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SHAREHOLDER ACTIVISM BULLET REPORT

February 2015

Developments in the World of Shareholder Activism

- ***Court Sets Aside SEC "Ordinary Business Operations" No-Action Letter.*** On November 26, 2014, the U.S. District Court for the District of Delaware ruled against Wal-Mart Stores, Inc., which had omitted from its 2014 proxy a proposal submitted by Trinity Wall Street, a church in downtown Manhattan and a Wal-Mart shareholder, based on Rule 14a-8(i)(7), which permits companies to exclude proposals dealing with "ordinary business operations." Trinity's proposal requested that Wal-Mart's Board of Directors amend the Compensation, Nominating and Governance Committee charter to provide that the Committee would oversee the formulation and implementation of policies to assess whether Wal-Mart should sell a product that endangers public safety, poses a substantial risk to Wal-Mart's reputation, or would be considered offensive to the values integral to Wal-Mart's brand. Trinity intended for this proposal to address whether Wal-Mart should sell guns with high-capacity magazines. Wal-Mart had received SEC no-action relief supporting its decision to omit the proposal under Rule 14a-8(i)(7).

The court ruled against Wal-Mart, citing the purpose of Rule 14a-8(i)(7) to prevent shareholders from micro-managing the company or hampering management's ability to operate the business, and finding that Trinity's proposal seeks action from Wal-Mart's Board, not its management, because the proposal merely asks the Board to develop and implement a policy and does not directly require action by management. The court noted that Trinity carefully limited its proposal to the Board's decision-making process and did not try to direct management's day-to-day operations.

The court also noted that Wal-Mart could not exclude the proposal because it focuses on significant social policy issues that are appropriate for a shareholder vote, and issued an injunction forcing Wal-Mart to put the proposal in its 2015 proxy statement if Trinity resubmits its proposal. Finally, the court noted that no-action relief reflects informal views of the SEC staff, and that only a court can make the final determination on whether a proposal may properly be excluded under Rule 14a-8(i)(7).

Takeaways: A company's decision to omit a shareholder proposal from its proxy statement can be challenged in court, even if the company has received no-action relief supporting the omission. Under the right circumstances, even if a court's decision comes too late for the current shareholder meeting, the court may issue an injunction to include a proposal in the proxy materials for the next shareholder meeting. SA shareholders submitting a proposal that could be subject to Rule 14a-8(i)(7) should draft the proposal so that it avoids directing management's day-to-day operations and instead focus on decision-making by the board.

- ***Division of Corporation Finance Will Express No Views on Rule 14a-8(i)(9) During Current Proxy Season.*** Following a statement by SEC Commission Chair Mary Jo White that she has directed the SEC staff to review Rule 14a-8(i)(9), CorpFin announced on January 16, 2015 that it will express no views on the application of the Rule during the current proxy season. In addition, it rescinded no-action relief previously granted to Whole Foods, Inc. on Dec. 1, 2014 pursuant to the Rule.

The announcement was preceded by negative public sentiment in the wake of the Whole Foods no-action letter, which granted no-action relief to omit a shareholder proposal in reliance on Rule 14a-8(i)(9). The Rule permits the exclusion of a shareholder proposal that directly conflicts with a management proposal. A shareholder had submitted a proposal that would permit proxy access to shareholders owning at least 3% of the company's stock for 3 years, for up to 25% of the board. Whole Foods contended that the shareholder proposal directly conflicted with a management proposal that would permit proxy access to shareholders owning at least 9% of the company's stock for 5 years, for up to 10% of the board. After the SEC staff rescinded its no-action relief, Whole

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Foods included a modified management proposal in its preliminary proxy statement. The modified proposal would permit proxy access to shareholders owning at least 5% of the company's stock for 5 years, giving them the opportunity to nominate directors for up to 10% of the board, subject to certain restrictions.

The Director of CorpFin, Keith Higgins, discussed the announcements relating to Rule 14a-8(i)(9) in a recent speech and addressed considerations given by the SEC staff in granting no-action relief under the Rule. He said that the staff has generally agreed that shareholder proposals conflict with management proposals where the inclusion of both would "present alternative and conflicting decisions for shareholders" that could lead to "inconsistent and ambiguous results." Higgins acknowledged several concerns with the Rule—for instance, that it might incentivize companies to present proposals solely to exclude shareholder proposals—but cautioned that having the staff assess whether a management proposal is made in good faith could be a perilous task. He weighed possible approaches to the issue, noting that the discussion is in very preliminary stages and that there are multiple views on the proper treatment of conflicting shareholder and management proposals. Higgins invited input from interested parties and noted that the SEC is accepting comments at i9review@sec.gov.

Takeaways: CorpFin's announcement that it will not consider further no-action requests under Rule 14a-8(i)(9) during the current proxy season means that a company that intended to seek no-action relief with respect to a shareholder proposal will need to consider alternatives, including seeking a judicial determination that the shareholder proposal may be excluded, negotiating with the proponents of the proposal, or including the shareholder proposal alongside management's dissenting statement or a counterproposal. A company may still exclude a shareholder proposal in reliance on the Rule so long as it files the reasons for the exclusion with the SEC, but the company may face increased risk of SEC enforcement action, shareholder lawsuits, negative publicity, damage to shareholder goodwill or adverse reaction from proxy advisory services. Glass Lewis stated recently that it may consider recommending shareholders vote against management's preferred directors when a firm excludes certain shareholder proposals in favor of diluted alternatives. The timing of the SEC's announcement may affect the "Boardroom Accountability Project 2015" undertaken by New York City Comptroller Scott Stringer on behalf of New York City Retirement Systems, which has announced that it intends to submit proxy access proposals to 75 public companies.

