Highlights of the Dialogue with the Director of the SEC's Division of Corporation Finance, Keith F. Higgins

Meeting of the Federal Regulation of Securities Committee of the ABA Business Law Section, as part of that Section's Annual Meeting in Chicago, Illinois, September 18, 2015[1]

On Friday, September 18, 2015, the Federal Regulation of Securities Committee of the American Bar Association's Business Law Section ("Committee") held its regular Dialogue with the Director of the Securities and Exchange Commission's Division of Corporation Finance, Keith F. Higgins. Committee participants were outgoing Committee Chair Cathy Dixon and Committee Vice-Chair David Sirignano. An audio replay of the Dialogue is available to ABA members (password required) at http://www.americanbar.org/tools/digitalassetabstract.html/content/dam/aba/events/business_law/2015/09/annual/audio/dialogue-with-the-director-201509.mp3.

After providing the customary disclaimer,[2] Director Higgins covered a wide spectrum of current developments involving the work of the Division, including (but not limited to) the following topics: universal proxies; recent Division guidance on the parameters of "general solicitation" and "general advertising" for purposes of Rule 502 of Regulation D under the Securities Act of 1933, as amended ("Securities Act"); the latest update to the Division's Financial Reporting Manual ("FRM") regarding "catch-up" reporting by delinquent registrants; a Commission *amicus* brief focusing on whether standard underwriter IPO lock-up arrangements alone trigger "group" formation covered by the beneficial ownership reporting requirements of Sections 13(d) and 16(a) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), and the short-swing profits recovery provision of Exchange Act Section 16(b); the status of rulemaking projects under the Dodd-Frank and JOBS Acts; shareholder proposals with a focus on the Rule 14a-8(1)(7)(ordinary business) and (i)(9)(conflicting proposals) exclusions; conflict minerals disclosure; and "bad actor" and Well-Known Seasoned Issuer ("WKSI") waivers.

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[1] Prepared by Catherine T. Dixon, a partner at Weil, Gotshal & Manges LLP.

[2] Mr. Higgins stated that the views he expressed during the Dialogue, as well as during the meeting of the Proxy Statements and Business Combinations Subcommittee that preceded the Dialogue, are his own, and do not necessarily reflect the views of the Securities and Exchange Commission or any of his colleagues on the staff of the Commission.

Among the Dialogue highlights:

Universal Ballots

Director Higgins began with a brief update on the Division's review of the feasibility of proxy rule revisions that would permit the use of universal proxies in contested elections, thus enabling shareholders to mix and match candidates from competing management and dissident slates via execution of a single proxy card. This initiative has been launched at the request of Commission Chair Mary Jo White, as described in her speech to the Society of Corporate Secretaries and Governance Professionals in June 2015 (available at http://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html). In a brief recap of a more extensive give-and-take session that took place during a meeting of the Committee's Proxy Statements and Business Combinations Subcommittee earlier that day, Mr. Higgins indicated that the Staff was proceeding on the basis of a broad policy consensus developed among diverse participants in a Proxy Voting Roundtable held by the Commission in February 2015 (webcast replay available at http://www.sec.gov/news/otherwebcasts/2015/proxy-roundtable-021915.shtml) that shareholders should be able to make the same choices when voting by proxy as they could make (assuming the requisite voting authority) if they were to attend a shareholder meeting involving a contested board election and cast their votes "from the floor." The objective should not be to permit one side or the other in a contest to gain an advantage, but rather to facilitate shareholder choice. In short (and vastly simplified), the premise is that if a shareholder could pick individual director candidates from competing slates if he or she (or it) were to vote in person at a shareholders' meeting, the same flexibility should be permitted if they vote by proxy, without the need to resort to the artificial mechanism created by Rule 14a-4's bona fide nominee rule.

With this guiding principle in mind, the Division is grappling with difficult implementation details, and welcomes input on such representative questions as whether a universal ballot system should be mandatory or voluntary (companies and dissidents could agree to do this now, but generally do not for a variety of reasons); whether dissidents should be required to solicit all or a minimum percentage of shareholders (rather than the targeted sub-groups they are now able to solicit); whether there should be minimum eligibility criteria (*e.g.*, share ownership) applicable to the nominating shareholders; and whether it would be feasible logistically to make a universal ballot mechanism work for street-name holders who lack voting power under relevant state corporate law and corporate charters and by-laws.

