Proxy Access Update—Director of SEC Division of Corporation Finance Remarks on Decision to Suspend No-Action Relief Based on Rule 14a-8

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On February 10, 2015, Keith Higgins, Director of the SEC Division of Corporation Finance, provided his informal views (available here) on the Division's controversial decision to "express no views" on the application of Exchange Act Rule 14a-8(i)(9), the basis for excluding a shareholder proposal that "directly conflicts" with a management proposal, in *any* no-action letters issued during the 2015 proxy season, and to reverse the no-action relief the Division had previously granted to Whole Foods based on Rule 14a-8(i)(9). The Division took these actions in response to SEC Chair Mary Jo White's January 16, 2015 directive to the Division to review and report back to the Commission on the "proper scope and application" of Rule 14a-8(i)(9).

Rule 14a-8(i)(9) permits a company to exclude a shareholder proposal from its proxy statement if the shareholder proposal "directly conflicts" with a proposal included in the proxy statement by management. In December 2014, Whole Foods had successfully obtained no-action relief from the Division to exclude a shareholder proposal on proxy access by including a management counterproposal that was significantly more restrictive than the shareholder proposal, which raised concerns about the scope of Rule 14a-8(i)(9). The effect of Chair White's action may be to drive registrants to exclude shareholder proposals based on their own analysis or, when in doubt, to seek relief from a federal district court.

Background: Proxy Access and the Fall of Rule 14a-8(i)(9)

Since the U.S. Court of Appeals for the District of Columbia Circuit vacated the SEC's "proxy access" rule (vacated Exchange Act Rule 14a-11) in 2011, proxy access has remained a hot topic in corporate governance circles. "Proxy access" refers to a company permitting large, long-term shareholders to nominate board candidates, and including those candidates in the same company-mailed proxy statement that lists candidates nominated by the board. Proxy access makes it easier for activist shareholders to seek to force out directors, increases a company's annual meeting expenses and facilitates contested director elections. Under vacated Rule 14a-11, a shareholder or group of shareholders holding at least three percent of a company's voting shares for at least three years would have been permitted to require a company to include board candidates representing up to 25 percent of the total number of directors on the board in the company's proxy statement.

The portion of the 2010 proxy access rule changes that survived the D.C. Circuit decision permits shareholders to submit proposals requesting that a company adopt a version of the SEC's 2010 rule—this process is referred to as "private ordering." Prior to the 2010 proxy access rules, companies could exclude all shareholder proxy access proposals. Companies have sought to shape private ordering, however, by including management proposals on proxy access that require higher standards, ownership of more than three percent of voting shares over more than three years, while seeking no-action relief from the Division to exclude shareholder proxy access proposals under Rule 14a-8(i)(9) as "directly conflicting" with the management counterproposal.

In his February 10, 2015 speech, Mr. Higgins made the following points about the Division's Rule 14a-8(i)(9) process:

- The Division has generally granted no-action relief based on Rule 14a-8(i)(9) under its long-standing interpretation that a shareholder proposal conflicts with a management proposal that is not identical in scope or focus where including both proposals in the proxy statement could "present alternative and conflicting decisions for shareholders" and "submitting both proposals to a vote could provide inconsistent and ambiguous results." EMC Corp. (Feb. 24, 2009).
- Companies infrequently invoked Rule 14a-8(i)(9) until recently, when Rule 14a-8(i)(9) activity substantially increased, beginning in 2009, with proposals related to a shareholder's right to call a special meeting of shareholders.
- The precatory/mandatory distinction has not been not a key factor in the Division's Rule 14a 8(i)(9) analysis, mainly because virtually all shareholder proposals are precatory and this exclusion would then rarely apply.
- Likewise, allowing a shareholder proposal because the conflicting management proposal was adopted "in response to" the shareholder proposal from concerns about management's motives could provide an inappropriate disincentive for the board to present its old proposal and discourage board responsiveness to shareholder concerns.

