Staff Legal Bulletin on Shareholder Proposals

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Summary

The Division of Corporation Finance issued Staff Legal Bulletin No. 14B on shareholder proposals on September 15, 2004. The purpose of the bulletin is to clarify and update some of the guidance that is included in Staff Legal Bulletin No. 14 and to provide additional guidance on issues that commonly arise under rule 14a-8.

Specifically, this bulletin contains the SEC's views regarding:

- The application of rule 14a-8(i)(3), which addresses companies' requests to exclude either all or part of a proposal or supporting statement.
- Common issues regarding a company's notice of defects to a shareholder proponent under rule 14a-8(f).
- The application of the 80-day requirement in rule 14a-8(j).
- Opinions of counsel under rule 14a-8(j)(2)(iii).
- Processing matters relating to the availability of submitted materials and the mailing and public availability of the staff's responses.

This discussion applies to the staff's review of rule 14a-8 no-action requests only; it does not apply to other contexts.

False and Misleading Statements in Shareholder Proposals and Supporting Statements

In past shareholder proposals, companies have relied on rule 14a-8(i)(3) to exclude portions of the supporting statement for a proposal, even if the balance of the proposal and the supporting statement may not be excluded. Companies have requested that the staff concur in the appropriateness of excluding statements in reliance on rule 14a-8(i)(3) for a number of reasons, including the following:

- *Vagueness*
- *Statements impugning character within the meaning of Rule 14a-9*
- *Statements that are irrelevant to the subject matter of the proposal*
- *Opinions presented as fact*
- *Statements without factual support*

In SLB No. 14B, the staff stated its view that "the company is not responsible for the contents of [the shareholder proponent's] proposal or supporting statement" and "[s]pecifically, because the shareholder proponent, and not the company, is responsible for the content of a proposal and its supporting statement, [the staff does] not believe that exclusion or modification under rule 14a-8(i)(3) is appropriate for much of the language in supporting statements to which companies have objected."

The staff indicated that from this point forward it would not be appropriate for companies to exclude supporting statement language and/or an entire proposal in reliance on rule 14a-8(i)(3) in the following circumstances:

- The company objects to factual assertions because they are not supported;
- The company objects to factual assertions that, while not materially false or misleading, may be disputed or countered;
- The company objects to factual assertions because those assertions may be interpreted by shareholders

in a manner that is unfavorable to the company, its directors, or its officers; and/or

- The company objects to statements because they represent the opinion of the shareholder proponent or a referenced source, but the statements are not identified specifically as such.

The staff indicated that companies could address their objections in their statements of opposition.

The staff did state in the legal bulletin that it is still possible to exclude statements in reliance upon rule 14a-8(i)(3) in situations where:

- the statements directly or indirectly impugn character;
- the company demonstrates objectively that a factual statement is materially false or misleading;
- the resolution contained in the proposal is so inherently vague that neither the stockholders nor the company, in implementing the proposal (if adopted), would be able to determine what actions are required; and
- substantial portions of the supporting statement are irrelevant to the subject matter of the proposal.

The staff of the Division of Corporation Finance noted in this legal bulletin and in Staff Legal Bulletin No. 14, that it spends an increasingly large portion of its time and resources each proxy season responding to no-action requests regarding asserted deficiencies in terms of clarity, relevance or accuracy in proposals and supporting statements and evaluating word changes. As a consequence, the staff will issue a no-action letter regarding a company's reliance on rule 14a-8(i)(3) to exclude or modify a proposal or statement only if the company has demonstrated **objectively** that the proposal or statement is *materially* false or misleading.

Notice of Defects to a Shareholder Proponent

SLB No. 14 set forth the following guidance for companies to consider when drafting letters to notify shareholder proponents of eligibility or procedural defects:

- Provide adequate detail about what the shareholder proponent must do to remedy the eligibility or procedural defect(s);
- Although not required, consider including a copy of rule 14a-8 with the notice of defect(s);
- Explicitly state that the shareholder proponent must transmit his or her response to the company's notice within 14 calendar days of receiving the notice of defect(s); and
- Send the notification by a means that allows the company to determine when the shareholder proponent received the letter.

In SLB No. 14B, the staff reiterated the guidance above and provided the following additional guidance on company statements to demonstrate proof of a shareholder proponent's stock ownership.

If the company cannot determine whether the shareholder satisfies the rule 14a-8 minimum ownership requirements, the company should request that the shareholder provide proof of ownership that satisfies the requirements of rule 14a-8. The company should use language that tracks rule 14a-8(b), which states that the shareholder proponent "must" prove its eligibility by submitting:

- the shareholder proponent's written statement that he or she intends to continue holding the shares through the date of the company's annual or special meeting; and
- either:
    - a written statement from the "record" holder of the securities (usually a broker or bank) verifying that, at the time the shareholder proponent submitted the proposal, the shareholder proponent continuously held the securities for at least one year; or
    - a copy of a filed Schedule 13D, Schedule 13G, Form 3, Form 4, Form 5, or amendments to those documents or updated forms, reflecting the shareholder proponent's ownership of shares as of or before the date on which the one-year eligibility period begins and the shareholder proponent's written statement that he or she continuously held the required number of shares for the one-year period as of the date of the statement.

The staff has expressed the view that a company does not meet its obligation to provide appropriate notice of defects in a shareholder proponent's proof of ownership if it refers the shareholder proponent to rule 14a-8(b) but does not either:

- address the specific requirements of that rule in the notice; or
- attach a copy of rule 14a-8(b) to the notice.