Exempt Offerings – Recent Staff Guidance

Reflecting on the passage of two years since the ban on general solicitation and general advertising was lifted with the adoption of Rule 506(c) of Regulation D, in accordance with Title II of the JOBS Act, Mr. Higgins observed that most of the questions the Staff has received have focused on which communications and/or activities do **not** constitute general solicitation/advertising. (This pattern is consistent with data gathered by the Staff indicating that an overwhelming majority of Rule 506-exempt offerings occurring during this two-year period, measured in both number and dollar amounts raised, were conducted under 506(b) rather than 506(c)). In response to such questions, the Division issued a series of new Compliance and Disclosure Interpretations ("CDIs"), Securities Act Rules Sections 256.22-256.33 (added Aug. 6, 2015, and available at http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm), and an interpretive letter, *Citizen VC, Inc.* (Aug. 6, 2015, available at http://www.sec.gov/divisions/corpfin/cf-noaction/2015/citizen-vc-inc-080615-502.htm). In a brief, high-level discussion, later amplified by Office of Small Business Chief Sebastian Gomez Abero and other participants during a CLE program on small business capital formation under various Securities Act exemptive provisions chaired by Stan Keller,[3] Mr. Higgins pointed out that the Staff's latest guidance:

- Confirms the Commission's longstanding view that the use of an unrestricted, publicly available Internet website to offer or sell securities is a "general solicitation" for purposes of Rule 502(c) of Regulation D (256.23);

- Reiterates that communications that do not involve an "offer" within the meaning of Securities Act Section 2(a)(3) may be disseminated widely without raising general solicitation concerns. (256.24).

- Explains that, depending on the relevant facts and circumstances, "factual business information" that is widely disseminated but does not condition the market is not an offer, and therefore does not give rise to a general solicitation. Examples are typically limited to information about the issuer, its business, financial condition, products, services or advertisement of such

[3] This CLE program is entitled "New Opportunities for Unregistered Securities Offerings – Today and Tomorrow," and is available for replay (ABA member password required) at http://www.americanbar.org/tools/digitalassetabstract.html/content/dam/aba/events/business_law/2015/09/annual/audio/new-opportunities-201509.mp3.

products or services; **provided that** this information is "not presented in such a manner as to constitute an offer of the issuer's securities." (256.25).

  - What information normally does **not** qualify as "factual business information"? Predictions, projections, forecasts or opinions regarding the valuation of a company's securities. Information on the past performance of a continuously offered fund likewise would not qualify as "factual business information" (256.25).

- Confirms that an offer of securities to a prospective investor with whom the issuer, or a person acting on the issuer's behalf, has a "pre-existing, substantive relationship," does not constitute a "general solicitation" within the meaning of Rule 502(c). That said, establishing the existence of such a relationship is not the sole means of demonstrating the absence of a general solicitation. (256.26).

- Clarifies that, in addition to a registered broker-dealer, a registered investment adviser may be able to form the requisite "pre-existing, substantive relationship" with a prospective offeree necessary to avoid a prohibited general solicitation. (256.28).

  - There may be facts and circumstances in which a third party other than a registered broker-dealer or investment adviser may form a pre-existing, substantive relationship with potential investors, although no other examples were identified in the CDIs. The Staff observed that the suitability obligations of registered broker-dealers to their customers (256.32), as well as the fiduciary obligations of registered investment advisers to their advisory clients (256.28), suggest that these regulated entities will perform the diligence required to establish the necessary relationship – regardless of whether they are a participant in a prospective offering.[4]

- Provides more insight into the elements of the "pre-existing, substantive relationship" doctrine, as follows:

[4] For a more fulsome discussion of this and other interesting aspects of the Staff's latest guidance, see Stan Keller's article in the September 2015 issue of **InSights.** *See* Stanley Keller, *SEC Guidance on General Solicitation,* 29 InSightS 16 (Sept. 2015)("Keller").

