

# Securities

## ADVISORY

November 9, 2009

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### SEC CHANGES APPROACH TO SHAREHOLDER PROPOSALS ON RISK ASSESSMENT AND CEO SUCCESSION

Recently, the staff of the Securities and Exchange Commission announced new approaches to shareholder proposals relating to risk assessment, including climate change, and succession planning for chief executive officers. Each will open a door for more proposals on those subjects and, as a result, be welcomed in particular investor quarters.<sup>1</sup> The staff announced these changes when it issued Staff Legal Bulletin 14E ("SLB 14E") regarding SEC Rule 14a-8 under the Securities Exchange Act of 1934, the so-called shareholder proposal rule.<sup>2</sup>

#### HISTORICAL APPROACH TO RISK ASSESSMENT AND CEO SUCCESSION PROPOSALS

Under the shareholder proposal rule, a shareholder of a public company has the right to include a proposal in that company's proxy materials for a vote of shareholders *unless* the proposal falls within an excluded category under the rule. One such category applies to proposals that relate to a company's ordinary business. The "ordinary business" category allows a company to exclude a shareholder proposal from its proxy materials if the proposal relates to ordinary business matters.

Historically, the staff has taken the position that a company may rely on the ordinary business exclusion to exclude a proposal, including a proposal that relates to climate change, if the proposal could be viewed as relating to the evaluation of risk to the company. This position, first described by the staff in 2005, has distinguished between proposals that focus on a company's internal assessment of operational risks and liabilities, which were excludable, and proposals that focus on a minimizing or eliminating operations that adversely affect the environment or the public's health, which the staff viewed as beyond exclusion.<sup>3</sup>

As a result of this interpretation, shareholders have had to draft proposals carefully to avoid any mention of risk assessment in order to avoid exclusion. In many cases, the mere reference to risk or risk-related issues in a proposal would have been enough for a company to be able to exclude a proposal in reliance on the ordinary business exclusion.<sup>4</sup>

<sup>1</sup> See, e.g., Carolyn Mathiasen, "Activists Welcome the SEC's New Guidance on Risk Proposals" (Oct. 27, 2009), avail. at <http://blog.riskmetrics.com>.

<sup>2</sup> Shareholder Proposals, Staff Legal Bulletin No. 14E (CF) (Oct. 27, 2009), avail. at <http://www.sec.gov/interps/legal/cfslib14e.htm>.

<sup>3</sup> Generally speaking, the SEC staff has held that proposals relating to subjects like the environment, including climate change, could not be excluded under the ordinary business exclusion on the basis that such proposals raise significant policy issues that transcend ordinary business. See, e.g., *Citigroup Inc.*, SEC No-Action Letter (Feb. 20, 2008) (proposal requesting a report on Citigroup's implementation of the Equator Principles could not be excluded as relating to ordinary business matters).

<sup>4</sup> See, e.g., *Assurant, Inc.*, SEC No-Action Letter (Mar. 17, 2009) (proposal requesting a report concerning the company's plans to address climate change excludable as relating to the evaluation of risk where the supporting statement indirectly alluded to risk.)

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Historically, the SEC staff has also found that shareholder proposals relating to the hiring and firing of employees, including executive officers, are excludable as relating to ordinary business matters.<sup>5</sup> More recently, the staff extended this approach to shareholder proposals that relate to a company's succession planning practices, presumably on the theory that succession planning is another example a hiring decision.<sup>6</sup>

## **CHANGES IN THE STAFF'S APPROACH TO RISK AND CEO SUCCESSION PLANNING PROPOSALS**

SLB 14E reverses the staff's historical approach to proposals involving the evaluation of risk. Going-forward, the staff will evaluate arguments to exclude risk proposals on a case-by case-basis. In conducting this evaluation, the staff will focus on the subject matter to which the risk pertains. If the risk relates to a significant policy issue, the proposal generally will not be excludable under the ordinary business exclusion, while risks that relate to ordinary business will remain excludable. An example of such a significant policy issue is a risk proposal that focuses on the board's role in the oversight of the management of risk, which SLB 14E indicates will not generally be excludable under the ordinary business exclusion.<sup>7</sup> The staff's change in approach to risk proposals appears premised on several factors: a marked increase in the number of no-action requests based on the evaluation of risk argument, concerns that the staff's approach may have resulted in the unwarranted exclusion of proposals that relate to the evaluation of risk but that focus on significant policy issues, and a recognition that the adequacy of risk management and oversight can have major consequences for a company and its shareholders.

