

# Client Alert

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## Federal Court Overrules SEC Staff No-Action Letter Excluding Shareholder Proposal

In a recent case involving Wal-Mart Stores, a federal district court overturned a staff no-action letter from the Securities and Exchange Commission (the "SEC") that had permitted the company to exclude a shareholder proposal from its proxy statement. Courts' decisions overturning SEC no-action letters that allowed companies to exclude shareholder proposals are exceedingly rare, although most shareholders do not challenge the SEC's decisions in court. This ruling may be part of a broader trend, however, in which federal courts have not deferred to the SEC. We discuss the case and its potential implications below.

### Background

In *Trinity Wall Street v. Wal-Mart Stores, Inc.*<sup>1</sup> the federal district court for the District of Delaware granted Trinity Wall Street, an Episcopal parish headquartered in New York City, a declaratory judgment and injunctive relief with respect to the decision by Wal-Mart Stores, Inc., to exclude from Wal-Mart's 2014 proxy materials a shareholder proposal that Trinity had submitted (the "Proposal"). Wal-Mart had previously obtained a favorable no-action letter from the SEC staff (the "Staff") permitting the exclusion of the Proposal based on the ordinary business exclusion under Rule 14a-8(i)(7) of the Securities and Exchange Act of 1934 (the "Ordinary Business Exclusion").

Trinity submitted the Proposal for the inclusion in Wal-Mart's 2014 proxy materials. The Proposal requested that the charter of Wal-Mart's Compensation, Nominating and Governance Committee be amended to add the following duties:<sup>2</sup>

"27. Providing oversight concerning the formulation and implementation of, and the public reporting of the formulation and implementation of, policies and standards that determine whether or not the Company should sell a product that:

1. especially endangers public safety and well-being;
2. has the substantial potential to impair the reputation of the Company; and/or
3. would reasonably be considered by many offensive to the family and community values integral to the Company's promotion of its brand."

### The Court's Decision

Although the court previously denied Trinity's request for a preliminary injunction to prevent Wal-Mart from printing or transmitting its 2014 proxy materials, the court looked to SEC guidance with regard to determining whether the Proposal should or should not be excluded under the Ordinary Business

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<sup>1</sup> C.A. No. 14-405-LPS, slip op. (D. Del. Nov. 26, 2014).

<sup>2</sup> The narrative portion of the Proposal states that the duties extend to determining "whether or not the company should sell guns equipped with magazines holding more than ten rounds of ammunition ('high capacity magazines') and to balancing the benefits of selling such guns against the risks that these sales pose to the public and to the Company's reputation and brand value."

Exclusion. The court reasoned that based on SEC guidance, the Proposal “is best viewed as dealing with matters that are not related to Wal-Mart’s ordinary business operations” and thus, not properly excluded under the Ordinary Business Exclusion.

The court explained that the Proposal did not select a task “so fundamental to management’s ability to run a company on a day-to-day basis” and subject it to “direct shareholder oversight.”<sup>3</sup> Rather, the court provided the following example of such a case: “if the Proposal attempted, through a shareholder vote, to dictate to management specific products that Wal-Mart could or could not sell.”<sup>4</sup> In contrast, the court clarified that Trinity’s Proposal leaves development of policy to the Board Committee, which in turn is free to delegate responsibility for the day-to-day aspects of implementation of any such policy to Wal-Mart’s officers and employees.

Moreover, the court reasoned that to the extent the Proposal “ ‘relat[es] to such matters’ as which products Wal-Mart may sell, the Proposal nonetheless ‘focus[es] on sufficiently significant social policy issues,’ ” rendering the Proposal not excludable because the Proposal “transcend[s] the day-to-day business matters and raise[s] policy issues so significant that it would be appropriate for a shareholder vote.”<sup>5</sup> The court found that the significant social policy issues of the Proposal that are appropriate for a shareholder vote include “the social and community effects of sales of high capacity firearms at the world’s largest retailer and the impact this could have on Wal-Mart’s reputation, particularly if such a product sold at Wal-Mart is misused and people are injured or killed as a result.” The court also notes that the Proposal is not excludable because it does not seek to “micro-manage” Wal-Mart or “prob[e] 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.”<sup>6</sup> Additionally the Proposal does not involve “intricate detail,” attempt to “impose specific time-frames” or dictate a method “for implementing complex policies.”<sup>7</sup>

The court then found that the Proposal intentionally ensured that any day-to-day decision-making concerning the matters raised in the Proposal was reserved to Wal-Mart management pursuant to policies created by management with Board oversight. For this reason, the court held that the no-action letters cited by Wal-Mart were distinguishable because each of them involved circumstances that Trinity has avoided by limiting the Proposal to the Board’s decision-making process, as opposed to a proposal that attempted to direct the company’s day-to-day operations.

### **The Court’s Ruling is Noteworthy, Not Unprecedented**

Shareholder proponents rarely challenge the Staff’s no-action position in court. Therefore, the *Trinity* holding is unusual, but it is not unprecedented.

For instance, in a prior case, coincidentally involving Wal-Mart,<sup>8</sup> the federal district court for the Southern District of New York held that because the Staff’s no-action letter<sup>9</sup> to Wal-Mart significantly deviated from

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<sup>3</sup> See Amendments to Rules on Shareholder Proposals, Release No. 34-40018, 63 Fed. Reg. 29106, 29108 (May 28, 1998) (“the 1998 Release”).

