Client Alert

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Political and Social Issues in the Boardroom: Examples from the Gun Industry

Boards of directors are increasingly having to make difficult decisions arising from social or political issues. In today's social media environment, companies can quickly find themselves facing consumer boycotts, targeted media campaigns, and other adverse publicity that could harm shareholder value. These threats may arise from the company's product line or services, or more indirectly from its affiliation with another business or political organization. Companies may decide to take a stance to build consumer goodwill, avoid criticism or backlash, or even because the issue has a direct bearing on the company's operations (e.g., immigration policy). Last year, for example, several chief executive officers resigned from the president's American Manufacturing Council. Other times, companies may choose to do nothing or try to remove themselves from the debate. In addition to dealing with these complex business decisions, boards also are being confronted by investors who are increasingly focused on environmental, social, and governance ("ESG") issues. This article discusses the intensifying boardroom environment of dealing with political and social issues by using gun violence as a recent example.

Introduction

On May 9, 2018, a majority of shareholders at Sturm, Ruger & Co. voted to approve a shareholder proposal calling for the gun manufacturer to report on harms and financial risks associated with its products. The vote marked a surprising victory for its proponents, a coalition of faith-based investors called the Interfaith Center on Corporate Responsibility ("ICCR"). It may also be a watershed moment in corporate governance, with a majority of voting shareholders expressing concern about a company's core products.

In March 2018, the ICCR had released an "Investor Statement on Gun Violence" calling for gun manufacturers, retailers, and distributors, along with companies with financial ties to the gun industry, to review their operations, supply chains, and policies and take "meaningful action on this public safety concern."[1] The statement was signed by groups of investors claiming to represent $634 billion in assets. The statement acknowledged government's traditional role in gun control legislation, but maintained that corporations have an important obligation to ensure they are using their operations, business relationships, practices, and policies to counter gun violence. In addition, many large institutional shareholders announced their intent to engage gun companies in their investment portfolios.

As a result of the growing social and political debate over gun violence, some retailers have stopped selling certain types of guns or have publicly called for new legislation that would regulate products which they sell, while other companies have had to decide whether to terminate, continue, or even expand their business relationships with various organizations supporting gun owners. Other companies have tried to stay "neutral."

In these situations, boards must consider numerous factors relating to taking or not taking action, such as:

[1] Interfaith Center on Corporate Responsibility, *Investor Statement on Gun Violence*, https://iccr.org/investor-statement-gun-violence (last visited Apr. 24, 2018).

- the risk of consumer backlash or boycotts;
- the creation or loss of goodwill among customers or other key constituents;
- public relations;
- whether the issue actually poses legal liability to the company;
- the potential for short-term and long-term reputational harm; and
- the overall effects of the issue on the company's business.

For a for-profit corporation, this analysis ultimately must focus on what is best for shareholder value.[2] The action taken by the board, however, will usually be protected by the business judgment rule. Nevertheless, dealing with significant social or political issues requires careful consideration about the pros and cons of taking or not taking a position.

Gun Safety Proposals and the Ordinary Business Exception

In past years, many gun safety proposals submitted by shareholder activists were excluded from companies' proxy statements under Rule 14a-8 of the Securities Exchange Act of 1934 (the "Exchange Act"). Companies, particularly retailers that sold guns as well as many other products, have sought and received permission to exclude these proposals from their proxy statements under the Securities and Exchange Commission's (the "SEC") ordinary business exclusion. Under Rule 14a-8(i)(7), the ordinary business exclusion allows a company to exclude a shareholder proposal that deals with a matter that is "so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight." Proposals that focus on "sufficiently significant" policy issues that transcend ordinary business, however, may not be excluded under this exception.

Companies and the SEC have usually taken the position that shareholder proposals requesting retailers to refrain from selling guns interfere with management's ordinary business judgment. For example, the SEC permitted exclusion of a shareholder request that Wal-Mart Stores, Inc., provide greater board oversight of the company's decision to sell firearms, because gun control, despite being a significant policy issue, did not transcend management's ability to determine what products to sell.[3] That result was affirmed by the US Court of Appeals for the Third Circuit, which stated that "the essence of a retailer's business is deciding what products to put on its shelves" and, therefore, the proposal did not transcend day-to-day business.[4]

The SEC's recent guidance in Staff Legal Bulletin No. 14I ("SLB 14I"), released in November 2017, also has bearing on the issue. SLB 14I indicates that a company can seek to exclude a proposal touching on a significant public policy issue if the issue is not "sufficiently significant" to the company's business. This

[2] *See eBay Domestic Holdings, Inc. v. Newmark*, 16 A. 3d 1, 35 (Del. Ch. 2010) ("Directors of a for-profit Delaware corporation cannot … defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law.").