SLB 14E also reverses the staff's historical approach to proposals involving CEO succession planning. Going forward, the staff will not accept arguments that shareholder proposals relating to CEO succession planning are excludable as relating to ordinary business matters. Instead, the staff's view is that CEO succession planning raises a significant policy issue regarding the governance of the corporation that transcends day-to-day business matters.

## **EFFECTS OF THE STAFF'S CHANGES IN POSITION**

The staff's new positions should result in the inclusion of more shareholder proposals relating to risk management, CEO succession planning and other related topics in companies' proxy statements in the coming year. The new positions will likely encourage shareholders to submit such proposals, while, conversely, companies will be discouraged from seeking exclusion. Such proposals will not necessarily go uncontested, however. We expect companies to make new arguments under other bases for exclusion, including arguments that such proposals micromanage their operations, would require the violation of applicable law and have been rendered moot by other actions. In this regard, we expect that some companies will enhance or formalize their risk management practices in order to provide themselves with a defense against shareholder proposals that seek further refinements to their oversight of risk management. To bolster this defense, we expect more companies to provide risk-related disclosures in their 2010 proxy materials.

The staff has given companies some ammunition in defending themselves against risk and CEO succession proposals. The staff qualified its changes in position in two important

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<sup>5</sup>See, e.g., *E\*Trade Group Inc.*, SEC No-Action Letter (Oct. 31, 2000) (proposal calling for the establishment of a committee that would be empowered to terminate the CEO is excludable as relating to ordinary business matters).

<sup>6</sup>See *Whole Foods*, SEC No-Action Letter (Nov. 25, 2008) (proposal requesting that the board adopt and disclose a written and detailed succession planning policy is excludable as relating to the hiring or firing of employees).

<sup>7</sup>SLB 14E ("In addition, we note that there is widespread recognition that the board's role in the oversight of a company's management of risk is a significant policy matter regarding the governance of the corporation. In light of this recognition, 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").

respects: first, the staff indicated that a risk proposal only raises significant social policy considerations if there is a sufficient nexus between the subject of the proposal and the company's operations.<sup>8</sup> For example, based on prior no-action positions, a retailer whose environmental impact is less significant and less direct than a utility or mining company may be able to exclude a climate change proposal from its proxy materials on the basis that there is an insufficient nexus between the proposal and the company's operations.<sup>9</sup> Second, in discussing the change in approach to CEO succession planning proposals, the staff noted that it will continue to evaluate whether a proposal micromanages a company's business by probing too deeply into matters that are inappropriate for shareholder action.<sup>10</sup>

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The change in approaches to risk assessment and CEO succession proposals is another example of the SEC staff's evolutionary willingness to reconsider interpretive positions under the shareholder proposal rule. This is a curious area of administrative law where staff views have quasi-legal authority, and such willingness is important to continued viability of the common law in this area. In the near term and on a practical level, these new approaches will lead to more proposals relating to risk management, including in areas such as climate change, and general corporate governance, including in areas like CEO succession planning. Since each of these is high on the agendas of many investors, SLB 14E is a new and important precedent.

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<sup>8</sup>As an example of this point, SLB 14E cites to *Lowes*, SEC No-Action Letter (Feb. 1, 2008), where the staff took the position that a proposal requesting that the company to discontinue the use of glue traps related to ordinary business matters.

<sup>9</sup>See, e.g., *CVS Caremark Corporation*, SEC No-Action Letter (Mar. 3, 2009) (proposal requesting report regarding "how the company is responding to rising regulatory, competitive and public pressures to halt sales of tobacco products" is excludable as relating to ordinary business).

<sup>10</sup>SLB 14E at footnote 5. ("Such a proposal could be excluded under Rule 14a-8(i)(7), however, if it seeks to micro-manage the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment. See Exchange Act Release No. 40018"). Although the staff made this point in the context of CEO succession planning, we expect the staff to apply this principle, as it has done in the past, to all shareholder proposals, including risk assessment proposals.