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SHAREHOLDER ACTIVISM BULLET REPORT

August 2015

Shareholder Activism Developments

- ***Delaware Law Prohibits Fee-Shifting Provisions in Stock Corporation Governing Documents.*** On June 24, 2015, Delaware Governor Jack Markell signed into law Senate Bill (S.B.) 75, amending the Delaware General Corporation Law (the "DGCL") to prohibit public stock corporations from adopting provisions in their governing documents that would shift legal fees in shareholder litigation to the losing party (commonly known as "loser pays" bylaws). The change to the DGCL does not invalidate any provision in stockholder agreements or other agreements signed by the stockholder against whom enforcement is sought. The changes effected by S.B. 75 become effective August 1, 2015.

S.B. 75 follows controversy that began a year ago when the Delaware Supreme Court ruled in *ATP Tour, Inc. v. Deutscher Tennis Bund* that fee-shifting provisions adopted by nonstock corporations could be valid under state law. That ruling left open the question of whether public stock corporations could impose similar provisions.

Corporations and their advocates generally have supported such provisions, arguing that they protect companies from increasingly aggressive and litigious investors, while shareholder advocates urge that fee shifting infringes on shareholders' rights and discourages meritorious suits. An advocate of fee shifting, the U.S. Chamber of Commerce's Institute for Legal Reform has argued that the new law could threaten Delaware's "billion-dollar incorporation franchise", but others have suggested that due to the various other benefits the state offers corporations, this alone is unlikely to be the catalyst for a corporate exodus from incorporation in Delaware. The long-term impact of this change is yet to be determined.

S.B. 75 also confirms the validity of forum-selection clauses in governing documents that designate Delaware as the exclusive forum to adjudicate internal corporate claims (*e.g.*, breach of fiduciary duties by directors and officers), but provides that the governing documents may not include a provision that prohibits such claims from being brought in Delaware.

Takeaways: As of August 1, 2015, the articles and bylaws of a Delaware stock corporation can no longer include a fee-shifting provision; they may, however, include provisions requiring that internal disputes are adjudicated in Delaware (but such provisions cannot mandate that such disputes are exclusively adjudicated in a jurisdiction other than Delaware), which offers protection from plaintiff-favorable forum shopping. Existing provisions that are not in compliance with the change in the DGCL will be invalidated. The new law does not affect the validity of fee-shifting provisions and forum-selection clauses in agreements entered into between the corporation and shareholders.

- ***Third Circuit Overrules Delaware District Court's Decision Setting Aside the SEC's "Ordinary Business Operations" No-Action Letter.*** On July 6, 2015, the U.S. Court of Appeals for the Third Circuit filed its opinion overruling the U.S. District Court for the District of Delaware's November 26, 2014 ruling, which required Wal-Mart Stores to include a proposal submitted by Trinity Wall Street in its 2015 proxy ballot. (*Trinity Wall Street v. Wal-Mart Stores, Inc.*, 2015 U.S. App. LEXIS 6072.) Trinity, a Manhattan church and Wal-Mart shareholder, had submitted a shareholder proposal requiring the Board to assess whether the sale of guns with high capacity magazines would violate the store's policies and values. Wal-Mart requested and received a no-action letter from the Securities and Exchange Commission ("SEC") on the basis that Rule 14a-8(i)(7) allowed Wal-Mart to omit the proposal because it concerned ordinary business operations. The Delaware District Court set aside the SEC's letter and held that Trinity's proposal did not direct Wal-Mart's day-to-day operations and instead focused on social policy issues. The Third Circuit held that Trinity's proposal is excludable under the ordinary business provision and that the significant social policy intended by the proposal does not provide an exception to the exclusion. Specifically, the Third Circuit held that a proposal must meet a two-pronged test in order to not be excludable under Rule 14a-8(i)(7): it must raise a significant social

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policy issue (which test Trinity's proposal may pass) and the policy Issue raised must transcend the company's ordinary business operations (which test Trinity's proposal fails).

Takeaways: Although the case was a victory for Wal-Mart and the staff of the SEC, the Third Circuit's opinion provides a detailed analysis of this issue, which may provide a road map for drafters of future shareholder proposals. Issuers will likely see proposals carefully crafted to take advantage of the Third Circuit's opinion.

- ***DE Supreme Court Allows "Late" Shareholder Slate.*** In *Hill International, Inc. v. Opportunity Partners L.P.,* the Delaware Supreme Court ruled in favor of an activist investor that proposed a slate of directors after the company had refused to include the shareholder director proposal because it was not received on time. Hill International, the company in question, made a public filing in 2014 announcing that its 2015 AGM would be held "on or about June 10, 2015." On April 30, 2015, it issued its notice to shareholders that the AGM would be held on June 9, 2015. Hill's articles and bylaws provide that if notice of the date on which the AGM will be held is given more than 70 days prior to the AGM, any shareholder proposal must be received by Hill no earlier than 90 days before or later than 60 days before the AGM (the "30 day window"). However, if notice of the date is given less than 70 days prior to the AGM, a shareholder proposal must be received no later than 10 days before the AGM (the "10 day window"). Opportunity Partners initially submitted its slate of directors on April 13, 2015 (*i.e.*, within the 30 day window) but Hill rejected that proposal on May 5, 2015 because it did not contain all required information. Opportunity Partners resubmitted its proposal on May 7, 2015 (after the 30 day window closed), arguing that since Hill had provided notice of the date of the AGM less than 70 days in advance of the AGM, the 10 day window applied.

The court ruled in favor of Opportunity Partners, finding that the notice issued in 2014 only stated that the AGM would be held "on or about June 10, 2015", which was not a "date" but a "range", and Hill's articles and bylaws require that notice of the date be given 70 days prior to the AGM in order for the 30 day window to apply. Importantly, because the AGM was close to being held at the time the complaint was filed, the court enjoined Hill from transacting any business at its June 9 AGM other than convening for the sole purpose of adjourning it for a minimum of 21 days, in order for the plaintiff to present a case and for the court to issue its ruling.

Takeaways. The case highlights that advance notice deadlines and shareholder proposal windows can be a two-edged sword. If the applicable notice provisions are observed, shareholders have a narrow window to submit a shareholder proposal, and procedural or informational defects may permit a company to reject such proposals in a fashion that makes it impossible for a corrected proposal to be resubmitted. On the other hand, a small deviation from the procedure set forth in the articles and bylaws may cause advance notice deadlines to be inapplicable.

- ***Withhold Campaign Changes Tempur Sealy's Management and Board.*** An activist shareholder decided to employ a "withhold" strategy (urging other shareholders to join in refusing to vote in favor of the board's nominees in order to make changes at the company) after missing the deadline to nominate its own slate of directors in time for Tempur Sealy International Inc.'s AGM. The campaign was wildly successful, resulting in the resignation of Tempur Sealy's CEO and three of its directors and the appointment of the activist shareholder's nominee as well as an independent director recommended by the activist shareholder.

Takeaways. Even if advance notice deadlines pass without any shareholder proposals being submitted or added to the AGM agenda, determined shareholders (particularly if they can garner support from influential proxy advisers) can still mount formidable proxy contests.

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