Securities Regulation Daily Wrap Up, PROXIES—3d Cir.: Trinity's Wal-Mart gun proposal headed for speedy appeals ruling, (Apr. 9, 2015)

Click to open document in a browser

By Mark S. Nelson, J.D.

The Manhattan Episcopal parish that urged Wal-Mart Stores, Inc. to create a board oversight regime for the dangerous products it sells defended a federal judge's ruling that Wal-Mart cannot exclude the parish's shareholder proposal from its proxy before the Third Circuit yesterday. But Wal-Mart's lawyer told the appeals court that Trinity Wall Street's legal theory overstated the degree to which SEC staff polices on shareholder proposals had evolved. Counsel on both sides got rave reviews from the presiding judge, who praised their "very well-presented arguments." The court will likely issue its opinion by April 15, one day before Wal-Mart's proxy is due to the printer (*Trinity Wall Street v. Wal-Mart Stores, Inc.* [oral argument audio], April 8, 2015; *Trinity Wall Street v. Wal-Mart Stores, Inc.*, November 26, 2014, Stark, L.).

Where's the line? Questions to Wal-Mart's lawyer, Theodore J. Boutrous, Jr., focused on where to draw the line between excludable shareholder proposals touching upon ordinary business operations, and includable ones that transcend a company's daily business. It was clear from the outset just how important the court thought the case was because the presiding circuit judge volunteered that the panel may "ignore the red light" to give counsel room to finish their thoughts.

After asking a series of questions about the "transcendence" (or lack of it) regarding Trinity's gun proposal, one judge asked Boutrous to say where the line should be drawn between includable and excludable proposals. The judge cited matters involving The Kroger Co., one of the U.S.'s biggest food retailers, and Denny's Corporation, the operator of a chain of franchised restaurants.

Boutrous noted that Denny's was a challenging example because the issue there was the incorporation of eggs into the products it sells to its restaurant patrons. The challenge is that Denny's is not a producer of eggs, but still must use them, making it unlike some purely manufacturing companies that shareholders have asked to stop doing some activity. A shareholder proposal had asked Denny's to take action regarding cage-free poultry.

In follow-up questions, Boutrous would reiterate that, as compared to Denny's and Kroger, Wal-Mart was not an "outlier" case because the policy urged by Trinity focused on a single product. A later query asked what, if any, difference it made that Trinity couched its proposal as asking Wal-Mart to "consider" taking some action instead of to "stop" doing something. Boutrous said Trinity was trying to end-run the SEC's guidance, including a 2009 staff legal bulletin that told parties to look at the underlying subject matter of a shareholder proposal.

Boutrous also fielded several questions about how much deference to give to the SEC's releases and other materials. He said the agency's releases are official statements of policy while other guidance, such a no-action letters, are merely persuasive. Boutrous told one judge, who had asked, that more recent SEC releases are not entitled to more deference than older ones, but he noted that the latest SEC releases on point likely "tightened-up" the analysis to be used when evaluating shareholder proposals. But Boutrous still had to concede that no one SEC release draws a clear line between shareholder proposals that can be excluded from a proxy under the ordinary business operations theory, and those that cannot.

Returning briefly to the "transcendence" theme, the judges sometimes peppered Boutrous with questions about who sets Wal-Mart's guidelines (the board or a committee do this), would it make a difference if Trinity limited its proposal to just the first item regarding products that endanger public safety (excludable, but shareholders can still have a voice at annual meetings), and what impact a broad versus a detailed proposal would have (no difference). On the last point, Boutrous noted that the ordinary business operations rule is implicated here because of the many and varied products Wal-Mart sells, and the potential for Trinity's proposal to reach other headline-grabbing topics, such as sugary drinks or music lyrics.

The judges never returned in earnest to the court's first questions to Boutrous about the breadth of Wal-Mart's firearms business. In reply to the lead-off question, Boutrous said Wal-Mart had nearly 3,000 stores, but only

one-third of them sold firearms with high capacity magazines (but not as a separate accessory). Boutrous also noted that most of Wal-Mart's stores sell firearms, but the retailer does not sell hand guns, and it does not sell firearms or hand guns outside the U.S.

On rebuttal, Boutrous answered a barrage of cross-exam-like questions from one judge: Is it policy if something impacts brand and reputation? No. What about public safety or well-being? No—There is no carve-out for retailers. What about things perceived by the community as harming a retailer's reputation? No. But Boutrous noted that sustainability issues might not be excludable, and suggested that proposals should be focused on any "epic issue for the company that transcends daily business." He also implied that Trinity's lawyer had overstated how much the SEC's guidance had evolved over the years.