<sup>4</sup> The 1998 Release gives the following examples of tasks so fundamental to management’s ability to run a company “decisions on production quality and quantity, and the retention of suppliers.”

<sup>5</sup> *Trinity* (quoting 1998 Release, 63 Fed. Reg. at 29108).

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc.*, 821 F. Supp. 877 (S.D.N.Y. 1993) *aff’d* 54 F.3d 69 (2d Cir. 1995).

<sup>9</sup> *Wal-Mart Stores, Inc.*, SEC No-Action Letter, 1992 WL 178127 (Apr. 10, 1992).

the standard that the SEC had previously expressed in the official SEC Release,<sup>10</sup> it refused to defer to a favorable no-action letter and followed the interpretation in the SEC Release. The shareholder proposal requested Wal-Mart's directors to prepare and distribute reports about: (1) Wal-Mart's equal employment opportunity ("EEO") and affirmative action policies and programs and (2) Wal-Mart's efforts to both publicize its EEO policies to suppliers and purchase goods and services from minority and female-owned suppliers. Similar to *Trinity*, the Staff determined the proposal could be excluded pursuant to the Ordinary Business Exclusion and issued a no-action letter advising Wal-Mart that it would not recommend enforcement action if the proposal was left out of its proxy materials. Despite this favorable no-action letter from the Staff, the court determined it was not excludable because it raised important social and political issues regarding the company's employment and retail practices.

Additionally, in *NYCERS v. American Brands, Inc.*,<sup>11</sup> the federal district court for the Southern District of New York refused to give deference to the Staff's 14a-8 no-action letter and granted a preliminary injunction requiring American Brands to include a shareholder proposal in the company's proxy solicitation materials for the annual meeting. The court held that the company improperly excluded the proposal under SEC Rule 14a-8(c)(2)<sup>12</sup> because the proposal was in fact legal under applicable law.

## Conclusion

A key reason that the decision in *Trinity* was so rare is that shareholders rarely go to court to overturn a Staff no-action letter relating to a shareholder proposal. *Trinity's* actions, however, show that some activists may pursue judicial relief where the potential benefits to advancing their agenda outweigh the costs of litigation. In this case, *Trinity's* complaint may not have been as much about Wal-Mart as it was about positioning *Trinity* to pursue a particular social agenda (i.e., controlling the sale of high-capacity firearms)<sup>13</sup> at Wal-Mart and possibly at other retailers. Other activists may take note.

The *Trinity* case underscores the point that the Staff's no-action position is not afforded the same judicial deference as a ruling by the five SEC commissioners. The Staff has acknowledged in its informal procedures that the courts are responsible for making the final determination whether a shareholder proposal is properly excludable.<sup>14</sup> The *Trinity* case also calls into question the Staff's no-action position permitting Ordinary Business Exclusions and provides a precedent that could potentially be used by shareholders to narrow the Staff's interpretation of "ordinary business." It remains to be seen whether the Staff will read the case broadly and apply it to future no-action requests, or if instead they will view the holding as a narrow one limited to the unique facts of the case. In the past, the Staff has at times been

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<sup>10</sup> *Wal-Mart*, 821 F. Supp. at 890 (emphasizing that the SEC Release stated that the exclusion for "ordinary business operations" applies only to proposals that are "mundane in nature," and that do not involve any "substantial policy or other considerations" (quoting Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) 80,812 at 87,131 (Nov. 22, 1976)).

<sup>11</sup> 634 F. Supp. 1382 (S.D.N.Y. 1986).

<sup>12</sup> Permitting an issuer of securities to omit from its proxy materials any shareholder proposal which, if implemented would require the issuer to violate any law of any foreign jurisdiction to which the issuer is subject.

<sup>13</sup> See *supra* note 2 and accompanying text.

<sup>14</sup> See *Apache Corp. v. N.Y.C. Emps. Ret. Sys.*, 621 F. Supp. 2d 444, 449 (S.D. Tex. 2008); Div. of Corporate Fin., Informal Procedures Regarding Shareholder Proposals; [www.sec.gov/divisions/corpfm/cf-noaction/14a-8-informal-procedures.htm](http://www.sec.gov/divisions/corpfm/cf-noaction/14a-8-informal-procedures.htm) (11/21/2011) ("It is important to note that the staffs no-action responses to Rule 14a-8G submissions reflect only informal views. The determinations reached in these no-action letters do not and cannot adjudicate the merits of a company's position with respect to the proposal. Only a court such as a U.S. District Court can decide whether a company is obligated to include shareholder proposals in its proxy materials. Accordingly, a discretionary determination not to recommend or take Commission enforcement action does not preclude a proponent, or any shareholder of a company, from pursuing any rights he or she may have against the company in court, should the company's management omit the proposal from the company's proxy materials.").

less deferential to rulings by federal district courts, as opposed to rulings by the circuit courts of appeal that are afforded greater weight. Additionally, the district court's grant of injunctive relief in *Trinity* may encourage more shareholders to seek judicial relief questioning a company's "proper" exclusion of the shareholder proposal under SEC Rule 14a-8.

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