- The term "pre-existing" means a relationship that the issuer has formed with a prospective offeree, either directly prior to commencement of a Rule 506(b)-exempt offering, or indirectly through a registered broker-dealer or investment adviser before the registered broker-dealer or investment adviser participates in such an offering. (256.29). No minimum waiting period is required in order for an issuer (or person acting on its behalf) to satisfy the "pre-existing" element – whether before the particular offering in the case of the issuer, or before participation by a registered broker-dealer or investment adviser in that offering. The 30-day minimum waiting period for private funds recognized by the Staff in the *Lamp Technologies, Inc.* no-action letter[5] represents a "limited accommodation" for private fund offerings conducted on a "semi-continuous" basis. (256.30).

- The term "substantive" means a relationship in which the issuer (or person acting on its behalf) has enough information to evaluate, and does in fact evaluate, a prospective offeree's eligibility to participate in a Rule 506(b) offering, either as an "accredited" or a "sophisticated" investor. (256.31). "[T]here is no specific duration of time or particular short form accreditation questionnaire that can be relied upon solely to create such a relationship." Instead, the determination of "[w]hether an issuer has sufficient information to evaluate, and does in fact evaluate, a prospective offeree's financial circumstances and sophistication will depend on the facts and circumstances." (*Citizen VC*). Mr. Higgins emphasized that investor self-certification alone (*i.e.* checking the "accredited investor" box in a questionnaire), without any other knowledge of a prospective offeree's financial circumstances or sophistication is insufficient to form a "substantive" relationship. (256.31).

- Through the recently issued *Citizen VC* interpretive letter, the Division charts a pathway for venture capital funds interested in using the Internet to solicit potential investors in Rule 506(b)-exempt offerings without running afoul of general solicitation prohibitions. Specifically, a sufficient

[5] (available May 29, 1997).

"substantive, pre-existing relationship" can be established by a venture capital firm operating an online investment platform through the adoption and application of detailed policies and procedures enabling an affiliated investment adviser to assess a prospective investor's sophistication, financial circumstances and ability to understand the nature and risks of investment before qualifying that person or entity as a "Member" and allowing access to any particular offering. The private exempt offerings available to qualified Members via the platform would be made by special-purpose vehicles created and managed by the investment adviser; each SPV would invest in turn in individual private companies (no blind pools).[6] From the Staff's perspective, "the quality of the relationship between the issuer (or its agent) and an investor is the most important factor in determining whether a 'substantive' relationship exists."

- As Stan Keller observed, in his article on the *Citizen VC* letter and related CDIs, the Staff's latest guidance does not resolve the still-open question of "whether the traditional approach [followed by some online platforms] of obtaining information, typically online, about accredited investor status without further actions and then waiting a reasonable period before making an offer will still be acceptable."[7] Mr. Higgins declined to answer this question when posed by an audience member, because the analysis is inherently fact-specific and necessarily depends on all relevant facts and circumstances. In this connection, the Keller article notes that "[a] clear message from the SEC guidance is that online investor platforms will have to up their game if they are to widely solicit and enroll members without engaging in general solicitation."[8]

[6] It is worth noting that counsel for CVC represented to the Division that the SPVs would be exempt from the registration requirements of the Investment Company Act of 1940, as amended, under either Section 3(c)(1) or Section 3(c)(7). Moreover, the operator of the online investment platform undertook to register with the Commission as an investment adviser once it has assets under management in excess of $150 million unless it is able to rely on the venture capital fund adviser exemption, and otherwise to comply with any applicable state laws.

[7] Keller, *supra*, at 20.

[8] *Id.*

- Focuses on the question of how a non-fund issuer can develop a "substantive, pre-existing relationship" with potential offerees. Citing a 1982 no-action letter for the proposition that this can be done without a placement agent or other intermediary,[9] the Staff nevertheless cautioned that, in "the absence of a prior business relationship or a recognized legal duty to offerees, we [the Division] believe that it is likely more difficult for an issuer to establish a pre-existing, substantive relationship, especially when contemplating or engaged in an offering over the Internet." This is because the issuer will have to evaluate not only "whether it has sufficient information about particular offerees, but also whether it can use that information appropriately to evaluate the financial circumstances and sophistication of … [these] offerees" before launching an offering. In short, the Staff suggests, an issuer planning to use the Internet for a Rule 506 offering would be wise to consider relying on the exemptive provisions of Rule 506(c), permitting the use of general solicitation, rather than Rule 506(b). (256.32).