Boutrous closed by getting as close as he could to drawing a clearer line between excludable and includable proposal. He told the panel the analysis must look at the impact on the products a company sells, and that the ordinary business operations exception would apply to anything that goes beyond a significant social policy.

The case is a close one. The first question to Trinity's lawyer, Joel E. Friedlander, focused on just how close the case is. (Friedlander's law firm was Bouchard Margules & Friedlander, P.A. until Andre G. Bouchard recently took over as Chancellor of Delaware's Chancery Court upon former Chancellor Leo E. Strine, Jr. becoming Chief Justice of that state's highest court). The judge who led-off the discussion noted that Chief District Judge Leonard P. Stark's rulings had first gone one way, before coming out the other way after more extensive briefing and argument.

That panel judge also asked where Friedlander would suggest the panel draw the line on which proposals are excludable, and which ones includable in a company's proxy. Friedlander hit upon a theme he would return to repeatedly: he said the best starting point is the SEC's 1998 release. He also noted that Judge Stark had relied on both the 1998 release and the SEC's 2009 staff legal bulletin in his later decision for Trinity.

The 1998 release, Friedlander added, "liberalized" the SEC staff's prior views, which tended to exclude too many shareholder proposals. Friedlander would later explain in reply to a similar question that this liberalization began in the 1970s in response to a proposal asking Dow to stop making napalm during the Vietnam War. He then urged the panel to find a way to ensure that proposals about a retailer's sale of products would not be automatically excluded from proxies.

One judge asked if the SEC had been consistent in its approach when it issued the 1998 release. Friedlander directed the panel to a speech last month by SEC Chair Mary Jo White. He said White acknowledged that the agency's guidance does change over time.

White had said this to an audience at Tulane University Law School's 27th Annual Corporate Law Institute in New Orleans: "While the staff strives for consistency and correctness in the administration of this process, their informal responses are neither 'precedent' nor binding on the Commission or a court. And, over time, views and interpretations may evolve, and changes may be reflected in guidance, interpretation, or rule changes if necessary." A footnote to this sentence cited Staff legal Bulletin 14E, the guidance document playing a co-starring role in Trinity's case against Wal-Mart.

Elsewhere, Friedlander said in reply to a variety of questions from several judges that Trinity's proposal for greater oversight by Wal-Mart's board was needed to make sure important social polices actually get reviewed by the company in a meaningful way. He said it was unclear how Wal-Mart's gun policies had been crafted, or whether its board had reviewed them. Friedlander also implied that Wal-Mart's gun polices could be seen as equivocal after the Sandy Hook Elementary School tragedy.

When asked if Trinity's proposal is different from product-driven ones, Friedlander said the parish's approach also fits the SEC's 2009 guidance regarding the role of a company's board in evaluating risks. Specifically, he said companies like Wal-Mart have reputation and event risks. He then posed the question: What if a Wal-Mart-sold gun was used in an event? He suggested that even the sales of models of guns could invite public scrutiny of the company.

The panel also had a keen interest in parsing the text of Trinity's proposal. Friedlander's explanation of how the SEC's views on shareholder proposals had evolved partly replied to a question about whether Trinity was asking Wal-Mart's board to micro-manage the company. He said it did not because Wal-Mart has a variety of tools it can use to decide which products need to be reviewed (*e.g.*, the retailer's communications with police departments or news reports).

The other two components of the proposal also drew the court's attention. The second one deals with "the substantial potential to impair" Wal-Mart's reputation. The third one is couched in the disjunctive from the other two and deals with things many persons may find offensive to family and community values that are key to Wal-Mart's branding. Several judges said they were troubled by the lack of clear definitions for many of the words used in both prongs.

Friedlander said all of the words in the third prong function as "important qualifiers." Another panel question asked what impact a finding that the third prong was too vague would have on Trinity's overall proposal. Friedlander noted that Trinity's gun proposal could fit in all three categories. Still other questions on this prong mulled what "many" means, or how broadly the third prong would apply to Wal-Mart's products, and how the disjunctive linkage from the first two prongs ("and/or") would work in practice.

According to Friedlander, Wal-Mart has lots of resources it can use to evaluate the concerns implied by the third prong. As for that prong's reach, he noted that Wal-Mart lagged its competitors in deciding to sell the morning after pill (the judge had asked about contraceptives). He also observed that Wal-Mart (rightly or wrongly) is a big player in the retail markets and tends to get singled out for public attention. But he said that is a valid reason for the company to "consider" a variety of social issues relating to its products, and this oversight would help it to deal with reputational risks.

