

# SEC Issues New Guidance on Exclusion of Shareholder Proposals

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A company that receives a shareholder proposal asking that proxy access rights be given to shareholders owning 3% of outstanding shares for three years, to nominate up to 25% of the board, would *not* be able to exclude that proposal under Rule 14a-8(i)(9) by offering its own management proposal that would allow shareholders owning at least 5% of the company's stock for 5 years to nominate 10% of the directors. That is the punch line of the long-awaited Staff Legal Bulletin 14H (SLB 14H) from the SEC Division of Corporation Finance.

**Background of SLB 14H.** As we previously described [here](#), the Staff had suspended making no-action decisions on the basis of Rule 14a-8(i)(9) earlier this season after issuing a controversial letter to Whole Foods allowing the company to exclude a proxy access shareholder proposal. SLB 14H is in response to Chair White's directive to the Staff to review the rule.

**New Meaning of "Direct Conflict".** Since 1998, Rule 14a-8(i)(9) has specified that a company is permitted to exempt a shareholder proposal when the proposal "directly conflicts" with one of the company's own proposals to be submitted at the meeting. In SLB 14H, the Division states that a "direct conflict" exists between the management and shareholder proposals when a shareholder cannot "logically vote" in favor of both proposals. A vote for one proposal must equate to a vote against the other proposal, so that the two proposals are, "in essence, mutually exclusive."

The examples given in SLB 14H of where a "direct conflict" arises, in spite of or perhaps due to their obvious nature, are illustrative of the Division's new thinking. A company proposal that asks shareholders to approve a merger would conflict with a shareholder proposal that asks shareholders to vote against that same merger. Along those lines, a shareholder proposal that asks the company to separate the CEO and chair positions would conflict with a management proposal to adopt a bylaw requiring the CEO to also be the chairman at all times.

By contrast, in addition to the example involving proxy access, SLB 14H stated that a shareholder proposal asking the compensation committee to implement a policy that equity awards must have a four-year vesting period would *not* conflict with a management proposal that gives the committee complete discretion. According to the Division, this represents two proposals seeking different approaches but similar objectives, and therefore fails to directly conflict as the rule requires.

**Prior Interpretation of the Rule No Longer Relevant.** In the 1998 release that added the concept of "direct conflict" to Rule 14a-8(i)(9), the SEC indicated that the two proposals need not be identical in "scope or focus" to meet the standards. With SLB 14H, however, the Division is moving away from its long line of prior no-action letters that expressed the view that shareholder proposals could be conflicting, and therefore excludable, if the two proposals present alternative and conflicting decisions for shareholders and create the possibility of inconsistent and ambiguous results.

For many years, the Staff had allowed shareholder proposals to be excluded when a management proposal provided for different terms than the shareholder proposal, even when the general subject matter of the two proposals are the same. For example, a company putting forth a management proposal to permit the right to call special meetings for shareholders owning 25% or more of the outstanding stock would have been able to exclude a shareholder proposal asking for the same right, but with a 10% or other threshold ownership level. SLB 14H departs from those precedents.

**Responses to Comments and Criticisms.** The Division rejected suggestions by those commenters, who generally represent shareholder proposal proponents, that precatory shareholder proposals do not conflict with management proposals because they are not binding and that the exclusion should not apply if the shareholder proposal is submitted before the company makes a decision to act under a management proposal. That will be cold comfort to those

commenters, speaking for issuers, who had urged the SEC to continue its historical application of the rule or adopt subject matter exclusions. The [WSJ](#) is calling the new Division guidance a gain for shareholders, noting that labor unions and pension funds are praising the SEC's decision.

SLB 14H does not address the criticism that this type of change in the interpretation of Rule 14a-8(i)(9) is significantly substantive as to require a rulemaking process under the Administrative Procedures Act, a criticism that began when the SEC stopped issuing decisions under the rule, and is likely to continue with the release of SLB 14H. The Business Roundtable issued [a statement](#) expressing disappointment that the change to long-established practice was made without formal rulemaking.

**Ordinary Business Exclusion.** SLB14H also clarified that the Division disagrees with the majority view expressed in the *Wal-Mart Stores* case implicating Rule 14a-8(i)(7), the ordinary business exclusion, which we previously discussed [here](#). The appeals court had used a two-prong analysis regarding when the significant policy exception to the ordinary business exclusion applied. The court concluded that in addition to raising a significant policy issue, the subject matter must “transcend” the company’s ordinary business, meaning a policy issue that is “divorced from how a company approaches the nitty-gritty of its core business.”

Instead, the Division sided with the concurring opinion as being consistent with its own views, which does not make the same distinction. The SEC intends to continue to apply the rule as articulated in its prior decisions, where proposals focusing on significant policy issues are not excludable because the proposal transcend day-to-day business matters, even if they relate to the “nitty-gritty of [a company’s] core business.”

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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