- The Division has instead focused on concerns that the results of a shareholder vote on conflicting proposals may provide data that is too ambiguous for the directors to interpret and so ambiguous as to make it difficult for shareholders to decide how to send their message.
- The Division could examine the structural limitation in current proxy rules that allow shareholders to vote only "for" or "against" each proposal without any flexibility to express a different preference, which prevents an effective side-by-side comparison of potentially conflicting proposals.
- The Division could decide to require companies to include a statement from the proponent of the excluded shareholder proposal, or limit how many times a company may exclude the same shareholder proposal or shareholder proposals on the same subject matter.

Whole Foods No-Action Letter…and Reversal

In October 2014, Whole Foods raised the management proposal approach to a new level, seeking to exclude a shareholder proposal permitting proxy access to a group of shareholders owning *three* percent of the company's shares for *three* years by including a management counterproposal. The counterproposal would permit proxy access to a single shareholder owning *nine* percent of the company's shares for *five* years, which are more restrictive terms than other companies had previously attempted in a counterproposal. The Division issued a no-action letter in December 2014, agreeing that Whole Foods could exclude the shareholder proposal from its 2015 proxy statement. This decision was generally consistent with past applications of Rule 14a-8(i)(9), under which companies have been permitted to exclude proposals that conflict with management counterproposals with more restrictive terms.

The Division's position expressed in the Whole Foods no-action letter set off two floods, one of similar no-action requests and the other of criticisms from shareholder rights groups.

In a statement issued on January 16, 2015, SEC Chair Mary Jo White directed the Division to review the scope and application of Rule 14a-8(i)(9). In light of this direction, the Division announced that, due to questions about Rule 14a-8(i)(9), it will "express no views" on the application of Rule 14a-8(i)(9) in *any* no-action letters issued during this proxy season and reversed its position on the Whole Foods no-action request.

In his February 10, 2015 speech, Mr. Higgins discussed and analyzed some of the issues that have arisen about the scope and application of the "directly conflicts" exclusion and potential responses, including possible changes to the shareholder proposal rules, with the usual disclaimer that his views do not reflect the views of the SEC or anyone else, "in this case likely including my own." Mr. Higgins acknowledged that the Division has effectively become "an informal arbitrator in the shareholder proposal process, assisting both companies and shareholder proponents, who might otherwise have to resort to litigation to resolve their disagreements."

Companies Can Still Exclude Shareholder Proposals Based on Rule 14a-8(i)(9)

The Division's refusal to express views on any no-action requests based on Rule 14a-8(i)(9) during this proxy season does not entirely prevent a company from excluding a shareholder proposal on this basis. A company may exclude a shareholder proposal from its proxy statement without first seeking no-action relief from the Division.

While Exchange Act Rule 14a-8(i) requires a company to file with the SEC a notice stating the reasons it intends to exclude a shareholder proposal no later than 80 calendar days prior to filing its definitive proxy statement, SEC rules do not require the Division to respond to these notice filings. For years, the Division's practice has been to respond to these notice filings with no-action letters that express the Division's informal view on whether a company demonstrated that it may properly exclude a shareholder proposal. No-action letters represent the Division's discretionary determinations not to recommend or take enforcement action—but only a court may decide whether a company is obligated to include a shareholder proposal.

Given the current status of Rule 14a-8(i)(9), a company excluding a shareholder proposal this proxy season on the basis that it conflicts with a management proposal may be more likely than usual to face a court challenge from the shareholder proponent.

Practical Tip

Companies Should Consider Alternatives to Support Excluding Proposal
A company faced with a shareholder proposal that it intends to exclude by providing a management counterproposal should consider seeking a declaratory judgment from a federal district court on whether the shareholder proposal can be properly excluded. A declaratory judgment would protect the company from potential shareholder litigation, as well as potential criticism from shareholders or proxy advisors. Alternatively, companies could rely on another grounds for exclusion, such as adopting a proxy access bylaw now and seeking no-action relief from the Division based on substantial implementation under Rule 14a-8(i)(10).

Additional Information

This update highlights key takeaways from the February 10, 2015, speech by Keith Higgins; the full text is available here. More information about these issues and discussions of other recent speeches, cases, laws, regulations and rule proposals of interest to public companies is available on our website.

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