

## **Trinity Wall Street v. Wal-Mart Stores, Inc. – “Lawyers, Guns and Money”**

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On July 6, 2015 the Third Circuit Court of Appeals issued its eagerly awaited opinion in *Trinity Wall Street v. Wal-Mart Stores, Inc.*, addressing the question of what constitutes a company’s ordinary business operations and thus may not be the subject of a shareholder proposal intended for that company’s proxy materials. As we have previously reported, on April 14, 2015, the Court summarily reversed the federal District Court in Delaware, promising that a full opinion was forthcoming.

### **Background**

Before arriving at the Appeals Court, the battle between Trinity Wall Street (one of the oldest and wealthiest Episcopal churches in the United States) and Wal-Mart Stores, Inc. (the largest retailer in the United States) started in December 2013 with a shareholder proposal submitted to Wal-Mart for inclusion in Wal-Mart’s annual proxy statement. Trinity’s proposal asked Wal-Mart’s board of directors to develop and implement standards for management to use in deciding whether to permit the sale of certain products “that especially endanger public safety,” “ha[ve] the substantial potential to impair the reputation of Wal-Mart” and/or “would reasonably be considered by many offensive to the family and community values integral to the Company’s promotion of its brand.” Trinity’s proposal made clear that they would specifically like the board of directors to consider the sale of high capacity assault rifles.

### **Wal-Mart Obtains a Favorable No-Action Letter**

Under Rule 14a-8 adopted by the SEC under Section 14(a) of the Securities and Exchange Act of 1934, a company generally must include a shareholder proposal in its proxy materials unless the proposal meets one of the specified exceptions set forth in the rule. In January of 2014, Wal-Mart submitted a no-action request to the SEC stating its intent to exclude the proposal from its proxy materials in accordance with the exception under Rule 14a-8(i)(7), which permits a company to exclude a proposal if it relates to the ordinary business operations of the company. The “ordinary business” exception may apply when a shareholder proposal relates to the fundamental functions of management’s ability to run a company on a day-to-day basis when the proposal seeks to micro-manage the company. Wal-Mart argued, and the SEC agreed, that Trinity’s proposal essentially regulated the sale of particular products.

### **Trinity Sues in Federal District Court and Wins**

On April 1, 2014, just 17 days before Wal-Mart’s proxy statement was scheduled to be delivered to the printer, Trinity continued its fight by taking the case to federal District Court in Delaware seeking to enjoin Wal-Mart from excluding its proposal from the proxy materials. At the hearing, the District Court denied Trinity’s request for a preliminary injunction, permitting the solicitation of proxies by Wal-Mart for its 2014 annual meeting. The District Court agreed with Wal-Mart (and the SEC) that the proposal related to Wal-Mart’s ordinary business operations and was therefore not an appropriate subject for a shareholder proposal.

After the preliminary injunction was denied, Wal-Mart moved to dismiss Trinity’s complaint but the Court dismissed only one count of the complaint. In November 2014, deciding on a summary judgment motion on the surviving count, and with more time to consider the merits, the District Court reversed itself and concluded that the proposal could not be excluded on “ordinary business practices” grounds. In its ruling, the District Court held that even though the proposal would have an impact on the products ultimately sold by Wal-Mart, the proposal was really for the board to consider what, if any, policy the board should implement in determining what products to sell. Further, the District Court held that even if the proposal did touch on the ordinary business practices of Wal-Mart, nevertheless the proposal focused on social policies that “*transcend the day to day business matters*” of Wal-Mart and thus would be appropriate for a

## Wal-Mart Appeals to the Third Circuit and Prevails

Wal-Mart appealed from the District Court's decision, and the Third Circuit Court of Appeals heard the case in January 2015 and issued its summary ruling in April 2015 that Wal-Mart may exclude Trinity's proposal from its 2015 proxy materials. The Appeals Court addressed, and disagreed with, both holdings from the District Court ruling.

The Appeals Court analyzed first, whether Trinity's proposal meddled in the ordinary business affairs of Wal-Mart, and second, if the proposal affects Wal-Mart's ordinary business, whether the proposal is not excludable because it transcends Wal-Mart's ordinary business by implicating a significant social policy.

### The Ordinary Business Exclusion

In deciding whether Trinity's proposal is excludable because it deals with ordinary business operations, the Appeals Court addressed two questions – first, what is the subject matter of the proposal, and second, whether that subject matter relates to Wal-Mart's ordinary business operations.

