interprets the Rule 14a-8(i)(9) exclusion narrowly, limiting its scope to “direct conflicts.” Under the new guidance, exclusions of shareholder proposals under Rule 14a-8(i)(9) are only permissible “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.”

The SLB provides two examples of shareholder and management proposals that may be found to directly conflict: where a company seeks shareholder approval of a merger, and a shareholder proposal asks shareholders to vote against the merger, and where a shareholder proposal asks for the separation of the company’s chairman and CEO positions, and a company proposal seeks approval of a bylaw provision requiring the CEO to be the chair at all times. However, the SLB notes that proposals that generally seek similar objectives, such as, for example, a shareholder proposal requesting the compensation committee to implement a policy that equity awards would have no less than four-year annual vesting and a management proposal to approve an incentive plan granting the compensation committee discretion to set the vesting provisions for equity awards, do not directly conflict. Consequently, in the proxy access context, proposals with different triggers or thresholds will not be considered to directly conflict because the approval of one does not expressly rise to a vote against the other, and therefore will not be excludable on that basis. This new interpretation imposes a significant limitation on the applicability of Rule 14a-8(i)(9) and will make it much more difficult for companies to exclude proposals on a “directly conflicts” basis going forward. In

addition, this new interpretation of the scope of Rule 14a-8(i)(9) could lead to voting outcomes that create ambiguous results where, for example, a company's shareholders approve both a company's proxy access proposal and a shareholder proponent's proxy access proposal containing different conditions to proxy access. In addition, it is unclear whether proxy advisory firms would expect a company to adopt the shareholder proponent's formulation of proxy access in all circumstances where it achieved at least majority support.

*Ordinary Business Operations Exclusion.* Rule 14a-8(i)(7) states that a company may exclude a shareholder proposal if such proposal deals with a matter relating to the company's ordinary business operations. The scope of Rule 14a-8(i)(7) was a focal point in *Trinity Wall Street v. Wal-Mart Stores, Inc.*, in which Wal-Mart Stores, Inc. (Wal Mart) sought to exclude from its proxy materials a shareholder proposal submitted by Trinity Wall Street (Trinity) requesting that the company's Board of Directors amend its Compensation, Nominating and Governance Committee charter to provide that the committee oversee the development and implementation of policies and standards for management to use in deciding whether to sell products that, among other things, endanger public safety. Wal-Mart argued that the proposal was excludable under Rule 14a-8(i)(7)'s ordinary business exclusion because it related to the products Wal-Mart decided to carry in its stores, and obtained a no-action letter from SEC staff supporting its position. The federal district court in Delaware disagreed, however, and enjoined Wal Mart from excluding Trinity's proposal. On appeal, the Third Circuit vacated the injunction and permitted Wal Mart to exclude Trinity's proposal from its proxy materials. In doing so, the Third Circuit introduced a new two-part test to the effect that a shareholder proposal must do more than focus on a significant policy issue, but that the subject matter of the proposal must also "transcend" the company's ordinary business. The Third Circuit closed its opinion by suggesting that the SEC issue fresh guidance on the scope of Rule 14a-8(i)(7).

The staff took the Third Circuit up on its offer and has now issued that fresh guidance. The staff did not endorse the majority's new two-part test. Instead, the SLB supports the staff's prior position reflected in the concurring judge's opinion that a proposal that focuses on significant policy issues necessarily transcends ordinary business operations, and is therefore not excludable under Rule 14a-8(i)(7).

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