

Legal Updates & News

Legal Updates

SEC Staff Narrows the “Ordinary Business” Exclusion for Shareholder Proposals

November 2009

by [Jackie Liu](#), [David M. Lynn](#), [Alina Ball](#)

On October 27, 2009, the staff of the Division of Corporation Finance of the Securities and Exchange Commission (the “Staff”) announced new guidance on the application of Rule 14a-8(i)(7) of the Securities Exchange Act of 1934 with regard to shareholder proposals relating to company risk assessments and CEO succession planning.^[1]

Rule 14a-8 addresses when a company must include a shareholder proposal in its proxy statement (and include the proposal on its form of proxy) when the company holds an annual or special meeting of shareholders. A company must include a shareholder’s proposal in its proxy statement unless the proposal is excludable pursuant to the enumerated substantive and procedural bases for exclusion under Rule 14a-8. Companies often rely on Rule 14a-8(i)(7) to exclude a shareholder proposal based on the position that the proposal relates to the company’s ordinary business operations. Under the Staff’s new guidance, it will no longer permit companies to exclude a shareholder proposal solely because the proposal requires the company to engage in an evaluation of the risks and liabilities that it faces as a result of its operations. Rather, the Staff will consider whether the underlying subject matter of the risk evaluation involves an “ordinary business” matter to determine whether the shareholder proposal is excludable under Rule 14a-8(i)(7). Similarly, the Staff stated in its new guidance that it generally will not allow a company to rely on Rule 14a-8(i)(7) to exclude a proposal that focuses on CEO succession planning.

Related Practices:

[Corporate](#)
[Public Companies & Corporate Governance](#)

Subject Matter Analysis of Shareholder Proposals Relating to Risk

The Staff explained that it will now apply a subject matter analytical framework to determine whether a company may exclude a shareholder proposal related to risk assessment pursuant to Rule 14a-8(i)(7). This new guidance reverses prior guidance provided in Staff Legal Bulletin No. 14C released in 2005, which provided that companies could omit proposals referencing environmental, financial or health risks under the “ordinary business” exception if such proposals “focused on the company engaging in an internal assessment of the risks or liabilities that the company faces as a result of its operations.”^[2] In SLB No. 14E, the Staff acknowledges that application of the framework set forth in SLB No. 14C may have resulted in “the unwarranted exclusion of proposals that relate to the evaluation of risk but that focus on significant policy issues.” In addition, the Staff recognizes that “the adequacy of risk management and oversight can have major consequences for a company and its shareholders.” Therefore, a shareholder proposal that requires a risk assessment will no longer be excludable under Rule 14a-8(i)(7) where its subject matter “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,” as long as there is a sufficient nexus between the proposal and the company. The Staff, however, reiterates in SLB No. 14E that “the determination as to whether a proposal deals with a matter relating to a company’s ordinary business operations is made on a case-by-case basis, taking into account factors such as the nature of the proposal and the circumstances of the company to which it is directed.” Nonetheless, the Staff specifically noted that a proposal focusing on the board’s role in the oversight of a company’s management of risk is an example of a proposal that may not be excludable under the new subject matter analysis.

The Staff also announced in SLB No. 14E that it generally will no longer allow companies to exclude proposals relating to CEO succession planning in reliance on Rule 14a-8(i)(7). Previously, the Staff considered proposals concerning CEO succession planning to be excludable because they relate to the termination, hiring or promotion of employees, which are each ordinary business matters. The Staff stated that it recognizes that CEO succession planning raises a significant policy issue regarding the governance of the corporation which transcends the day-to-day business matter of managing the workforce.

The Staff Encourages Communication Regarding Submission of Correspondence

One of the perennial problems that the Staff faces in the course of the shareholder proposal season is the problem of “crossing” correspondence with companies and shareholder proponents because the Staff is not aware that a company or shareholder proponent is planning to submit additional arguments. The Staff indicates in SLB No. 14E that companies and shareholder proponents are encouraged to contact the Staff (via telephone or e-mail) to notify them of a pending submission and the anticipated date for the submission.

Impact on the 2010 Proxy Season

The Staff’s change in position on proposals relating to risk and succession planning could mean that more proposals relating to environmental, social and corporate governance issues (including CEO succession planning) will be submitted in the upcoming proxy season. Such proposals might include, for example, proposals requesting an evaluation of the potential risks arising from climate change or sub-prime lending. Companies that have received risk-oriented proposals in the past that were excludable under the prior Staff position should begin preparing for how to address similar proposals that will not now be excludable. Such preparations might include consideration of substantially implementing the analysis requested in the prior proposals, formulating an engagement strategy with the proponent, or drafting the statement in opposition that the company would anticipate including if any such proposal will be included in the proxy statement.

Footnotes

[1] The Division of Corporation Finance Staff Legal Bulletin No. 14E, “Shareholder Proposals,” dated October 27, 2009 (“SLB No. 14E”), is available at <http://www.sec.gov/interps/legal/cfslb14e.htm>.

[2] The Division of Corporation Finance Staff Legal Bulletin No. 14C, “Shareholder Proposals,” dated June 28, 2005 (“SLB No. 14C”), is available at <http://www.sec.gov/interps/legal/cfslb14c.htm>.