As they did in questions to Wal-Mart's lawyer, the judges asked Friedlander to explain how much deference the court should give to SEC releases and other guidance. Friedlander said the agency's no-action letters deserve deference to the extent they are persuasive, just as a Second Circuit panel had remarked in a recent opinion. The judge who asked the question then quipped that Friedlander's reply sounded a lot like the Supreme Court's *Skidmore* respect standard. Friedlander added that a "one-line" no-action letter was entitled to less deference than an SEC staff legal bulletin, which he said demonstrated greater formality and deeper soul-searching about the agency's prior views.

Guns on shelves. In a proxy season that has taken its share of odd turns (*e.g.*, Whole Foods), it should be no surprise that Judge Stark initially had doubts about Trinity's case against Wal-Mart. Judge Stark told lawyers at a preliminary injunction hearing that he felt the court was less well equipped than the SEC to rule on the omission of shareholder proposals ("It's very clear that the SEC has had hundreds of opportunities to consider questions like this. I have not."). As the judge added, the court's time is limited and he was being asked to disagree with the SEC.

In fact, Judge Stark went on to say that he thought he would end up siding with Wal-Mart (and by extension the SEC) because Trinity's proposal dealt with the retailer's ordinary business operations (See Exchange Act Rule 14a-8(i)(7)). But in revealing his new mindset in a November 2014 opinion, the judge explained in a footnote that a colloquy with Trinity's lawyer at the preliminary injunction hearing had initially led him to Wal-Mart's view. That exchange helped to narrow the scope of the case from, as Judge Stark said, "Guns in society," to "guns on the shelves," as related by Trinity's lawyer.

The emphasis on Wal-Mart's "shelves" led the court to deny Trinity's request for a preliminary injunction based on the proposal's touching on Wal-Mart's ordinary business operations. But that did not end the matter. In later reversing course at the summary judgment stage, Judge Stark would recall his admonition to Trinity and Wal-Mart that the frenetic preliminary injunction hearing (also noting the limited briefing opportunity) left the judge wanting more time to think about the proxy issue.

For purposes of Wal-Mart's motion to dismiss, Judge Stark found Trinity's claim for declaratory relief regarding Wal-Mart's 2014 proxy excluding the gun proposal was not moot because it was capable of repetition yet evading review (*i.e.*, short proxy season coupled with Trinity's plan to submit another proposal if it lost its case).

But Trinity's claim regarding Wal-Mart's 2015 proxy was unripe because it lacked the needed "adversity of interest" (Trinity had yet to draft or submit a new proposal, which may be worded differently, and Wal-Mart could alter its views on exclusion).

And then Judge Stark took Trinity's side in ruling on the parish's and Wal-Mart's cross-motions for summary judgment. According to the judge, Trinity's gun proposal had enough social policy emphasis to take it out of the ordinary business operations exclusion under the SEC's proxy rules.

Judge Stark cited two pieces of SEC guidance. The first was a 1998 rulemaking release that updated the agency's shareholder proposal rules and explained that exclusion might not be proper when a proposal deals with "sufficiently significant social policy issues." The release noted that exclusion under this scenario would be improper because the issue raised goes beyond a company's daily operations. The court also cited SEC Staff legal Bulletin No. 14E, which in 2009 reiterated and explained some of the guidance in the 1998 release.

Moreover, the judge noted that Trinity's proposal would not let the parish "micro-manage" Wal-Mart, and that the retailer's shareholders could handle the issues raised. But the court said Wal-Mart's proffered litany of SEC no-action letters was inapt, and Wal-Mart's formulation of the ordinary business operation exclusion was too broad despite that rule's inherent breadth.

Lastly, the court rejected Wal-Mart's argument (not raised until the company filed its summary judgment briefs) that Trinity's proposal was excludable because it was "vague and indefinite." Wal-Mart had theorized the proposal ran afoul of Exchange Act Rule 14a-8(i)(3), which broadly serves to exclude any proposal or supporting statement that is contrary to the SEC's proxy rules. As a result, the court granted Trinity's request for a declaratory judgment and a permanent injunction against Wal-Mart. Wal-Mart's appeal and yesterday's oral argument ensued.

The case is No. 14-4764 [Oral Argument] [District Court Opinion].

Attorneys: Joel E. Friedlander (Friedlander & Gorris, P.A.) for Trinity Wall Street. Theodore J. Boutrous, Jr. (Gibson Dunn & Crutcher LLP) for Wal-Mart Stores, Inc.

Companies: Trinity Wall Street; Wal-Mart Stores, Inc.; The Kroger Co.

LitigationEnforcement: CorporateGovernance Proxies RiskManagement DelawareNews NewJerseyNews PennsylvaniaNews VirginIslandsNews