[3] *See* Wal-Mart Stores, Inc., SEC No-Action Letter, (March 9, 2001); *see also* Wal-Mart Stores, Inc., SEC No-Action Letter (March 20, 2014). After the SEC issued a no-action letter permitting exclusion under the ordinary business exception of a shareholder proposal requesting that Wal-Mart implement policies to evaluate whether the company should sell certain types of guns, the shareholder sued Wal-Mart. In *Trinity Wall Street v. Wal-Mart Stores, Inc.*, No. 14-4764 (3d Cir. July 6, 2015), the Third Circuit Court of Appeals affirmed the SEC's decision that exclusion was appropriate.

[4] *Id.*

rationale would seem applicable to a retailer where firearms are merely a subset of the products that it sells. SLB 14I signaled the SEC's intent to give increased deference to boards of directors in determining whether a public policy issue is significant to a particular company.

By contrast, shareholder proposals requesting that gun manufacturers report on the effects of their products on gun violence have not historically fallen under the SEC's ordinary business exclusion.[5] Rather, these proposals have been considered by the SEC to touch on significant policy issues and have a sufficient nexus to the manufacturers' operations. The gun safety proposals submitted by shareholder activists this season fall within this analysis and thus do not trigger the ordinary business exclusion.

The shareholder proposal submitted by ICCR members to Sturm, Ruger & Co., for example, requested that its board of directors issue a report on the company's activities related to gun safety measures and the mitigation of harm associated with gun products. The proposal asked the manufacturer to provide evidence of its monitoring of "violent events" associated with its products and assess the "reputational and financial risks" to the company of gun violence.[6] Because the proposal requested reporting by a manufacturer of its primary products rather than made demands related to product sales or selections, it did not fall into the ordinary business exclusion. Shareholders have submitted a substantially similar proposal to another firearms manufacturer.

Trends Going Forward

Shareholder Voting and Engagement

Traditionally, shareholder proposals seeking that companies take a greater role in gun safety have not garnered much support. Prior to 2018, the only gun safety proposal that was submitted to a shareholder vote in recent years requested that a gun manufacturer report on its compliance with the "Sandy Hook Principles."[7] This proposal received a mere 8.21% of shareholder support. Thus, the majority approval of Sturm, Ruger & Co.'s shareholders is noteworthy when compared to the weak approval that similar proposals received in the past.

The gun-safety debate has received more attention recently than it has in past years, which may lead to greater support for such proposals, including from institutional shareholders. BlackRock, the world's largest asset manager, reportedly voted its shares in favor of the gun-safety proposal at Sturm, Ruger & Co.[8] This action is seemingly in line with BlackRock's recent statements on social responsibility. Specifically, in January 2018, BlackRock's Chief Executive Officer Larry Fink announced via letter that BlackRock expected companies in which it invested to be socially responsible. BlackRock also publicly stated its intention to engage with gun companies in its portfolio to "understand their response" to mass shootings.

Voting outcomes may also be affected by the recommendations of proxy advising firms. Institutional Shareholder Services ("ISS") had recommended that shareholders vote to support the gun-safety

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[5] *See* Sturm, Ruger & Co., SEC No-Action Letter (March 5, 2001).

[6] The full text of ICCR's proposed resolution is as follows:

"RESOLVED: Shareholders request the Board of Directors issue a report by February 8, 2019, at reasonable expense and excluding proprietary information, on the company's activities related to gun safety measures and the mitigation of harm associated with gun products, including the following:

- Evidence of monitoring of violent events associated with products produced by the company.
- Efforts underway to research and produce safer guns and gun products.
- Assessment of the corporate reputational and financial risks related to gun violence in the U.S."

[7] Maria Lemos Stein, *Shareholders Push Gun Safety Via Proxy Ballots*, WALL ST. J., Mar. 21, 2018, ***available at*** https://blogs.wsj.com/riskandcompliance/2018/03/21/shareholders-push-gun-safety-via-proxy-ballots/.

[8] Liz Moyer, *Sturm Ruger Shareholders Approve Proposal for Gun-maker to Report on Risks of its Business*, CNBC.COM, May 9, 2018, available at https://www.cnbc.com/2018/05/09/sturm-ruger-shareholders-approve-proposal-for-gun-maker-to-report-on-risks-of-its-business.html.

proposal submitted to Sturm, Ruger & Co.[9] Proxy advisor Glass Lewis made the same recommendation, citing the potential effects of gun violence on the manufacturer's reputation.

