

Division of Corporation Finance Staff Legal Bulletin
Proposals of Security Holders: Ordinary Business Operations Exclusion

On October 27, 2009, the Securities and Exchange Commission's (the "Commission") Division of Corporation Finance (the "Division") issued Staff Legal Bulletin No. 14E, providing guidance regarding Rule 14a-8 under the Securities Exchange Act of 1934.¹ Specifically, Bulletin No. 14E contains information regarding:

- the application of Rule 14a-8(i)(7) to proposals relating to risk;
- the application of Rule 14a-8(i)(7) to proposals focusing on succession planning for a company's chief executive officer ("CEO"); and
- the manner in which shareholder proponents and companies can notify the Division that they will be submitting correspondence in connection with a no-action request.

Rule 14a-8 focuses on when a company must include a shareholder's proposal in its proxy statement and identify the proposal in its form of proxy when the company holds an annual or special meeting of shareholders.² Rule 14a-8(i)(7), one of the substantive bases for exclusion in Rule 14a-8, permits a company to exclude a proposal that deals with a matter relating to the company's ordinary business operations.³

As the Division explained, the general underlying policy of this exclusion is consistent with the policy of most state corporate laws: to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting. The fact that a proposal relates to ordinary business matters, however, does not conclusively establish that a company may exclude the proposal from its proxy materials.

I. PROPOSALS RELATED TO RISK

A. Background

Over the past decade, the Division has received numerous no-action requests from companies seeking to exclude proposals relating to environmental, financial or health risks under Rule 14a-8(i)(7). As set forth in Staff Legal Bulletin No. 14C, in analyzing such requests, the Division has sought to determine whether the proposal and supporting statement as a whole relate to the company engaging in an evaluation of risk, which is a matter the Division viewed as relating to a company's ordinary business operations.⁴ Recently, the Division has witnessed a marked increase in the number of no-action requests in which companies argued that proposals that do not explicitly request an evaluation of risk are nonetheless excludable under Rule 14a-8(i)(7) because they would require the company to engage in risk assessment.⁵

¹ See SEC Staff Legal Bulletin No. 14E (CF) (Oct. 27, 2009), available at <http://www.sec.gov/interps/legal/cfs1b14e.htm>.

² 17 C.F.R. § 240.14a (2009).

³ 17 C.F.R. § 240.14a-8(i)(7) (2009).

⁴ See SEC Staff Legal Bulletin No. 14C (CF) (June 28, 2005), available at <http://www.sec.gov/interps/legal/cfs1b14c.htm>.

⁵ See *supra* note 1.

Under the framework set forth in Bulletin No. 14C, proposals and supporting statements focusing on a company's internal assessment of the risks and liabilities it faces as a result of operations were permitted to be excluded under Rule 14a-8(i)(7) as relating to an evaluation of risk. To the extent that a proposal and supporting statement focused on a company minimizing or eliminating operations that may adversely affect the environment or the public's health, however, the Division did not permit companies to exclude these proposals. The application of this framework has sparked concern over potentially unwarranted exclusions of proposals that relate to the evaluation of risk but that focus on significant policy issues.⁶

In Bulletin No. 14E, the Division has reexamined the analysis used for risk-related proposals. The Division noted that as most corporate decisions involve some evaluation of risk, the evaluation of risk should not be viewed as an end in itself, but rather, as a means to an end. Because the adequacy of risk management and oversight can have major consequences for a company and its shareholders, the Division concluded that there is a more appropriate framework to apply for analyzing these proposals.

B. New Analysis Framework

On a going-forward basis, rather than focusing on whether a proposal and supporting statement relate to the company engaging in an evaluation of risk, the Division will instead focus on the subject matter to which a risk pertains or that gives rise to the risk. The fact that a proposal would require an evaluation of risk will not be dispositive of whether the proposal may be excluded under Rule 14a-8(i)(7). Instead, the Division will consider whether the underlying subject matter of the risk evaluation involves a matter of ordinary business to the company.⁷ Proposals whose underlying 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 generally will not be excludable under Rule 14a-8(i)(7) as long as a sufficient nexus exists between the nature of the proposal and the company. Conversely, proposals whose underlying subject matter involves an ordinary business matter to the company generally will be excludable. In determining whether the subject matter raises significant policy issues and has a sufficient nexus to the company, as described above, the Division will apply the same standards that it applies to other types of proposals under Rule 14a-8(i)(7).⁸

Furthermore, in light of a widespread recognition that the board of director's role in the oversight of a company's management of risk is a significant policy matter regarding the governance of the corporation, the Division noted that a proposal focusing on this board function may transcend the day-to-day business matters of a company and raise policy issues so significant that it would be appropriate for a shareholder vote.

