

# ClientAlert

## Capital Markets/Securities

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### SEC Issues New Guidance Regarding Exclusion of Shareholder Proposals

On October 27, 2009, the Division of Corporation Finance of the Securities and Exchange Commission (the "SEC") issued Staff Legal Bulletin No. 14E to provide guidance on the ability of companies to exclude shareholder proposals under the "ordinary business" exclusion provided by Rule 14a-8(i)(7) under the Securities Exchange Act of 1934, as amended (the "Exchange Act").<sup>1</sup> The new guidance represents a significant victory for shareholder activists. Since most shareholder proposals are filed in November, companies should prepare for the upcoming proxy season aware that this new Staff position will impact their ability to exclude shareholder proposals that they may have succeeded in excluding in prior years.

#### Proposals Relating to Risk

The SEC Staff adopted an informal position in 2002—later codified in Staff Legal Bulletin No. 14C<sup>2</sup>—that companies seeking to exclude shareholder proposals relating to environmental, financial or health risks could do so under the "ordinary business" exclusion under Rule 14a-8(i)(7). This was premised on the notion that, irrespective of the subject matter involved, the proposal essentially sought an internal assessment of risk, and any risk assessment was a matter of ordinary business operations. The narrow opening left by the SEC for such proposals to be included required the proposals to be focused on a company minimizing or eliminating operations that may adversely affect the environment or public health rather than the risks the activities posed to the subject company.

Staff Legal Bulletin No. 14E now states that the SEC will no longer focus on whether a shareholder proposal requires an evaluation of risk. Rather the SEC will focus on the subject matter to which the risk pertains or that gives rise to the risk, and will consider whether the underlying subject matter of the risk evaluation "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 SEC notes that a proposal that focuses on the board's oversight of a company's risk management is likely to be viewed as transcending the day-to-day business matters of a company and raising policy issues so significant that it would be appropriate for a shareholder vote.



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<sup>1</sup> Staff Legal Bulletin No. 14E (CF) dated October 27, 2009 (available at <http://www.sec.gov/interps/legal/cfslb14e.htm>).

<sup>2</sup> Staff Legal Bulletin No. 14C (CF) dated June 28, 2005 (available at <http://www.sec.gov/interps/legal/cfslb14c.htm>).

As a result of this change, more shareholder proposals addressing matters of social policy will likely be submitted and included in proxy statements in the upcoming proxy season. Such proposals could cover the financial risks associated with a wide variety of issues, such as climate change, public health, subprime lending, human rights and environmental activities. Shareholders will still need to demonstrate that a sufficient nexus exists between the proposal and the company based on the nature of the company's business, and will need to satisfy other requirements of Rule 14a-8, for example, that the proposal does not seek to micromanage, avoids duplications and has not been substantially implemented. However, a substantial hurdle to the inclusion of such proposals has been removed.

### **Exclusion of Proposals Regarding Succession Planning for CEO**

During the last two proxy seasons, the SEC Staff has permitted the exclusion of proposals related to CEO succession planning on the basis that the proposals related to the termination, hiring or promotion of employees, which are ordinary business matters under Rule 14a-8(i)(7). Staff Legal Bulletin No. 14E now seeks

to draw a distinction between a company's CEO and its other employees. The SEC notes that CEO succession planning raises a significant policy issue regarding the governance of a company that transcends the day-to-day business of managing a company's workforce. The SEC will now take the view that a company generally may not rely on Rule 14a-8(i)(7) to exclude a proposal that focuses on CEO succession planning.

As a result, more shareholder proposals related to CEO succession planning will likely be submitted and included in proxy statements in the upcoming proxy season. Such proposals generally request that companies adopt and disclose written and detailed CEO succession planning policies with specified features, including that the board develop criteria for the CEO position, identify and develop internal candidates and use a formal assessment process to evaluate candidates.

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