Moreover, even companies that have not received gun-related proxy proposals this season could see the issue arise at their annual meetings. For example, at one financial institution's 2018 annual meeting, shareholders representing various investment groups criticized the financial institution for its ties to the gun industry. One union notified the financial institution that it was dropping it as a recommended mortgage lender to its members.

Inside the Boardroom

These issues reflect the difficult conversations taking place in boardrooms of numerous companies, particularly in the retail industry. Regardless of the impact of shareholder proposals, it is likely that corporations, socially conscious investors, and consumers will remain key players in the gun safety debate. After the shooting in Parkland, Florida, several large public companies took action to limit their connection to firearms. Several major retailers, for example, announced they would not sell firearms or ammunition to anyone under 21 years old. Others announced that they would stop selling "assault-style" rifles or high-capacity magazines, which in one case prompted Mercy Investment Services to withdraw its shareholder proposal calling for the retailer to do so. And most recently YETI, the popular cooler maker, decided to stop offering discounts to National Rifle Association ("NRA") members. These companies acted quickly to change their policies in response to what they presumably believed was increased pressure from consumers or from groups that would affect consumer decisions.

Of course, these decisions may or may not improve shareholder value. For example, many of the companies that have taken recent action have been criticized by some gun rights groups and gun owners for wading into the issue. For example, YETI has faced backlash from customers for its decision to end NRA discounts, with some customers blowing up their YETI coolers and posting videos of the event to social media. Another company faced backlash from state legislators, who changed a tax bill after the company announced an end to group discounts for NRA members, even though the NRA-related business was negligible and the company said it was simply trying to remove itself from the debate.

These examples show that addressing emerging or important political or social issues can be quite difficult for businesses. But legally, decisions as to what products to sell or with which organizations to affiliate are classic business decisions protected by the business judgment rule. Under traditional notions of shareholder primacy, a decision to stop selling a product could be justified by an informed and good faith belief that it is necessary to avoid a consumer backlash or boycott or to avoid future risks associated with the product that would harm shareholder value.[10] Likewise, an informed decision by a majority of independent directors to maintain a current product line or affiliation, in a manner that complies with applicable law, would be protected by the business judgment rule where the board concluded that doing so will create shareholder value.[11]

Another key issue is whether institutional investors' views will continue to evolve. In recent years, some of the leading money managers have taken very public positions on a range of environmental, social, and governance issues. As discussed above, this includes shareholder engagement with companies in the

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[9] Ross Kerber, *Proxy Adviser ISS Backs Call for Gun Safety Report at Sturm Ruger*, REUTERS, Apr. 25, 2018, available at https://www.reuters.com/article/us-usa-guns-sturmruger/proxy-adviser-iss-backs-call-for-gun-safety-report-at-sturm-ruger-idUSKBN1HW2YA.

[10] *See* Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 Wake Forest L. Rev. 135, 147 n. 34 (2012) ("[S]tockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to advance that end."); *id.* ("It is, of course, accepted that a corporation may take steps, such as giving charitable contributions or paying higher wages, that do not maximize corporate profits currently. They may do so, however, because such activities are rationalized as producing greater profits over the long-term.").

[11] *See eBay Domestic Holdings, Inc. v. Newmark*, 16 A. 3d 1 (Del. Ch. 2010).

gun industry. Yet recently, on April 23, 2018, the US Department of Labor ("DOL") issued Field Assistance Bulletin No. 2018-01, which addresses certain ERISA-covered benefit plans' involvement in environmental, social, and governance issues. The bulletin stated that prior DOL guidance "was not meant to imply that plan fiduciaries, including appointed investment managers, should routinely incur significant plan expenses to, for example, fund advocacy, press, or mailing campaigns on shareholder resolutions, call special shareholder meetings, or initiate or actively sponsor proxy fights on environmental or social issues relating to such companies." It also indicated that a cost-benefits analysis may be required before incurring expenses in furtherance of environmental or social matters. How this guidance may affect institutional investors' engagement on gun safety or similar political or social issues remains to be seen.

Looking forward, it is probable that companies—especially those that deal directly with consumers or that face overt pressure from customers—will seek to create a perception that they are socially responsible entities in an increasingly transparent digital age. If so, the trend of changing corporate policies to fall in line with popular political sentiment may grow. Shareholder proposals will also be an increasingly useful tool for social activists to apply additional pressure and gain public attention, and large institutional investors can be expected to engage on these issues. Nevertheless, the board of a for-profit corporation must make its decisions in an informed manner and based on shareholder value. In an ever-changing environment, political and social issues are unlikely to leave the boardroom anytime soon.

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