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RECENT SUCCESSES REVEAL INCREASING USE OF COURTS TO RESOLVE SHAREHOLDER PROPOSAL DISPUTES

Companies seeking to exclude shareholder proposals have traditionally sought no-action relief from the SEC in order to exclude those proposals under Rule 14a-8.[1] However, a recent string of successes by companies in federal court may signal a new avenue for resolving shareholder proposal disputes. In this alert, we highlight two recent court decisions and several pending cases that could chart a new course for companies seeking expeditious resolution of shareholder proposal disputes.

RECENT OPINIONS

Express Scripts Holding Co. v. Chevedden. In December 2013, Express Scripts filed suit in the U.S. District Court for the Eastern District of Missouri seeking a declaratory judgment that it could exclude from its proxy materials a shareholder proposal from activist investor John Chevedden.[2] The proposal sought a policy requiring that the company's chairman be an independent director. The company argued that it could exclude the proposal from its proxy materials in reliance on Rule 14a-8(i)(3) on the basis that the supporting statement for the proposal included statements that were demonstrably false and misleading.[3] For example, the proposal stated that the company's CEO received $51 million in total compensation, even though the company's public disclosures indicated that his total compensation was $12.8 million in 2012 and $31.6 million for 2010 through 2012 *combined*. Other statements that the company alleged were demonstrably false and misleading included statements that:

- the company did not have a clawback policy, even though the company had adopted a clawback policy in 2011, which it had reported in its 2013 Proxy Statement;
- a particular director had received the most negative votes among the company's directors, even though several other directors had received higher numbers of negative votes at the company's 2013 annual meeting, a fact reported in the company's Form 8-K; and
- the company had a plurality voting standard for the election of directors, even though the company's bylaws, which were publicly available as an exhibit to a Form 8-K, provided that, when a quorum was present, only the affirmative vote of a majority of votes was necessary to elect a director.

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[1] Under Rule 14a-8(j), a company is required to notify the SEC of its plans to exclude a shareholder proposal from its proxy materials. While this notification is typically done through the submission of a no-action letter, a company may satisfy this requirement through a simple notification, which is the approach typically used by companies that intend to litigate to exclude shareholder proposals.

[2] *Express Scripts Holding Co. v. Chevedden*, No. 4:13-CV-2520, 2014 WL 631538 (E.D. Mo. Feb. 18, 2014).

[3] Rule 14a-8(i)(3) provides that a company may exclude a shareholder proposal from its proxy materials if the proposal or its supporting statement is contrary to any of the SEC's proxy rules—including Rule 14a-9, which prohibits materially false or misleading statements in proxy soliciting materials.

On a motion for summary judgment, the court ruled in favor of the company, noting that the supporting statement contained "inaccuracies [that] are more than mere 'minor defects' that could be corrected easily with minimal editing." Consequently the court stated that "[h]aving found the misstatements in the four supporting statements material and, therefore, not in compliance with SEC rules and regulations, the Court concludes that the criteria for exclusion under SEC Rules 14a-8 and 14a-9 have been met."[4]

Waste Connections, Inc. v. Chevedden. In a separate case in the U.S. Court of Appeals for the Fifth Circuit, John Chevedden appealed a district court decision that would have allowed Waste Connections to exclude a shareholder proposal submitted by Chevedden which asked the company to eliminate its staggered board and adopt annual elections of directors.[5] In the district court, Chevedden had sought to dismiss the litigation on the basis that the case was moot after Chevedden stipulated that he would not sue the company if it did not include his proposal in its proxy materials. The district court denied his motion to dismiss and granted the company's cross-motion seeking a declaratory judgment that the company could exclude the proposal in reliance on Rule 14a-8. Quoting an earlier opinion, the Fifth Circuit upheld the district court decision, noting that the company had standing because "Chevedden's request to include his proposal placed [the company] in the position of spending a significant sum to revise its proxy statement, or excluding Chevedden's proposal and exposing itself to potential litigation."[6]