⁶ See *supra* note 1. In December 2008, a group of 60 investing organizations urged then President-elect Obama to prioritize the reversal of the impediment to shareholder resolutions seeking disclosure of financial risks posed by Staff Legal Bulletin No. 14C. Corporate Disclosure Alert, <http://corporatedisclosurealert.blogspot.com> (Oct. 1, 2009, 8:48 EST). On September 22, 2009, a group of investor representatives met with the director of the Division of Corporation Finance and asserted that this staff ruling deserves priority attention for reversal. Corporate Disclosure Alert, <http://corporatedisclosurealert.blogspot.com> (Dec. 11, 2008, 11:00 EST).

⁷ This approach is similar to the way in which the Division analyzes proposals asking for the preparation of a report, the formation of a committee or the inclusion of disclosure in a Commission-prescribed document. See Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 20091, 48 Fed. Reg. 38,218 (Aug. 16, 1983); see also *Johnson Controls, Inc.* (Oct. 26, 1999).

⁸ See SEC Staff Legal Bulletin No. 14C (CF) (June 28, 2005), available at <http://www.sec.gov/interp/leg/cfs/lb14c.htm>.

II. PROPOSALS RELATED TO CEO SUCCESSION PLANNING

During the past two proxy seasons, the Division has received a number of no-action requests from companies seeking to exclude proposals relating to CEO succession planning in reliance on Rule 14a-8(i)(7). These proposals generally requested that the companies adopt and disclose written and detailed CEO succession planning policies with specified features, including that the board of directors develop criteria for the CEO position, identify and develop internal candidates, and use a formal assessment process to evaluate candidates.⁹

In a previous release, the Commission stated that proposals involving “the management of the workforce, such as the hiring, promotion, and termination of employees” relate to ordinary business matters.¹⁰ Based on this guidance, the Division’s historical approach has been to permit exclusion of this type of proposal.¹¹ In the same release, however, the Commission recognized that a proposal relating to ordinary business matters may transcend the company’s day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote.¹²

In Bulletin No. 14E, the Division observed that one of the board of directors’ key functions is to provide for succession planning so that the company is not adversely affected due to a vacancy in leadership. In light of recent events which underscored the importance of this board function to the governance of the corporation, the Division recognized that CEO succession planning raises a significant policy issue regarding the governance of the corporation that transcends the day-to-day business matter of managing the workforce. Going forward, the Division will 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.¹³

III. NOTICES RELATED TO NO-ACTION REQUESTS

The Division receives the heaviest volume of no-action requests between December and February of each year, often receiving 70 to 80 no-action requests a week during this peak period. At most, the Division can respond to 30 to 40 requests in any given week.¹⁴

In Bulletin No. 14E, the Division encouraged companies or shareholder proponents intending to submit correspondence in connection with a no-action request to contact the Division so that, if possible, the correspondence can be reviewed prior to the issuance of a no-action response. The Division further encouraged companies and shareholder proponents to provide it with the date by which they intend to submit their correspondence.

⁹ See *supra* note 1.

¹⁰ See *supra* note 7.

¹¹ See *supra* note 1.

¹² See *supra* note 7.

¹³ See *supra* note 1.

¹⁴ See SEC Staff Legal Bulletin No. 14 (July 13, 2001), available at <http://www.sec.gov/interp/legal/cfs14.htm>.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Jon Mark at 212.701.3100 or jmark@cahill.com, or John Schuster at 212.701.3323 or jschuster@cahill.com, or Oleg Rezy at 212.701.3490 or orezzy@cahill.com.

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