

Client Update

Got No-Action Relief? Recent Developments Impact Exclusion of Shareholder Proposals

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In recent years, corporate governance and environmental and social-related shareholder proposals have proliferated and shareholders and governance advocates have become more active and sophisticated in their approach to shareholder proposals. As the 2015 proxy season kicks off, two important developments will limit the substantive grounds upon which companies may seek to exclude certain shareholder proposals from their proxy materials. In particular, companies that have received a proxy access shareholder proposal or a proposal which may involve a “significant policy issue” should carefully consider these developments when developing a response strategy.

SEC WILL EXPRESS NO VIEWS ON 14a-8(i)(9) DURING PROXY SEASON

On January 16, the SEC’s Division of Corporation Finance issued a statement that it will express no views on the application of Rule 14a-8(i)(9) during the current proxy season. Chair White, citing “questions that have arisen about the proper scope and application” of the rule, has directed the SEC staff to review the rule and prepare a report.

While not referenced in the SEC’s public statements, this action relates to the controversy surrounding the 2015 Whole Foods proxy access proposal. Whole Foods received a proxy access proposal from activist investor James McRitchie that would permit proxy access to shareholders owning at least 3% of the company’s common stock for three years, for up to 25% of the board. In response, Whole Foods determined to include a management proposal in its proxy statement that would permit proxy access at a threshold of 9% ownership for five years, for up to 10% of the board and to seek SEC no-action relief to exclude McRitchie’s proposal under Rule 14a-8(i)(9) on the basis that it directly conflicted with the company’s proposal to be submitted to the shareholders at the meeting. The SEC issued a no-action letter in favor of Whole Foods. The decision was a company-friendly one and received a great deal of publicity as

Whole Foods' tactics and the Staff's no-action decision were widely criticized by various shareholder and proxy access advocates.

The strategy deployed by Whole Foods is not a new one and is not limited to the subject matter of proxy access. However, the Staff's decision to express no views on whether a proposal directly conflicts with one of the company's own proposals under Rule 14a-8(i)(9) will be particularly relevant to the many companies that received proxy access proposals during the 2015 proxy season. Notably, New York City Comptroller Scott Stringer, on behalf of New York City's \$160 billion pension funds, filed proxy access proposals with 75 companies that would permit proxy access to shareholders meeting a 3% ownership for three years threshold. With SEC no-action relief under Rule 14a-8(i)(9) unavailable, those companies will need to consider other alternatives, including negotiating with the proponent and their other shareholders, including the proposal for shareholder vote with management's dissenting statement or a counterproposal or seeking a judicial determination that the shareholder proposal may be excluded on the basis of Rule 14a-8(i)(9).

Companies and their advisors should note that the SEC's no-action relief was not a silver bullet for Whole Foods. Following the public media debate and private negotiations with its proponent and shareholders, Whole Foods included a modified management proposal in its filed proxy statement at a 5% ownership for five years threshold, subject to notable restrictions. The continuing public debate indicates that Whole Foods' struggle with this proposal may not be over.

COURT REJECTS SEC INTERPRETATION OF "ORDINARY BUSINESS"

The corporate community received another reminder that an SEC no-action letter may not be the final word in the battle to exclude a shareholder proposal from company proxy materials in November 2014 when the U.S. District Court for the District of Delaware (the "Court") determined that the SEC should not have granted no-action relief to Wal-Mart and that it should not have excluded a shareholder proposal from its 2014 proxy statement.

In December 2013, Trinity, an Episcopal parish in New York City, submitted a proposal for Wal-Mart's 2014 annual meeting requesting that the Compensation, Nominating and Governance Committee charter be amended to add oversight of implementation of policies that would evaluate whether the company should sell a product that endangers public safety, has the substantial potential to impair the company's reputation or would be considered offensive to the values that are integral to the company's brand. The proposal was meant to pressure Wal-

Mart's board to determine whether or not the company should sell guns equipped with magazines holding more than 10 rounds of ammunition.

Wal-Mart sought to exclude the proposal under Rule 14a-8(i)(7) on the basis that it related to the company's ordinary business operations. In its request, Wal-Mart cited the broad and diverse variety of products, customers and communities encompassed by its business. Wal-Mart also argued that the proposal was "impermissibly vague and ambiguous." When the SEC agreed with Wal-Mart and granted no-action relief, Trinity took its case to the Court. After initially rejecting Trinity's request for a preliminary injunction, in part in deference to the SEC's no-action decision, the Court held that Trinity's 2014 shareholder proposal does not deal with matters that relate to Wal-Mart's ordinary business operations, but rather seeks to have Wal-Mart's board oversee the development and effectuation of a policy. In its decision, the Court noted that social policy issues, such as the sale of high-capacity firearms, may "transcend the day-to-day business matters." The Court also reiterated that SEC no-action responses are informal views and that the application of the ordinary business exception under Rule 14a-8 is ultimately for a court to determine. As a result of the Court's decision, Trinity may re-submit its proposal for Wal-Mart's 2015 annual meeting.

In light of the Wal-Mart decision, shareholders may be more willing to invest the time and expense in challenging company decisions to exclude shareholder proposals under Rule 14a-8, in particular the ordinary business exception under Rule 14a-8(i)(7), and on the basis of SEC no-action decisions. Certainly, shareholders will take note of techniques for tailoring shareholder proposals to make them more resilient to challenge under Rule 14a-8.

WHAT COMPANIES SHOULD DO NOW

Companies should consult their advisors and carefully consider their strategy and approach to responding to shareholder proposals. Companies may continue to seek SEC no-action relief under Rule 14a-8 for an array of identified procedural and substantive deficiencies. A measured and thoughtful response will be tailored to specific factors including the company's business and industry, the subject matter of the proposal, the wording and structure of the proposal, the specific shareholder proponent(s), shareholder engagement and relations, board and management judgments and other matters.

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Please do not hesitate to contact us with any questions.