

## CLIENT MEMORANDUM

# SEC Staff Sharply Limits Use of “Directly Conflicting Proposal” Ground for Excluding Rule 14a-8 Shareholder Proposals from Company Proxy Materials

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## AUTHORS

**Michael A. Schwartz** | **David K. Boston**

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On October 22, 2015, the Staff of the Securities and Exchange Commission issued Staff Legal Bulletin No. 14H, sharply limiting an option previously available to reporting companies for excluding Rule 14a-8 shareholder proposals from their proxy materials. Under Rule 14a-8(i)(9), which allows the exclusion of proposals that directly conflict with proposals by management, companies have been able to exclude a shareholder’s proposal by agreeing to present to its shareholders a modified version of the proposal that is more to the board’s liking.

The Staff’s reconsideration of the Rule 14a-8(i)(9) exclusion was announced on January 16, 2015 with a statement by Chair Mary Jo White that she had directed the Staff to review the exclusion, a Staff announcement that it would express no views on the exclusion for the remainder of the 2015 proxy season, and the unusual withdrawal of a no-action letter the Staff had issued six weeks earlier to Whole Foods Market, Inc. (“Whole Foods”).

### **The Whole Foods “Proxy Access” Proposals**

In late 2014, a well-known shareholder proponent submitted a proposal to Whole Foods that requested adoption of “proxy access” rules requiring the company to include in its proxy materials nominations by an individual or group of shareholders that have continuously held more than 3% of Whole Foods’ shares for a period of at least three years. Under the proposal, the shareholder or group could nominate directors composing up to 20% of the Whole Foods board.

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In response, the Whole Foods board resolved to present to shareholders its own proxy access proposal that would allow any shareholder, but not a group of shareholders, who has continuously held more than 9% of Whole Foods’ shares for a period of at least five years to include director nominations in the company’s proxy materials. Under the Whole Foods proposal, the shareholder could nominate a single director or, if more, directors composing up to 10% of the board.

On December 1, 2014, in response to Whole Foods’ request to omit the shareholder proposal from its proxy materials, the Staff issued a no-action letter on the ground that the two proposals directly conflicted within the meaning of Rule 14a-8(i)(9). In granting no-action relief, the Staff followed its prior guidance that the “directly conflicts” language of the rule “[is not intended] to imply that proposals must be identical in scope or focus for the exclusion to be available.” Consistent with its own guidance and past practice, the Staff accepted Whole Foods’ conclusions that the two proposals directly conflicted and “that inclusion of both proposals would present alternative and conflicting decisions for the stockholders and would create the potential for inconsistent and ambiguous results.” As noted above, six weeks later the Staff withdrew this no-action letter.

### **The Staff’s New Approach**

The Staff concluded from its review that the purpose of the Rule 14a-8(i)(9) exclusion was to prevent shareholders from using the Rule 14a-8 proposal process to circumvent the SEC’s rules governing proxy solicitations. Specifically, the Staff believed that the provision was adopted to prevent a shareholder from using Rule 14a-8 to conduct a solicitation in opposition to a company proposal without having to comply with the full panoply of proxy rule requirements, including the preparation, filing and distribution of a full proxy statement.

Based on this understanding of the provision, the Staff concluded that it must refocus its analysis on whether a direct conflict exists between management and shareholder proposals, rather than on the possibility of ambiguity and confusion regarding the meaning of the shareholder vote. The Staff explained that two proposals would now directly conflict only “if a reasonable shareholder could not logically vote in favor of both proposals, *i.e.*, a vote for one proposal is tantamount to a vote against the other proposal.” The Staff noted, for example, that a shareholder proposal to separate a company’s chairman and CEO positions would directly conflict with a company proposal to require the CEO to be the company’s chairman.

In the case of the Whole Foods proxy access proposals, the company would not be permitted under the new test announced by the Staff to exclude the non-binding shareholder proposal from its proxy materials. A shareholder favoring proxy access might logically vote for both proposals because they generally seek a similar objective. For example, the shareholder might vote for the management proposal because it implements some form of proxy access and might vote for the shareholder proposal because it asks the board to implement proxy access with less strict requirements and for a greater number of nominees than permitted under the management proposal.

In some cases, where a shareholder proponent seeks to present a binding proposal, it may be possible for management to fashion a competing binding proposal such that the two proposals mandate mutually exclusive outcomes. However,

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the Staff indicated that in those circumstances, if the shareholder proponent could resolve that conflict by making its proposal non-binding, the Staff may allow the shareholder proponent a reasonable opportunity to do so.

### **Implications of the Staff’s New Position**

As a result of the views expressed in Staff Legal Bulletin No. 14H, companies will find it much more difficult, or impracticable, to exclude shareholder proposals from their proxy materials by committing to present a similar proposal to shareholders. Companies seeking to omit proposals will have to redouble their efforts in finding other grounds to omit shareholder proposals, and in some cases will find that the Staff’s changed policy leaves no option for doing so.

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If you have any questions concerning shareholder proposals or solicitations in general, please contact Michael A. Schwartz (212-728-8267, mschwartz@willkie.com), David K. Boston (212-728-8625, dboston@willkie.com) or the Willkie attorney with whom you regularly work.

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