PENDING DECISIONS

Since the beginning of 2014, several other companies have filed complaints in federal court seeking to exclude shareholder proposals from their proxy materials under Rule 14a-8. These include a case brought by EMC Corporation to exclude under Rule 14a-8(i)(3) a proposal seeking the adoption of a requirement that a board chairperson be "independent," and a case brought by Chipotle Mexican Grill, Inc. to exclude under Rule 14a-8(i)(3) a proposal seeking a "simple majority vote" for any "corporate action."[7] In a third case, Omnicom Group, Inc. filed suit in the U.S. District Court for the Southern District in New York to exclude a proposal seeking the adoption of a bylaw that would prevent the management of Omnicom from accessing or using "interim vote tallies" and similar information in connection with proxy solicitations.[8] All of these cases are presently being considered on motions to dismiss or for summary judgment.

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[4] *Id.* at *5.

[5] *Waste Connections, Inc. v. Chevedden*, No. 4:13-CV-00176 (S.D. Tex. June 3, 2013), *aff'd*, No. 13-20336, 2014 WL 554566 (5th Cir. Feb. 13, 2014) (per curiam) (unpublished opinion). The facts are discussed in greater detail in the letter of Waste Connections, Inc. to the SEC, dated January 30, 2013, which is viewable at http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/jamesmcritchiecheveddennoresponse013013-14a8.pdf.

[6] *Waste Connections*, 2014 WL 554566, at *2 (quoting *KBR Inc. v. Chevedden*, 478 Fed. App'x 213, 215 (5th Cir. 2012) (per curiam) (unpublished opinion)) (internal ellipsis and citations omitted).

[7] *See* Complaint at 8, 13-14, *EMC Corp. v. Chevedden*, No. 1:14-CV-10233 (D. Mass. Jan. 30, 2014), and Complaint at 9-11, *Chipotle Mexican Grill, Inc. v. Chevedden*, No. 1:14-CV-00018 (D. Colo. Jan. 2. 2014).

[8] *See* Complaint at 6-8, *Omnicom Grp. Inc. v. Chevedden*, No. 14-CV-03867 (S.D.N.Y. Jan. 21, 2014). Among these cases, *Omnicom* may ultimately have the greatest impact. In that case, the company argues that—if adopted—the proposal would violate New York state law by preventing directors from accessing data on votes cast by proxy regarding certain corporate decisions. The company also argues that the proposal violates Rule 14a-8(i)(3) for reasons similar to those considered in *Express Scripts*. Lastly, the company argues that the proposal violates Rule 14a-8(i)(7), which allows the exclusion of proposals that deal with ordinary business matters. While many of these arguments echo those considered in *Express Scripts*, *Omnicom* may have special resonance because the case will be considered in the U.S. District Court for the Southern District of New York,

TAKEAWAYS

We believe the cases described above could have a meaningful impact on shareholder proposals going forward. Here are some key takeaways:

- **Litigation is becoming a more realistic option for the resolution of shareholder proposal disputes.** As the Staff of the Division of Corporation Finance recognizes in its "Informal Procedures" statement that accompanies every no-action response, "[o]nly a court such as a U.S. District Court can decide whether a company is obligated to include shareholder proposals in its proxy materials."[9] Realistically, however, companies have generally eschewed litigation in favor of the no-action letter process. This is due to the fact that seeking a no-action letter is a relatively predictable process where a company can reasonably expect to get an answer from the SEC in advance of finalizing and distributing its proxy materials. Further, there is a well-developed and reliable body of interpretive guidance in no-action letters that companies can rely on in developing responses to shareholder proposals. This has not historically been the case with litigation. First, litigation can take much longer than no-action letters and the duration of litigation is less predictable. Second, many courts are unfamiliar with Rule 14a-8 matters, making the outcome of Rule 14a-8 challenges in court less predictable. As the *Express Scripts* and *Waste Connection* cases demonstrate, however, things are changing. In both cases, the courts ruled several months before the applicable shareholder meeting, while the decisions in these and other cases are contributing to a rapidly-growing body of case law that will help companies and shareholders evaluate the potential judicial treatment of Rule 14a-8 challenges, to say nothing of providing a growing body of precedent for future judicial consideration.
- **The costs and uncertainty of litigation will deter most companies and shareholders from pursuing litigation for the near term**. Notwithstanding the recent successes that companies have had in pursuing litigation to resolve Rule 14a-8 disputes, the costs and uncertainty of litigation will deter most companies from pursuing litigation for the near term. To start, litigation still injects a degree of uncertainty into the process that can be avoided with a no-action letter submission. As mentioned above, litigation can take months, if not years to resolve. Even though courts have recently responded to Rule 14a-8 challenges fairly quickly, this is not always the case and may not always be the case. Consequently, a company that chooses to litigate may eventually have to decide whether to exclude a shareholder proposal from its proxy materials even though it has not yet received a final ruling in the related litigation. In addition, it will be some time before a sufficient body of case law develops to give companies comfort that they can reliably predict the outcome of a judicial challenge. For example, even after the cases discussed in this alert are resolved, there will still only be a handful of opinions that have dealt with shareholder proposals on the merits, which does not compare favorably to the literally thousands of no-action letters that have been issued since the shareholder proposal rule was adopted.
- **The *Express Scripts* decision and the pending decisions in the *EMC*, *Chipotle*, and *Omnicom* cases may reopen the doorway for companies to exclude portions of a supporting statement or even the proposal as a whole.** Even if it is some time before a substantial body of case law develops with respect to Rule 14a-8 more generally, the decision in the *Express Scripts* case and the coming decisions in the *EMC*, *Chipotle*, and *Omnicom* cases could have far reaching consequences with respect to Rule 14a-8(i)(3) arguments for exclusion. For example, *Express*

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which is among the most sophisticated courts for securities matters due to its jurisdiction over many large financial institutions.

[9] SEC Division of Corporation Finance, Informal Procedures Regarding Shareholder Proposals (Nov. 2, 2011), *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8-informal-procedures.htm.

Scripts calls into question the Staff of the Division of Corporation Finance's position since 2004 that it will not engage in micro-editing of shareholder proposals. Specifically, the Staff has stated that it will not allow a company to exclude a supporting statement or proposal—even if it contains unsupported factual assertions, is disputed or countered, impugns the company or its management, or relies upon unidentified sources—unless the company can demonstrate "objectively that the proposal or statement is *materially* false or misleading."[10] The ruling in *Express Scripts* calls this approach into question and suggests that the Staff's approach to Rule 14a-8(i)(3) may be too narrow. While it is impossible to predict what the Staff will do in the future, it is not unreasonable to expect that the SEC could eventually be forced to re-evaluate its approach to arguments under Rule 14a-8(i)(3), particularly if the courts in the *EMC*, *Chipotle*, and *Omnicom* cases follow suit.[11] Until the Staff changes its approach, however, companies that are unable to persuade shareholder proponents to correct similarly-deficient supporting statements may choose to pursue litigation rather than relying on the no-action letter process.

CONCLUSION

The decisions in *Express Scripts* and *Waste Connections* are recent developments in what could signify a trend of increasingly aggressive approaches by companies toward shareholder proposals that do not comply with Rule 14a-8. While it remains to be seen how many other companies will follow suit, companies and shareholders alike should pay attention to this possible trend, which could meaningfully impact the future use of Rule 14a-8.

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[10] SEC Division of Corporation Finance, Staff Legal Bulletin No. 14B, at B(4) (Sept. 15, 2004), *available at* https://www.sec.gov/interps/legal/cfslb14b.htm.

[11] These cases could influence the SEC's interpretation of Rule 14a-8(i)(3) in the same way that a district court decision in *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554 (D.D.C. 1985) has influenced the SEC's interpretation of Rule 14a-8(i)(5). *See generally* Richard Y. Roberts, Commissioner, SEC, Remarks at the American Society of Corporate Secretaries—New York Chapter: Shareholder Proposals—Rule 14a-8, at 9-10 (Oct. 5, 1991), *available at* https://www.sec.gov/news/speech/1991/100591roberts.pdf.