October 23, 2015

SEC Narrows Shareholder Proposal Exclusion for Rule 14a-8
Proposals that "Directly Conflict" with Company Proposals

Yesterday, the Staff of the Securities and Exchange Commission's Division of Corporation Finance issued Staff Legal Bulletin No. 14H. SLB14H formally narrows the long-standing approach to interpreting Rule 14a-8(i)(9), which permits a company to exclude a shareholder proposal that otherwise complies with Rule 14a-8 from its proxy statement "[i]f the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting."

Prior to the 2015 proxy season, the exclusion applied in many corporate governance, shareholder rights and executive compensation contexts to avoid the risk of inconsistent and confusing meeting results, to facilitate private ordering and to promote the gradual and deliberative evolution of company practices and investor perspectives. For example, under the historical approach that the SEC Staff acknowledged had been applied "for decades," if a shareholder submitted a Rule 14a-8 proposal seeking the right to call special meetings at a 10% threshold, companies could, in their fiduciary judgment, put to a vote giving shareholders the right to call a special meeting at a higher threshold (*e.g.*, 25%) without also putting the 10% formulation to a vote at the same meeting. During the 2015 proxy season, in the context of several proxy access proposals, the rule allowing shareholder proposals to be excluded on this basis became mired in controversy, and the SEC Staff suspended its review of company requests for no-action relief under the rule.

For the 2016 proxy season, under SLB14H companies may obtain no-action relief to exclude "directly conflicting" shareholder proposals in favor of the company's own proposals only 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 proposal" as "they are, in essence, mutually exclusive proposals." The exemption could not be used to exclude proposals that "propose different means of accomplishing an objective, but do not directly conflict" or where "a reasonable shareholder, although possibly preferring one proposal over the other, could logically vote for both." Whether a shareholder proposal is binding or precatory or "came first" will not impact the availability of the exclusion.

Accordingly, and as the SEC Staff makes clear, companies should not expect to get no-action relief under this exception to:

- Exclude shareholder proposals seeking new proxy access, special meeting, written consent or other rights simply by putting company-sponsored versions of such new rights to a vote; or

- Exclude shareholder proposals relating to executive compensation matters, such as those seeking new clawback policies or modified approaches to accelerated change of control vesting, simply because the company seeks approval at the same meeting for a new compensation plan that vests discretion over such matters in the compensation committee.

Thus, SLB14H's new interpretation effectively nullifies the "directly conflicts" rule in the vast majority of cases. Procedural questions have been raised, with the Business Roundtable expressing its disappointment that "this departure from long-established practice was adopted without a formal rulemaking process."

As issued, SLB14H would apply the "directly conflicts" exclusion to prevent shareholders from circumventing the SEC's proxy rules by, for example, using Rule 14a-8 to solicit in opposition to a management proposal. For example, if a company is seeking shareholder approval to approve a merger, Rule 14a-8(i)(9) can be used to stop a shareholder from using Rule 14a-8 to include in the company's own proxy statement a proposal asking shareholders to vote against the merger. Another example of a permitted exclusion (unlikely to occur in practice) would be where a Chair/CEO separation proposal is submitted for consideration at the same meeting that the company seeks approval of bylaw provisions requiring the CEO to always be the Chair of the Board.

Rule 14a-8's other substantive bases for exclusion continue to be available. These include, among others, the company having already "substantially implemented" the shareholder proposal, the proposal being materially false and misleading (whether because of its vagueness, content or otherwise), or the proposal relating to personal grievances or special interests. With respect to excluding proposals that relate to "ordinary business operations," SLB14H confirmed that the SEC Staff will not change its own approach to interpreting that rule, notwithstanding the U.S. Court of Appeals for the Third Circuit's different analysis in *Trinity Wall Street v. Wal-Mart Stores, Inc*.

SLB14H is not binding, and companies retain the right to seek to invoke the rule as historically applied without obtaining a no-action letter from the SEC. However, proxy advisory firms and certain shareholders have indicated they will consider "withhold" votes from directors if a company omits a properly submitted shareholder proposal without obtaining: (i) the voluntary withdrawal of the proposal by the proponent; (ii) no-action relief from the SEC; or (iii) a federal court ruling confirming that the proposal has been properly excluded. In addition, shareholder proponents may themselves utilize litigation to challenge company attempts to rely on the historical form of the exclusion.

Accordingly, the 2016 proxy season is likely to look like 2015 did after the SEC suspended its Rule 14a-8(i)(9) guidance, with companies needing to:

- Anticipate which shareholder proposals they will receive (*e.g.*, proxy access; special meeting or written consent rights; executive compensation; Chair/CEO separation; ESG and political topics; etc.) and develop an early view with their advisors as to what their responses and options might be if they get one;

- Assess the nature of any proposal received, evaluate what is being asked and confirm that all of the technical and procedural requirements of Rule 14a-8 are met;

- Analyze the company's options, including: (i) negotiating a compromise or alternative outcome with the shareholder proponent; (ii) submitting the proposal to a shareholder vote, advising shareholders of the company's recommendation (which need not necessarily be a recommendation against the proposal) and soliciting accordingly; (iii) preemptively addressing the topic being raised by the proposal, whether through unilateral board action or other means; (iv) submitting a competing management-sponsored proposal (which could be binding or precatory) to a vote alongside the 14a-8 proposal and explaining the differences; and/or (v) attempting to exclude the proposal in reliance on SEC rules;

- When opposing a proposal, prepare for more aggressive and organized solicitation campaigns by proponents, featuring exempt solicitations; letters to the board, management and fellow shareholders; use of the media; requests for non-public interim vote tallies; and heightened scrutiny of the details of company counter-proposals (if any) and of the tone and content of a company's opposition statement; and

- Prioritize early and deliberate shareholder engagement by management and, when appropriate, directors, effective advocacy with proxy advisory firms and tailored investor outreach.

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