

SEC Guidance for Shareholder Proposals on Risk-Assessment and CEO Succession

On October 27, 2009, the Division of Corporation Finance of the U.S. Securities and Exchange Commission (the “SEC”) issued Staff Legal Bulletin No. 14E (the “Bulletin”), which provides new guidance relating to the treatment of certain shareholder proposals under Rule 14a-8(i)(7) (the “Rule”) of the Securities Exchange Act of 1934. The Rule allows a public company to exclude from its proxy materials shareholder proposals dealing “with a matter relating to the company’s ordinary business operations.”

In particular, the Bulletin addressed two important points to note for the 2010 proxy season: on a going forward basis, (1) the SEC will no longer deem shareholder proposals relating to risk assessment to be automatically excludable under the Rule and (2) a public company generally may not rely on the Rule to exclude proposals addressing CEO succession planning. The Bulletin also encourages issuers and shareholders to notify the SEC in advance if they intend to submit correspondence in connection with a no-action request related to a shareholder proposal.

Proposals Related to Risk Assessment

Prior Practice

Public companies frequently seek to exclude shareholder proposals relating to environmental, financial or health risks under the Rule. Previously, the SEC analyzed whether a shareholder proposal related to a general and broad evaluation of the company’s risk. If it did, the SEC would view the proposal as relating to the company’s ordinary business operations and so would deem it excludable under the Rule. On the other hand, if the proposal addressed minimizing or eliminating company operations that adversely effect the environment or the health of the public, the SEC would not permit its exclusion on the basis that such proposals focus on matters exceeding the ordinary business operations of the company.

The SEC recently re-evaluated its position and expressed concern that its position may have resulted in the exclusion of proposals dealing with significant policy issues relating to risk management. Further, in light of the recent turmoil in the markets and in the governance of public companies, the SEC recognized that the “adequacy of risk management and oversight can have major consequences for a company and its shareholders.” As a result, the SEC outlined a new framework for analyzing such proposals.

New Position

The Bulletin states that the SEC will now focus on the subject matter to which the risk pertains or that gives rise to the risk when determining whether a risk-related proposal may be excluded. The analysis will turn on whether the underlying subject matter of the risk evaluation involves a matter of ordinary business to the company. If the subject matter of the proposal raises “policy issues so significant that it would be appropriate for a shareholder vote,” the proposal generally will not be excludable under the Rule so long as there is a sufficient nexus between the proposal and the interests of the company. However, if the subject matter pertains to ordinary business matters of the company it generally would be excludable under the Rule.

Interestingly, the SEC stated that in recognition of the board’s important role in the company’s management of risk, a “proposal that focuses on the board’s role in the oversight of a company’s management of risk 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.”

Proposals Related to CEO Succession PlanningPrior Practice

During the last two proxy seasons, the SEC permitted the exclusion of shareholder proposals relating to CEO succession planning because they related to hiring, promoting and terminating employees, which are "ordinary business matters" under the Rule.

The SEC has now drawn a distinction between a CEO and a company's other employees. The Bulletin underscores that a "key function" of the board of a company is to provide for succession planning "so that the company is not adversely affected due to a vacancy in leadership." Again, the SEC recognized that recent events have emphasized "the importance of this board function to the governance of the corporation."

New Position

The SEC has now changed its position regarding CEO succession planning proposals. The SEC expressly acknowledged that CEO succession planning proposals transcend ordinary business matters and that on a going forward basis, "a company generally may not rely on [the Rule] to exclude a proposal that focuses on CEO succession planning."

Correspondence Relating to No-Action Requests

In addition, the Bulletin encourages companies and shareholder proponents to notify the SEC ahead of time if either intends to submit correspondence in connection with a no-action request and to include in the notice the date by which they intend to submit the correspondence. Notifications of pending submissions can be made to the SEC by calling (202) 551 3500 or e-mailing shareholderproposals@sec.gov. The notice is designed to prevent the problem of "crossing" the SEC's no-action position with additional arguments by a company or shareholder proponent.

Conclusion and Recommended Actions

As a result of the SEC's revised positions, certain shareholder proposals that were previously excludable now must be included in a company's proxy materials if the proponent satisfies the procedural requirements of Rule 14a-8 and the proposals are not otherwise excludable. Consequently, public companies should consider planning in advance how to respond to a proposal relating to risk assessment or CEO succession, both in terms of information to be included in their proxy statements and in their communication with shareholders.

Companies should consider the following:

1. Before submitting a no-action request to the SEC regarding proposals relating to risk, analyze whether the underlying subject matter is either an ordinary business matter or a significant policy matter.
2. The advisability of adopting formal CEO succession policies, which would include matters such as: establishing criteria by which potential successors will be judged; identifying and developing potential inside candidates for succession to the CEO position; and developing and formalizing a formal assessment process to evaluate CEO candidates.

This shift in the approach of the SEC to proposals marks deference to the role shareholders can play in company policies addressing the overall viability and risk protection of a public company.

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