Application of the 80-day Requirement in Rule 14a-8(j)

The staff advises that a company is not required to wait 80 days to file its definitive proxy materials if the staff denies a company's request for a waiver of rule 14a-8(j)'s 80-day requirement. Rule 14a-8(j) provides that a company must file its reasons for exclusion of a shareholder proposal with the Commission no later than 80 calendar days before it files its definitive proxy statement and form of proxy with the Commission. The staff may permit the company to make its submission later than 80 days before the company files its definitive proxy statement and form of proxy if the company demonstrates "good cause" for missing the deadline. In that instance, the failure to comply with rule 14a-8(j) would not require the company to delay its filing date until the expiration of 80 days from the date that it submits its no-action request. The most common basis for the company's showing of good cause is that the shareholder proposal was not submitted in a timely manner.

There are instances in which the staff will not agree that a company has demonstrated good cause for failing to make its rule 14a-8 submission at least 80 days before the intended filing of its definitive proxy materials. In those instances, the staff generally will still consider the bases upon which the company intends to exclude a proposal, believing it is an appropriate exercise of their responsibilities under rule 14a-8. When the staff advises such a company and the shareholder proponent of its views regarding the application of rule 14a-8 to the proposal, it also will advise them of its view that the company has not followed the appropriate procedure under rule 14a-8. The staff's response in that situation would not require the company to wait to file its proxy materials until 80 days after its rule 14a-8 submission.

Companies that have not demonstrated good cause for failing to make a timely rule 14a-8 submission should be aware that, despite the staff's expression of a view with regard to the application of the eligibility or substantive requirements of rule 14a-8 to a proposal, the filing of their definitive proxy materials before the expiration of the 80-day time period in that situation may not be in accordance with the procedural requirements of rule 14a-8. Companies should note that, in issuing such a response, the staff is making no determination as to the appropriateness of filing definitive proxy materials less than 80 days after the date of the rule 14a-8(j) submission.

The staff will consider the timeliness of a rule 14a-8 no-action request in determining whether to respond. It reserves the right to decline to respond to rule 14a-8 no-action requests if the company does not comply with the time frame in rule 14a-8(j).

Opinions of Counsel under Rule 14a-8(j)(2)(iii)

Rule 14a-8(i)(1) and rule 14a-8(i)(2) permit companies to exclude a proposal if it meets its burden of demonstrating that the proposal is improper under state law or that the proposal, if implemented, would cause the company to violate any state, federal or foreign law to which it is subject. Rule 14a-8(i)(6) permits the company to exclude a proposal if it meets its burden of demonstrating that the company would lack the power to implement the proposal. Rule 14a-8(j)(2)(iii) requires the company to provide the Commission with a supporting opinion of counsel when the asserted reasons for exclusion are based on matters of state or foreign law. In submitting such an opinion of counsel, the company and its counsel should consider whether the law underlying the opinion of counsel is unsettled or unresolved and, whenever possible, the opinion of counsel should cite relevant legislative authority or judicial precedents regarding the opinion of counsel.

Proposals that would result in the company breaching existing contractual obligations may be excludable under rule 14a-8(i)(2), rule 14a-8(i)(6), or both, because implementing the proposal would require the company to violate applicable law or would not be within the power or authority of the company to implement. If a company asserts either of these bases for exclusion in

its rule 14a-8 submission, it expedites the staff's review when the company provides a copy of the relevant contract, cites specific provisions of the contract that would be violated, and explains how implementation of the proposal would cause the company to breach its obligations under that contract. The submission also should provide a supporting opinion of counsel or indicate that the arguments advanced under state or foreign law constitute the opinion of counsel.

In analyzing an opinion of counsel that is submitted under rule 14a-8(j)(2)(iii), the staff considers whether counsel is licensed to practice law in the jurisdiction where the law is at issue. The staff also considers the extent to which the opinion makes assumptions about the operation of the proposal that are not called for by the language of the proposal. Shareholder proponents who wish to contest a company's reliance on an opinion of counsel as to matters of state or foreign law may, but are not required to, submit an opinion of counsel supporting their position.

Shareholder Proposal Processing Matters

Pursuant to Rule 82 of the Commission's Rules of Practice "all materials required to be filed with the Commission pursuant to proxy rule 14a-8[j] will be considered public records of the Commission." [Rule 82] also provides for the public availability of written communications related to the materials filed pursuant to rule 14a-8[(j)] which may be voluntarily submitted by shareholder-proponents or other persons." See Exchange Act Release No. 9785 (September 22, 1972). As such, when a company submits a no-action request, the staff forwards a copy of the request to the Commission's Public Reference Room and it is available immediately. It is important to note that the staff bases its determinations solely on the written materials provided to it.

Staff responses to no-action request are generally sent by mail to both the shareholder proponent and the company. Since the staff also forwards a copy of its response, along with all other relevant correspondence, to the Commission's Public Reference Room at that time, commercial databases that check the Public Reference Room routinely for new no-action responses often upload the responses to their systems. As a result, the company or the shareholder proponent often may find the staff's response in the Public Reference Room or on a commercial database prior to their receipt of that response by mail.

Companies and shareholder proponents may receive faxed copies of the staff's responses in order to ensure that shareholder proponents and companies are given timely responses and to avoid prejudicing either party unnecessarily in resolving disputes that may arise in connection with the rule 14a-8 no-action requests when the staff has a fax number for both the company and the shareholder proponent, if the staff is unable to mail the response promptly. When the staff has a fax number for the company but not for the shareholder proponent, it will fax the response to the company where the company agrees to forward promptly to the shareholder proponent. The practice of faxing copies of staff responses is a courtesy and is not required by Commission rules. In order to facilitate the prompt delivery responses to no-action letters, provide as much contact information regarding the shareholder proponent as possible.

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