

July 10, 2015

## Excluding Shareholder Proposals: *Trinity Wall Street v. Wal-Mart Stores, Inc.*

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### **Third Circuit Provides Guidance on When Shareholder Proposals Raising Significant Social Policy Issues *Do Not* Transcend the Day-to-Day Business Matters and May be Excluded**

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#### **SUMMARY**

On Monday, the U.S. Court of Appeals for the Third Circuit released its opinion in *Trinity Wall Street v. Wal-Mart Stores, Inc.*<sup>1</sup> The Court had issued an earlier order, without an opinion, that Wal-Mart could exclude Trinity's Rule 14a-8 shareholder proposal relating to the sale of firearms with high-capacity magazines from Wal-Mart's proxy materials because it related to "ordinary business operations." At the time, the Court stated it would subsequently issue a more detailed opinion explaining its rationale.

In Monday's opinion, the Court held that a company may exclude a Rule 14a-8 shareholder proposal that relates to ordinary business operations but raises a significant social policy issue, if the subject matter of the proposal "targets day-to-day decision-making" or is "enmeshed with [the company's] day-to-day business." In these instances, the social policy issues do not "transcend a company's ordinary business" and are excludable. On the other hand, a proposal that "is disengaged from the essence" of a company's business is more likely to "transcend its daily business dealings" and not be excludable. Because the Court found that "the essence of a retailer's business is deciding what products to put on its shelves," it concluded Trinity's proposal did not transcend ordinary business and was properly excluded. The Court noted the ordinary business exclusion remained hard to define and recommended that the SEC issue new interpretive guidance.

## BACKGROUND

Rule 14a-8 under the Securities Exchange Act of 1934 provides a process by which shareholders may submit proposals for inclusion in the proxy materials of publicly traded companies. Among the reasons a company may exclude a proposal under the rule is if it “deals with a matter relating to the company’s ordinary business operations.” This exclusion is based on the principle that shareholders should not manage (or micromanage) a company’s day-to-day operations. However, in applying the rule, the SEC and its staff have developed an exception to this basis for exclusion, if the proposal also presents a significant social policy issue for consideration. The line between ordinary business operations and social policy matters has been difficult to define, and the SEC and its staff have grappled with the treatment of social policy issues for decades. Currently, seemingly similar proposals often yield opposite responses by the SEC staff, and the Court begins its analysis of this area by noting that the ordinary business exclusion has been called the “most perplexing” of the exclusions to Rule 14a-8.

The dispute in *Trinity Wall Street* arose after shareholder Trinity submitted a proposal to Wal-Mart for inclusion in Wal-Mart’s 2014 proxy materials. The proposal sought to amend the charter of Wal-Mart’s Compensation, Nominating and Governance Committee to provide that the committee would “overs[ee] . . . the formulation and implementation of . . . policies and standards that determine whether or not [Wal-Mart] should sell a product that: 1) especially endangers public safety and well-being; 2) has the substantial potential to impair the reputation of [Wal-Mart]; and/or 3) would reasonably be considered by many offensive to the family and community values integral to [Wal-Mart’s] promotion of its brand.”

On March 20, 2014, the staff of the SEC Division of Corporation Finance issued a no-action letter stating that the staff would not object to Wal-Mart excluding Trinity’s proposal from its proxy materials on the basis that it addressed ordinary business operations. Trinity sued in the U.S. District Court for the District of Delaware, seeking to preliminarily enjoin Wal-Mart from excluding the proposal in connection with its 2014 annual meeting. Although the District Court declined to enjoin Wal-Mart at that time, it later concluded that Wal-Mart was not entitled to exclude the proposal because it did not meet the requirements of the ordinary business operations exclusion and, in the alternative, because it did meet the requirements for the significant social policy exception. Wal-Mart appealed, and on April 14, 2015, the Third Circuit vacated the District Court’s order, permitting Wal-Mart to exclude the proposal from its 2015 proxy materials.

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## THE COURT’S DECISION

The Court employs a two-step analysis, each of which has two subparts. In the first step, the Court considers whether the proposal “deals with a matter relating to the company’s ordinary business operations.” If the answer is yes, the Court engages in the second step to determine whether the

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proposal “transcends the day-to-day business matters of the company *and* raises policy issues so significant that it would be appropriate for a shareholder vote.”

### Ultimate Subject Matter that Relates to Ordinary Business Operations

In considering whether a proposal deals with ordinary business operations, the Third Circuit’s approach requires that one first determine the *ultimate subject matter* of the proposal and then evaluate whether that subject matter is *related* to the company’s *ordinary business operations*.

In the first part of this approach, the Third Circuit contends that the subject matter of a proposal is the “*ultimate consequence*” resulting from the proposal rather than its immediate consequence. Accordingly, for the Third Circuit, the fact that Trinity’s proposal asked Wal-Mart’s board to create and implement a policy regarding dangerous products instead of directing its management to stop selling assault rifles was not relevant. In both cases the Court finds that the “subject matter” or “ultimate consequence” is “how Wal-Mart approaches merchandising decisions . . . .”