#### WHAT IS THE SUBJECT MATTER OF THE PROPOSAL?

In the first step of the analysis, the Appeals Court notes that although the “clever” drafting of the Trinity proposal purports to request the development of a policy at the board level, in reality the action being requested is an ordinary business matter. Where the District Court viewed the proposal as a request for a board policy rather than a directive to management as to what the store could put on its shelves, the Appeals Court considered whether the proposal was addressing a matter that could normally be handled by management personnel without referral to the board. Trinity argued that the immediate consequence of the proposal – the board adopting a policy regarding its merchandise – is the actual subject matter of the proposal. However, the Appeals Court held that the actual subject matter of the proposal that needs to be analyzed is the *ultimate* consequence of the proposal, not the *immediate* consequence. The Appeals Court found that the immediate consequence of Trinity's proposal being approved would be a policy that would ultimately change what the stores put on shelves.

#### DOES THE SUBJECT MATTER RELATE TO ORDINARY BUSINESS?

Once the Appeals Court determined that the subject matter of the proposal was whether Wal-Mart should sell certain kinds of products, it next considered whether that subject matter relates to the “ordinary business” of Wal-Mart. The Appeals Court found that even though the proposal did not actually request particular changes, it struck at the core of Wal-Mart's day-to-day business operations and would affect how Wal-Mart chooses its inventory. The Appeals Court explained that a retailer's approach to how it selects its product offerings is the “bread and butter” of its business and even though the proposal doesn't dictate a particular outcome in either direction, the implementation of such a policy would affect its day-to-day business.

The Appeals Court concluded its analysis on this subject by stating: “In short, so long as the subject matter of the proposal relates – that is, bears on – a company's ordinary business operations, the proposal is excludable unless some other exception to the exclusion applies.” Trinity argued that even if the proposal did concern Wal-Mart's ordinary business operations, it still should not be excluded because the social policy it addresses is so significant that it transcends the company's ordinary business.

### The Social Policy Exception

The Appeals Court next examined whether the social policy exception to the general ordinary business exclusion might apply. The Appeals Court cited an SEC staff bulletin which explained that the significant social policy exception provides that when “a 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, the proposal generally will not be excludable.”

This analysis has two steps: (1) whether the proposal focuses on a significant policy and, if so, (2) whether the significant policy issue “transcends” the company's ordinary business operations.

#### DOES THE PROPOSAL RAISE A SIGNIFICANT SOCIAL POLICY ISSUE?

With respect to step one, the Appeals Court determined that Trinity's proposal did raise a matter of sufficiently significant policy. The

Appeals Court makes reference to the “we-know-it-when-we-see-it” approach adopted by the SEC, 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”.

EVEN IF THE PROPOSAL RAISES A SIGNIFICANT POLICY ISSUE, DOES THAT ISSUE TRANSCEND WAL-MART’S ORDINARY BUSINESS OPERATIONS?

The Appeals Court understands the term “transcend” in this analysis to refer to a policy issue that is “divorced from how a company approaches the nitty-gritty of its core business,” and that this requirement plays a key role in the social-policy exception calculus. The Appeals Court said that a social policy issue is more likely to transcend day-to-day business dealings if it disengages from the core of a retailer’s business (*i.e.*, deciding whether to sell particular products).

The Appeals Court illustrated this framework by contrasting two proposals. First, a proposal that “asks a supermarket chain to evaluate its sale of sugary sodas because of the effect on childhood obesity” would not transcend ordinary business matters because it is “too entwined with the fundamentals of the daily activities of a supermarket running its business.” In contrast, a proposal “raising the impropriety of a supermarket’s discriminatory hiring or compensation practices” would transcend ordinary business operations and therefore not be excludable because it is “disengaged from the essence of a supermarket’s business.”

Trinity argued that its proposal included both corporate policy and social policy, and that the policy issue was transcendent in that it “goes to the heart of Wal-Mart’s impact on and approach to social welfare as well as the risk such impact and approach may have to Wal-Mart’s reputation and brand image and its community.” But the Appeals Court disagreed, concluding that the proposal did not transcend day-to-day business matters. The Appeals Court explained that “because the proposal relates to a policy issue that targets the retailer-consumer interaction, it doesn’t raise an issue that *transcends*...Wal-Mart’s ordinary business operations, as product selection is the foundation of retail management.”

For retailers like Wal-Mart that deal with thousands of products and many options for each, the decision of whether to sell a particular product is precisely the sort of business decision a retailer makes many times every day. Consequently, the Appeals Court held that Wal-Mart could exclude the proposal from its proxy materials.

## Conclusions

*Trinity Wall Street v. Wal-Mart Stores, Inc.* deals with complex issues. Trinity argued that its proposal was about governance, not what goes on the shelves of Wal-Mart, but in the end the Appeals Court disagreed. Even more metaphysical is the “transcendence” argument, which strikes some analysts as sensible but others as artificial. The Appeals Court made no reference to the so-called “Wall Street Rule” – if you don’t like the management, sell the stock – even though that location was a conspicuous part of the plaintiff’s name.

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