- Provides helpful guidance on how an issuer can participate in a demo day or venture fair without being deemed either to be making an "offer" for purposes of Securities Act Section 2(a)(3), or engaging in a general solicitation within the meaning of Rule 502(c). (256.33).

FRM Update: "Catch-up" Exchange Act Reporting by Delinquent Registrants

In late August 2015, the Staff updated the FRM to add new Section 1320.4, *Delinquent Filers* (available at http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf#page=2), indicating that the Staff would no longer issue comments asking a delinquent registrant to file all delinquent Exchange Act reports once that registrant files a comprehensive annual report on Form 10-K (sometimes referred to as a "super 10-K") that includes all material information that would have been disclosed in these filings. The Staff has not been prescriptive about what missing information is "material" and therefore should be supplied in the comprehensive, or "catch-up," Form 10-K (and any additional reports a registrant may propose to provide), but Mr. Higgins observed that what companies historically have done is to provide audited financial statements plus selected financial data and other material information, unaudited quarterly financial information for the past eight quarters

[9] *Woodtrails-Seattle, Ltd.* (avail. Aug. 9, 1982).

(ending on the last day of the audited period), and a discussion and analysis of operating trends, etc. In some cases delinquent registrants would write in, often to the accounting staff, to propose a "catch-up" reporting plan, particularly where difficult accounting and/or financial statement presentation questions are implicated. Mr. Higgins advised that, while delinquent registrants can still call and consult with CF-OCA if they need guidance, the basic message of the update is that the Staff is getting out of the business of responding to delinquent filers' written requests for accommodations.

The August 2015 update reaffirms the Staff's longstanding position that the filing of such a comprehensive Form 10-K does not absolve a registrant from Exchange Act liability for failing to file all required reports, or otherwise preclude a Commission enforcement action based on a registrant's filing delinquencies. Nor would the filing of a comprehensive Form 10-K, without more, result in the registrant becoming "current" for purposes of Form S-8, Regulation S or Rule 144. Last but not least, the registrant would not be eligible to use Form S-3 until it establishes a sufficient history of making timely Exchange Act filings.

Underwriter Lock-ups and "Group" Status – SEC *Amicus* Brief

Director Higgins discussed the *amicus* brief recently filed by the Commission at the invitation of the U.S. Court of Appeals for the Second Circuit, in *Lowinger v. Morgan Stanley & Co., LLC* (available at https://www.sec.gov/litigation/briefs/2015/lowinger-morgan-stanley.pdf). Here, the Commission urged the Court to conclude that: (1) typical (180-day) underwriter lock-up agreements with selling shareholders in an underwritten public offering (in this case, the Facebook IPO) are not sufficient, standing alone, to establish a "group" for purposes of the beneficial ownership reporting provisions of Exchange Act Section 13(d) or Exchange Act Section 16; and (2) the underwriters' purchases and sales in connection with their participation in a *bona fide* underwritten public offering are covered by the exemptions provided by Exchange Act Rules 13d-3(d)(4)(temporary exemption from the beneficial ownership calculation of securities that an underwriter acquires in good faith in a firm-commitment underwriting) and 16a-7 (exemption from Section 16(b) short-swing profits liability where person effecting the transactions is engaged in the business of distributing securities and is participating in good faith in such distribution), even though the underwriters have obtained material non-public information regarding the issuer and its securities.