The Court terms its approach as “mindful” of the SEC’s focus on substance over form in this area and its distaste for “clever drafting,” and cites favorably several SEC staff no-action letters, including *Sempra Energy* (January 12, 2012) (granting relief where a proposal requested board review of the company’s management of certain political, legal and financial risks but the underlying subject matter of those risks involved ordinary business matters). In addition, the Court emphasizes that it rejects the District Court’s approach, which would have treated a proposal directing management as to certain products differently from a proposal that “merely” asks the board of directors to oversee the development and effectuation of a merchandising policy.

In the second stage of the analysis, the Third Circuit considers whether this subject matter related to Wal-Mart’s ordinary business operations and easily concludes that it did, because a retailer’s merchandising approach is “the bread and butter of its business” and involves “operational judgments that are ordinary-course matters.” The Third Circuit, responding to Trinity’s argument that its proposal did not dictate which products should be sold or what policies should be implemented, clarified that a shareholder proposal merely needs to relate to a company’s ordinary business, not dictate a particular outcome, to come within the exclusion.

### Raises Significant Social Policy Issues That Transcend Day-to-Day Business Matters

Having concluded that the subject matter of Trinity’s proposal related to Wal-Mart’s ordinary business operations, the Third Circuit turns to the second step of its analysis, which is to evaluate if the “proposal’s underlying subject matter transcends the day-to-day business matters of the company *and* raises policy issues so significant that it would be appropriate for a shareholder vote.” For the majority of the Court, this analysis has two distinct parts: (1) does the proposal raise a *significant policy issue* and (2) do those issues *transcend day-to-day business*.

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With respect to the first part, the Third Circuit concludes that Trinity's proposal focused on significant policy issues without specifying what constitutes a sufficiently significant issue. The Third Circuit appears to follow what it described as the SEC's "we-know-it-when-we-see-it" approach and concludes that "it is hard to counter that Trinity's proposal doesn't touch the bases of what are significant concerns in our society and corporations in that society."

With respect to the second part, the Court emphasized that the subject matter of the shareholder proposal must *transcend* the ordinary business matters of the company *in addition to* raising a significant policy issue. The Court interprets the concept of transcendence as being "disengaged from the essence" of the company's business or "divorced from how a company approaches the nitty-gritty of its core business." Accordingly, if the subject matter of a proposal "targets day-to-day decision-making" or is "enmeshed with [the company's] day-to-day business," it likely does not "transcend" day-to-day business matters.

To illustrate its framework, the Court contrasts two proposals: one that "asks a supermarket chain to evaluate its sale of sugary sodas because of the effect on childhood obesity," which would not transcend day-to-day business operations because it is "too entwined with the fundamentals of the daily activities of a supermarket," and another that "rais[es] the impropriety of a supermarket's discriminatory hiring or compensation practices," which is disengaged from the essence of a supermarket's business (notwithstanding that human resources is a core business function) and therefore could transcend day-to-day business operations.

For retailers of multiple products, the Third Circuit states that determining the appropriate product mix is "the meat of management's responsibility" and an issue typically addressed by management rather than the board of directors. In contrast, a decision to stop selling a particular product is more likely to transcend ordinary business matters when the company is a manufacturer of a narrow line of products. Because Wal-Mart is a major retailer and Trinity's proposal addressed how Wal-Mart approaches merchandising decisions, the Third Circuit concludes that the proposal did not transcend the company's day-to-day business matters. Consequently, the Third Circuit held that Wal-Mart could exclude the proposal from the company's proxy materials.<sup>2</sup>

It is notable, however, that not all three judges agreed that to avoid exclusion, a proposal must both raise a significant social issue and separately transcend day-to-day business matters. In a concurring opinion, Judge Shwartz argues that the evaluation of whether a proposal raises an issue of significant social policy cannot be appropriately separated from whether it transcends a company's day-to-day business. "Rather, a proposal is sufficiently significant 'because' it transcends day-to-day business matters."

## IMPLICATIONS

*Trinity Wall Street* largely reinforces the current SEC staff approach in evaluating the subject matter of shareholder proposals and provides some new considerations for how companies and the SEC staff should evaluate proposals that relate to ordinary business operations. However, it is not clear how the distinction the Court draws between proposals that raise significant policy issues and those that also transcend day-to-day business will be implemented in practice. The Third Circuit concludes by empathizing with companies and shareholders struggling with the unclear issues involved in the ordinary business operations exclusion and explicitly recommends that the SEC revise its regulations and issue new interpretive guidance in this area.

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## ENDNOTES

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<sup>1</sup> *Trinity Wall St. v. Wal-Mart Stores, Inc.*, No. 14-4764 (3d Cir. July 6, 2015).

<sup>2</sup> Two of the three judges also found that Trinity's proposal was excludable on the basis of vagueness under Rule 14a-8(i)(3), as the third component of the proposal (which related to products that "would reasonably be considered by many offensive to the family and community values integral to [Wal-Mart's] promotion of its brand") did not provide any concrete guidance on what constitutes "many" or what "family values" should be considered, despite Trinity's attempts to link these terms back to company statements.

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