

US SEC Staff Offers Guidance On Exclusion of Shareholder Proposals from Company Proxy Statements

Rule 14a-8(i) of the Securities Exchange Act of 1934 provides a list of the permitted, non-procedural reasons for an issuer to exclude a shareholder proposal from its proxy statement. Rule 14a-8(i)(7) allows an issuer to exclude a proposal that “deals with a matter relating to the company’s ordinary business operations.”

On October 27, 2009, the Division of Corporation Finance of the Securities and Exchange Commission issued a staff legal bulletin, available at <http://www.sec.gov/interps/legal/cfs1b14e.htm>, that provides guidance relating to shareholder proposals submitted for inclusion in an issuer’s proxy statement. The bulletin addresses application of Rule 14a-8(i)(7) to proposals relating to risk or to chief executive officer succession planning. The bulletin also suggests that shareholder proponents and issuers inform the staff in advance if they intend to submit correspondence in connection with a no-action request involving a shareholder proposal.

Proposals Relating to Risk

Prior Position. In a bulletin issued in 2005, available at <http://www.sec.gov/interps/legal/cfs1b14c.htm>, the SEC staff analyzed Rule 14a-8(i)(7) in the context of environmental or public health proposals. In the 2005 bulletin, the staff indicated that it evaluated whether the shareholder proposal and supporting statement, as a whole, related to a company’s internal evaluation of the risks and liabilities faced by the company as a result of its operations, and, if they did, the staff permitted the company to exclude the proposal. On the other hand, if the staff concluded that the proposal and supporting statement were directed at minimizing or eliminating operations that may adversely affect the environment or the public’s health, the staff did not permit the proposal to be excluded on the ordinary business operations ground provided by Rule 14a-8(i)(7).

New Position. In the new bulletin, the staff revised its position regarding risk-based shareholder proposals. Instead of focusing on whether a proposal essentially calls for the company to evaluate its risk, the staff will now examine the “subject matter to which the risk pertains or that gives rise to the risk” to determine “whether the underlying subject matter of the risk evaluation involves a matter of ordinary business to the company.”

If the underlying subject matter of the proposal “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) as long as a sufficient nexus exists between the nature of the proposal and the company.” If, however, the underlying subject matter involves something that is an ordinary business matter for the company, the proposal generally would be excludable under Rule 14a-8(i)(7). This new approach mirrors the staff’s analysis for determining whether Rule 14a-8(i)(7) provides an appropriate basis for exclusion of proposals asking for the preparation of a report, the formation of a committee or the inclusion of disclosure in a document required by the SEC.

The methodology for analyzing shareholder proposals under Rule 14a-8(i)(7) detailed in the new bulletin was not limited to specific types of risks. However, the bulletin addressed this issue in the context of proposals that have recently been submitted relating to environmental, financial or health risks. Therefore this new guidance may affect shareholder proposals concerning matters such as global warming, pollution concerns, health care or sub-prime lending.

Proposals Relating to CEO Succession Planning

Prior Position. Over the last two years, the SEC permitted the exclusion of a number of shareholder proposals relating to succession planning for chief executive officers from issuer proxy statements as ordinary business operation matters under Rule 14a-8(i)(7). This position was based on Exchange Act Release No. 40018 (May 21, 1998), available at <http://www.sec.gov/rules/final/34-40018.htm>, which stated that proposals involving “the management of the workforce, such as the hiring, promotion, and termination of employees” relate to ordinary business matters.

New Position. In the new bulletin, the staff observed that while the 1998 release treated management of the workforce as ordinary business, it expressly recognized that some ordinary business matter proposals may “transcend” day-to-day business matters and raise policy issues “so significant that it would be appropriate for a shareholder vote.” The staff has now changed its position with respect to CEO succession planning proposals, characterizing succession planning as “one of the board’s key functions,” and concluding “that CEO succession planning raises a significant policy issue regarding the governance of the corporation that transcends the day-to-day business matter of managing the workforce.”

Accordingly, the staff has indicated that companies “may not rely on Rule 14a-8(i)(7) to exclude a proposal that focuses on CEO succession planning.” However, if such a proposal “seeks to micro-manage the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make informed judgment,” exclusion pursuant to Rule 14a-8(i)(7) may be permitted.

Notifying the Staff of Additional Correspondence to be Submitted Relating to No-Action Requests

The staff encouraged companies and shareholders to contact the staff if they intend to submit correspondence relating to a shareholder proposal no-action request so that, if possible, the staff can review that material before issuing its no-action response. The staff would appreciate knowing the date by which companies and shareholders intend to submit their correspondence. The bulletin reminds shareholder proponents who plan to respond to a company’s no-action request to

submit the reply as soon as possible after the company submits its no-action request.

Practical Considerations

As a result of the staff’s revised positions, certain shareholder proposals that companies previously have been permitted to exclude from their proxy statements as relating to ordinary business matters will need to be included in issuer proxy statements if the proposals are submitted in accordance with all procedural requirements of Rule 14a-8, and if no other basis for exclusion is applicable. It is possible that, as a result of the new bulletin, more risk-related and CEO succession shareholder proposals will be submitted to public companies this year than in prior years. As proxy season nears, it would be worthwhile for issuers to plan in advance how they would respond if they anticipate receiving a proposal that may not be excludable under the new guidance, both in terms of possible company responses to be contained in the proxy statement and strategies for negotiating with shareholder activists.

With respect to proposals relating to risk, before submitting a no-action request in reliance on Rule 14a-8(i)(7), companies will need to analyze whether the risk at the heart of the proposal can be characterized as an ordinary business matter, as opposed to a significant social policy matter that transcends day-to-day business. Companies should be aware that over time, the staff adjusts its views as to what rises to the level of a significant social policy.

CEO succession proposals should be evaluated to determine if they focus on complicated issues not susceptible to informed shareholder action.

Companies planning to submit no-action requests seeking exclusion of any type of shareholder proposal should be cognizant of the staff’s desire to be notified of the company’s intention to submit additional correspondence relating to the request so that it can be considered before the staff issues its reply.

If you have any questions about the staff legal bulletin or other shareholder proposal issues, please contact the author of this Securities Update, Laura D. Richman, at +1 312 701 7304, any of the lawyers listed below or any other member of our Corporate & Securities practice.

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