SEC Provides Guidance on Exclusion of Shareholder Proposals Under the "Ordinary Business" and "Direct Conflict" Exclusions of Rule 14a-8

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On October 22, 2015, the staff of the SEC's Division of Corporation Finance issued Staff Legal Bulletin No. 14H (SLB 14H), which addresses issues related to shareholder proposals that conflict with a company's own proposal or that relate to a company's ordinary business operations. This recent guidance suggests that the staff is less likely to allow companies to exclude shareholder proposals that touch upon a company's ordinary business or conflict with the company's own proposals.

Direct Conflict Exception

Rule 14a-8(i)(9) allows a company to exclude a shareholder proposal if that proposal directly conflicts with a proposal put forth by the company at the same meeting. The SEC has previously issued guidance stating that such proposals do not necessary have to be identical in scope or focus for the exclusion to be available.

In its latest guidance, the SEC states that in considering no-action requests under the "directly conflict" exception it will now focus on whether a reasonable shareholder could logically vote for both proposals, "*i.e.* whether a vote for one proposal is tantamount to a vote against the other proposal." For example, proposals on similar objectives with different thresholds would not be considered to be in direct conflict with one another, representing a sharp deviation from prior practice. The staff notes that although allowing shareholders to vote on similar proposals with different thresholds may lead to a situation where the board of directors of the company would have to consider the effects of both proposals if both proposals were approved, such consideration is not the type of "direct conflict" the rule was designed to address. In light of this new guidance, we expect companies will have a much harder time excluding shareholder proposals when relying on the "direct conflict" exception.

Given the significant change in the guidance – previously a 5% threshold proposed by an issuer for direct access was viewed as a direct conflict to a holder's proposed 3% threshold – it may not be too long before an issuer challenges the validity of the guidance change as a rule amendment required to be promulgated in accordance with the Administrative Procedure Act.

Ordinary Business Exception

As we previously reported, in the recent *Trinity Wall Street v. Wal-Mart Stores, Inc.* case, the U.S. Court of Appeals for the Third Circuit addressed the application of Rule 14a-8(i)(7), which allows a company to exclude a shareholder proposal that deals with matters related to a company's ordinary business operations. In its decision allowing Wal-Mart to exclude a shareholder proposal calling for the company's board of directors to implement policies in deciding whether to sell certain products, in this case high capacity rifles, the court applied a two-part test in considering whether there is a significant policy exception to the ordinary business exclusion. The court concluded that for there to be a significant policy exception, the proposal must transcend the company's ordinary business and be separate from how a company approaches the "nitty-gritty" of its business operations.

Even though the staff agrees that the shareholder proposal should have been excluded from the Wal-Mart proxy, the staff does not agree with the two-part test advanced by the Third Circuit. Instead, the staff believes that a proposal that addresses the "nitty-gritty" of a Company's business may, nevertheless, still transcend a company's business operations.

Past guidance from the staff on this issue states that a proposal will generally not be excludable as long as there is a sufficient nexus

between the nature of the proposal and the company. In SLB 14H, the staff explains that it plans to continue to follow that practice (supported in the concurring opinion in the Third Circuit) when considering no-action requests under Rule 14a-8(i)(7) and will not apply the two-part test set forth by the majority opinion in the Third Circuit.

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