- ***SEC Commissioner States That SEC Will Not Tighten Timing On Filing Of Schedules 13D In Immediate Future, While SEC Staff Announces Enforcement Sweep.*** In a speech given on October 2, 2014, SEC Commissioner Daniel Gallagher stated that it is unlikely that the SEC will tighten in 2015 the rule regarding the ten-day reporting window under Section 13(d) of the U.S. Securities Exchange Act of 1934 ("Exchange Act"). The rule currently allows investors to quietly acquire additional shares of an issuer beyond the five percent reporting threshold if the additional share purchases occur during the ten day reporting window. Commissioner Gallagher noted that he was not speaking on behalf of the SEC while making these remarks at a Manhattan Institute conference. Meanwhile, on September 10, 2014 the SEC announced an enforcement sweep regarding Section 13(d) reporting requirement violations. The SEC charged 28 officers, directors, or major shareholders and six publicly-traded companies with reporting violations relating to holdings of company stock. 33 of the 34 individuals and companies charged agreed to settle the charges and pay penalties. For a more detailed description of the enforcement action, click here.

Takeaways: It appears that it may take a while for the SEC to change the reporting time frame for Section 13(d) filings. However, in light of the SEC's enforcement sweep, investors and their advisers should determine whether they, their clients and/or their principals have current Exchange Act reporting obligations; review past filings to ensure that there are no current amendment obligations and that all persons and entities in the investment adviser's structure that were required to report on such filings were included as reporting persons; remediate any issues identified (i.e., submitting initial filings or amending past filings); and review applicable compliance policies and procedures.

- ***SEC's Insider Trading Enforcement Efforts Hit A Speed Bump.***

Newman: The Second Circuit's decision in *United States v. Newman* in December 2014 overturned the insider conviction of two tippees under the misappropriation theory because of two missing elements: (1) the SEC failed to prove that the tipper received a "personal benefit" from providing the material, non-public information and (2) neither tippee knew of any personal benefit to the tipper from disclosing the material, non-public information. The decision is generally viewed as a significant win for the defendants' bar, and on January 23, 2015, the U.S. Attorney's office in Manhattan asked for a rehearing of the case or a rehearing *en banc*. For a copy of the Newman decision click here.

Peixoto: In September 2014 the SEC opened an administrative proceeding against Jordan Peixoto on the misappropriation theory. Peixoto learned that Pershing Square Management, L.P. was preparing a public presentation regarding its negative view of Herbalife from his friend Szymik, who was the roommate of the analyst that prepared the report. Peixoto then purchased a number of Herbalife put options prior to the release of the presentation and obtained $47,100 in profit. The SEC alleged that Peixoto knew or had reason to know that the information about Pershing's report on Herbalife was improperly obtained and that he therefore violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Szymik settled, but Peixoto did not. Importantly, the SEC did not allege that Peixoto knew of any personal benefit to Szymik or the

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analyst as a result of the tip, or even that such a benefit existed. On January 29, 2015, the SEC dismissed the administrative proceeding on the grounds that both Szymik and the analyst had returned to Poland and refused to testify in the Peixoto proceeding. For a copy of the administrative action against Peixoto click here.

Takeaways: Despite some setbacks, it is unlikely that the SEC will change its interpretation of what constitutes insider trading, and it appears that SEC staff will continue to use all of the tools at its disposal to continue to pursue its agenda; the statement at the National Seminar and the administrative action are examples of this (note that in the Peixoto case, Szymik settled; if Peixoto had not fought on, this would be one more "successful" enforcement action on the books). The Second Circuit's ruling in *Newman* may present a meaningful change in the application of the misappropriation theory, subject to the outcome of the U.S. Attorney's rehearing request and subsequent proceedings in the case, if any.

- ***SEC's Investor Advisory Committee Discusses Proxy Access.*** At its meeting on February 12, 2015, the SEC's Investor Advisory Committee ("IAC") discussed, among other things, proxy access. The IAC was established by Dodd-Frank to advise the SEC on regulatory priorities and initiatives to protect investor interests.

The general tone at the meeting was in favor of a regulation to set guidelines for proxy access proposals. Zachary Oleksiuk of Blackrock characterized proxy access as a basic accountability mechanism, and pointed out that proxy access thresholds that are too high or too low both pose risks. Mike Garland of the New York City Comptroller Office echoed that sentiment, calling proxy access a fundamental right that should be adopted by all companies, and spoke in favor of the three percent threshold ceiling that had been set by the SEC in its proposed rule, which his office supported. The SEC staff was represented by David Fredrickson of CorpFin, who reported that part of the staff's examination of Rule 14a-8(i)(9), which is being conducted at the direction of SEC Commission Chair Mary Jo White, will be to either rethink how the Rule is applied or recommend that the SEC create a new rule.

Takeaways: While the general sentiment is supportive of proxy access, it is unlikely that the SEC will reach a regulatory resolution on either proxy access thresholds or the application of Rule 14a-8(i)(9) quickly, and quite likely not before the end of the 2015 proxy season.

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