Disclosure of Voting Standards in Director Elections

As the 2016 proxy season approaches, Mr. Higgins urged Dialogue attendees to remind corporate clients that more careful attention should be paid to the often-overlooked details of proxy statement disclosure of voting standards governing uncontested elections of directors. After the SEC received rulemaking petitions earlier this year from each of the Council of Institutional Investors ("CII")[10] and the United Brotherhood of Carpenters and Joiners of America ("Carpenters")[11] highlighting perceived disclosure deficiencies in corporate proxy materials, the Commission's Division of Economic and Risk Analysis ("DERA") compiled a random sample of issuers drawn from the Russell 3000 index. In reviewing the relevant portions of proxy statements and forms of proxy filed this year by issuers in the sample pool, the Division observed several ambiguous, or less than ideal, disclosures similar to those described in the CII and Carpenters petitions, including (but not necessarily limited to) the following: (1) erroneously describing a "plurality plus" voting standard as a "Policy on majority voting"; (2) suggesting incorrectly that a "withhold" vote constitutes a vote "against" a director candidate in a plurality voting system; and (3) inconsistencies in descriptions of applicable director election voting standards in the body of the proxy statement vs. the face of the proxy card.

Disclosure Effectiveness Initiative

Mr. Higgins indicated that something would emerge soon, in accordance with the SEC's plan to tackle consideration of possible financial and business disclosure reforms on a staggered basis. About a week later, on September 25, 2015, the Commission published a release requesting public comment on the effectiveness of current financial disclosure requirements in Regulation S-X relating to third parties other than the registrant (available at http://www.sec.gov/rules/other/2015/33-9929.pdf); *e.g.*, Rules 3-05 (financial statements of business acquired or to be acquired), 3-09 (separate financial statements of certain equity investees), 3-10 (financial statements of guarantors and

[10] Letter to Keith F. Higgins, Director, Division of Corporation Finance, Securities and Exchange Commission, from Glenn Davis, CII Director of Research, dated June 12, 2015, available at http://www.sec.gov/rules/petitions/2015/petn4-686.pdf.

[11] Letter to Brent J. Fields, Secretary, Securities and Exchange Commission, from Edward J. Durkin, Director, Corporate Affairs Department, United Brotherhood of Carpenters, dated March 10, 2015, available at http://www.sec.gov/rules/petitions/2015/petn4-630-supp.pdf.

issuers of guaranteed securities registered or being registered), and 3-16 (financial statements whose securities collateralize an issue registered or being registered).

Mr. Higgins further indicated that the Staff is considering suggestions from the AICPA's Center for Audit Quality and others for improving EDGAR search functions. There are some improvements that can be made, without the need for rulemaking, with respect to the accessibility and navigability of documents filed via EDGAR. Additional testing is required before any of these improvements can be implemented.

Rulemaking Activities

Pay Ratio (Section 953(b) of Dodd-Frank; Adopted in 8/15) -- The new CEO/median employee pay ratio disclosures required by Item 402(u) of Regulation S-K must be included in annual reports on Form 10-K and proxy/information statements filed in 2018 by companies with fiscal years ending on or after January 1, 2017 (other than emerging growth companies, smaller reporting companies, and investment companies; foreign private issuers reporting annually on Form 20-F also are carved out). Mr. Higgins highlighted a few of the flexible features of the final version of Item 402(u), as follows: (1) the delayed transition date just noted; (2) the availability of alternative "reasonable" methodologies to identify the median employee, including but not limited to statistical sampling; (3) the frequency of the median employee determination (once every three years, subject to changes in the employee population and/or employee compensatory arrangements that the registrant reasonably believes would result in a significant change to its pay ratio); (4) the calculation of the median employee's compensation as of a trigger date within the last three months of the company's last completed fiscal year; (5) *de minimis* exception for non-US employees; and (6) the ability to make cost-of-living adjustments in calculating the relevant compensatory amounts.

Clawbacks (Section 954 of Dodd-Frank; Proposed in 7/15)—Over 50 comment letters had been submitted as of September 16, 2015. Commenters focused on a number of issues raised by the proposing release, according to Mr. Higgins. First, some objected to the Commission's proposal to "scope in" compensatory awards whose vesting is tied to total shareholder return ("TSR") or stock price, thus requiring companies to estimate the impact of the restatement on the company's stock price (*e.g.*, through event studies). The Staff is interested in commenters' thoughts, including any challenges in estimating this impact on stock price. There would seem to be a significant loophole that may diminish the statute's objective if the rule excluded TSR as a relevant metric, given its use in many long-term incentive plans.

Commenters' views differed widely on such other key topics as: (1) the "no-fault" nature of the proposed rule (Exchange Act Rule 10D), along with the limitations imposed on board discretion to override the consequences of a clawback (some commenters think the limitations on board discretion are excessive, while others think there should be no latitude for board discretion); (2) the breadth of the proposed definition of "executive officer," which would capture all persons covered by Exchange Act Rule 16a-1(f) (some think that this makes little sense given the no-fault nature of the rule, and argue that the affected management group should be limited to the Named Executive Officers; others disagree and support this aspect of the proposal); (3) the proposed applicability of the rule to foreign private issuers, controlled companies, emerging growth companies and debt-only issuers (some think this is fine because of the voluntary nature of listing on a U.S. stock exchange, while others disagree for varying reasons tied to the type of issuer); (4) identifying those officers who haven't repaid the amount sought to be clawed back within 180 days (while some expressed strong support, others have voiced equally strong opposition); (5) the "reasonably should have concluded" aspect of the clawback trigger; and (6) the definition of an "accounting restatement" for purposes of the proposed rule.

With respect to the last topic just listed, Mr. Higgins confirmed that the proposal extends only to so-called "Big R" restatements, meaning restatements to correct material errors in the financial statements. There is no intention here to create new restatement definitions that deviate from GAAP concepts associated with restatement under ASC 250.

The Staff has heard expressions of concern about whether the proposed rule would conflict with state labor laws, but it would be helpful to see more detailed analysis by commenters (rather than vague threats of possible violations of state law, without specific citations and analyses).

Pay-for-Performance (Section 953(a) of Dodd-Frank; Proposed in 4/15) – The Staff is working on formulating final recommendations to the Commission; there are many comments to sift through. The guiding principle in crafting the proposal was two-fold: to publish a set of workable proposals, knowing that there is no single accepted definition of "actually paid," and that the statutory language contemplates that the financial performance of the registrant take into account any change in the value of the shares of stock and dividends of the registrant and any distributions. Moreover, TSR seemed to provide the most meaningful basis for comparison across companies. In addition, the Commission wanted to use information that companies already have to disclose – such as the Summary Compensation Table and Regulation S-K Item 201(e) performance graph – to

minimize compliance burdens. Several commenters are unhappy with the proposed presentation, and would prefer a more flexible, principles-based approach that would allow companies to describe how their financial performance actually influenced pay decisions. Presumably, however, companies are already providing this type of disclosure in their CD&As.

Hedging (Section 955 of Dodd-Frank; Proposed in 2/15) – The major question raised by commenters involves whether there is a clear enough distinction between covered "hedging" and "normal" (*i.e.* prudent) portfolio diversification activities. The Staff is working on finding the right answer. Mr. Higgins observed that, while companies with existing hedging policies and proxy advisory firms alike seem to "know it when they see it," bright definitional lines are difficult to draw. The Staff does not believe that ordinary portfolio management techniques should be captured by the proposed rule. Finally, the Staff is working hard on getting final recommendations to the Commission.

Review of "Accredited Investor" Eligibility Standards for Individual Investors (Section 413 of Dodd-Frank) – the review is ongoing. Note that Congress mandated a Commission review at least once every four years (beginning in 2014) of the Regulation D definition of "accredited investor" as applied to natural persons. Although the statute itself does not prescribe any particular "output," the Division is working on something for Commission consideration. (Later that afternoon, during a CLE panel, Small Business Office Chief Sebastian Gomez Abero indicated that the "accredited investor" review is being finalized, and that it covers entities as well as natural persons.)[12]

Regulation A Amendments (Section 401 of the JOBS Act; Adopted in 3/15) – Mr. Higgins deferred to Mr. Gomez Abero, who indicated later that day, during a CLE panel discussion of the various Securities Act exemptions used by smaller companies to raise capital,[13] that since the June 2015 effective date of the amendments to Regulation A creating a new Tier 2 offering, the total number of Regulation A offerings filed publicly (24) was evenly split between Tier 1(12) and Tier 2 (12). A total of 30 circulars had come in, 9 of them in draft form for confidential staff review (of which 3 had since been filed publicly).

[12] *See* note 3, above.

[13] *Id.*

Crowdfunding (Title III of the JOBS Act; Proposed) – still pending; stay tuned. (Final rules were adopted on October 30, 2015; the Commission's adopting release is available at http://www.sec.gov/rules/final/2015/33-9974.pdf.)

Shareholder Proposals

Rule 14a-8(i)(9): Conflicting Shareholder and Management Proposals

In early 2015, the Division decided to express no view under Rule 14a-8(i)(9) this proxy season. Although broadly applicable to (i)(9) no-action requests addressing any topic covered by potentially conflicting shareholder and management proposals, the Staff's decision arose from the particular application of the (i)(9) exclusion to competing shareholder/management proposals relating to proxy access. Mr. Higgins noted that there were no instances this year in which both shareholder- and management-sponsored access proposals obtained a majority vote, suggesting that shareholders were not confused by the presentation of competing proposals to a vote on the company's proxy card.

In closing, Mr. Higgins indicated that Staff guidance in this area would be published in the near future. On October 22, 2015, that guidance was published in the form of Staff Legal Bulletin No. 14H (CF), which is available at http://www.sec.gov/interps/legal/cfslblb14h.htm.

Rule 14a-8(i)(7): The "Ordinary Business" Exclusion

Mr. Higgins touched briefly on the recent Third Circuit case interpreting the Rule 14a-8(i)(7) exclusion for shareholder proposals relating to a company's "ordinary business operations," *Trinity Wall Street v. Wal-Mart Stores, Inc.*[14] This litigation arose from the Division's grant of no-action relief to Wal-Mart Stores, Inc., indicating that the Staff would not object if the company were to omit, on ordinary business grounds, a shareholder proposal requesting that its board of directors amend a committee charter to provide for that committee's oversight of the "formulation of policies and standards" governing decisions whether to sell certain types of firearms. The proponent filed suit against Wal-Mart in federal district court seeking to enjoin the company's solicitation of proxies without including the disputed proposal in its proxy materials. On appeal to the Third

[14] 792 F. 3d 323 (3rd Cir. 2015).

Circuit from the district court's ruling in favor of the proponent, Wal-Mart ultimately prevailed.

Without getting into the details of the Third Circuit's opinion – a subject that had been discussed at some length during an earlier CLE program in which another Division staff member had participated[15] – Mr. Higgins stated that, absent a different determination by the Commission in the future, the Division would continue to apply the same analysis under (i)(7) described in the concurring opinion.[16] Although Mr. Higgins did not elaborate on this observation, the author notes that this divergence in application of the (i)(7) exclusion analysis is explained succinctly in the concurring opinion, as follows: "[T]he SEC treats the [social policy] significance and transcendence issues as interrelated, rather than independent," while the majority opinion not only evaluated these issues separately but also posited, contrary to Commission precedent, that the subject-matter of a proposal must be disengaged from the business of the corporation before it will be deemed to transcend "ordinary business" within the meaning of (i)(7).

Conflict Minerals Disclosure

As of the date of the Dialogue, the Commission had not yet made a decision on whether to file a petition for rehearing *en banc* of the second opinion -- by a divided panel of the U.S. Court of Appeals for the D.C. Circuit – holding that the requirement in the Commission's conflict minerals disclosure rule and the predicate statute that covered companies disclose (both in their Form SD filings and on their websites) that any of their products containing "necessary conflict minerals" have "not been found to be 'DRC conflict free'" violates the First Amendment.[17] As a result, Director Higgins was unable to discuss either the pending litigation or what guidance, if any, the Commission or the Staff might issue once the agency decided on next steps with respect to that litigation. With these caveats, Mr. Higgins went on to say that, as of September 18, 2015, the

[15] Entitled "Shareholder Proposals in 2015 and Beyond," this interesting panel discussion is available for audio replay (ABA password required) at http://www.americanbar.org/tools/digitalassetabstract.html/content/dam/aba/events/business_law/2015/09/annual/audio/shareholder-proposals-201509.mp3. e r

[16] The Staff's position is memorialized in Staff Legal Bulletin No. 14H, which is discussed in the text above relating to Rule 14a-8(i)(9).

[17] *See Nat'l Ass'n of Mfrs., et al. v. SEC,* No. 13-5252 (D.C. Cir., Aug. 18, 2015)("NAM II"), reaffirming on rehearing the same panel's majority holding (on the First Amendment issue) in *Nat'l Ass'n of Mfrs., et al. v. SEC,* 748 F. 3d 359 (D.C. Cir. 2014)("NAM I").

Division's previous guidance -- published in April 2014,[18] in the wake of the D.C, Circuit panel's initial, similarly divided opinion on First Amendment grounds -- remains in effect. Pending further action, registrants therefore will not be required to obtain an independent private-sector audit ("IPSA") of certain portions of the Conflict Minerals Report ("CMR") for the calendar 2015 reporting period unless a particular registrant opts to identify its affected products as "DRC conflict free."

The practical effect of Mr. Higgins' remarks, in the author's view, is to preserve – absent further guidance from the Commission or the Division in light of the agency's subsequent filing of a petition for rehearing *en banc* on Friday, October 2, 2015,[19] which was denied in a terse *per curiam* opinion issued November 9, 2015[20] -- the *status quo ante* as set forth in the Division's April 2014 guidance. What is different now, of course, is that the two-year transition period for registrants (other than smaller reporting companies) that allowed them to use the descriptive phrase "DRC conflict undeterminable," and to forego an IPSA, has expired.[21] On the other hand, given the surgical precision of the latest D.C. Circuit panel's majority opinion (re-affirming its 2014 ruling that statutory and/or regulatory language mandating that an issuer describe its products as having "not been found to be 'DRC conflict free'" violated the First Amendment of the Constitution[22]), companies should be prepared at a minimum to file their Form SDs and accompanying CMRs (if required) for the current calendar year and obtain an IPSA only if they plan voluntarily to describe their products as "DRC conflict free."

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[18] *See* Keith F. Higgins, Statement on the Effect of the Recent Court of Appeals Decision on the Conflict Minerals Rule (April 29, 2014), available at http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370541681994.

[19] A second petition for rehearing *en banc* was filed on October 2, 2015, by Amnesty International.

[20] *Nat'l Ass'n of Mfrs, et al. v. SEC*, No. 1352 (D.C. Cir., Nov. 9, 2015)(*per curiam*).

[21] *See* Form SD, Item 1.01(c)(1)(iv) and Instruction 2 to Item 1.01 (providing a two-year transition period during which companies could use the descriptive term "conflict undeterminable" and forego an IPSA. Smaller reporting companies have a five-year transition period). The Division's April 2014 guidance further enabled companies to dispense with any of the following product descriptions in their CMRs: "DRC conflict free," "having 'not been found to be 'DRC conflict free,'" or "DRC conflict undeterminable."

[22] *See* NAM II, *slip op.* at 25 n. 32 and accompanying text.

"Bad Actor" and WKSI Waivers

The SEC has delegated authority to the Division to grant waivers of the "bad actor" disqualification provisions of Regulation A, and Rules 506(d) and 505 of Regulation D, while retaining the authority to consider waiver requests and review actions taken by the Staff pursuant to this delegation.[23] In addition, the Division has delegated authority to grant waivers of WKSI ineligibility based on a showing of good cause.[24] Mr. Higgins announced that all bad actor and WKSI waiver responsibilities have been centralized within the Division under the oversight of Elizabeth Murphy, Associate Director–Legal. The Commission is notified of each such request upon receipt by the Division and has the power, increasingly exercised over the past year, to make waiver decisions.

Mr. Higgins reminded the audience that all waiver requests are subject to release in response to Freedom of Information Act ("FOIA") requests, even though confidentiality is maintained during the Commission or Division decisionmaking process. In this regard, there has been substantial media interest in identifying waivers that are withdrawn in situations where the Division is unable to grant the relief requested; companies should be aware that such requests remain accessible via FOIA.

[23] *See* Division of Corporation Finance, Waivers of Disqualification under Regulation A and Rules 505 and 506 of Regulation D (March 2015), available at http://www.sec.gov/divisions/corpfin/guidance/disqualification-waivers.shtml.

[24] *See* Division of Corporation Finance, Revised Statement on Well-Known Seasoned Issuer Waivers (April 24, 2014), available at http://www.sec.gov/divisions/corpfin/guidance/wksi-waivers-interp-031214.htm.