

Appeals Court Opinion in Wal-Mart Case Outlines Two-Prong Test for Analyzing Ordinary Business Shareholder Proposals

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The United States Court of Appeals for the Third Circuit issued its opinion that permitted Wal-Mart to exclude a shareholder proposal that had asked the board to oversee policies to evaluate the sale of certain types of guns. The proponent had argued that the products endanger public safety and could impair the company's reputation or damage its brand as a family retailer. We discussed the proposal and the background in several [prior posts](#).

In its ruling, the Appeals Court provided a clear set of tests under which to analyze these types of proposals.

1. *What is the subject matter of the proposal (and its ultimate consequence)?*

In emphasizing that the proposal should be reviewed on its substance, not the form, the Appeals Court found that the District Court placed undue weight on the distinction between a directive to management and a request for board action to review and oversee the development of a merchandising policy. In this case, the Appeals Court disagreed with Trinity's assertion that the primary focus of the proposal would be to improve corporate governance as a result of board oversight. Instead, the Appeals Court decided that the subject matter is the potential change in the way Wal-Mart decides which products to sell, since that is the ultimate consequence of the board review sought in the proposal.

2. *Does the proposal focus on a significant policy issue that transcends Wal-Mart's day-to-day business operations?*

Even if the proposal touches on ordinary business matters, the Appeals Court acknowledged that there is a significant social policy exception to the default rule that a proposal relating to a company's ordinary business is excludable. The question is complex but must be analyzed ("...we cannot sidestep what some may deem an unreckonable area.") in two steps:

a. *Does the proposal raise a significant social policy issue?*

The Appeals Court indicates that the current SEC staff policy regarding whether a proposal concerns a significant social policy issue can best be described as a "we-know-it-when-we-see-it-approach," citing to a third-party that criticizes the SEC's reasoning in this area as the "most dramatic and prominent example of SEC inconstancy" under Rule 14a-8. But they concur with the District Court that the proposal does raise matters that are of significant concern to society, and corporations in that society, because it deals with products that could endanger public safety, the company's reputation and brand value.

b. *Even if the proposal raises a significant social policy issue, does that issue transcend Wal-Mart's ordinary business operations?*

In addition to raising a social policy issue, the subject matter of the proposal must "transcend" the company's ordinary business to be excludable, which the Appeals Court believes refers to a policy issue that is "divorced from how a company approaches the nitty-gritty of its core business." The requirement to "transcend" ordinary business is crucial. Here, the Appeals Court distinguishes between, for example, a proposal that asks supermarkets to stop selling sugary sodas because of childhood obesity concerns (excludable since deciding what food products to sell is fundamental to a supermarket's operations) against a proposal that tells supermarkets to stop discriminatory employee hiring practices (not excludable since hiring is not the essence of a supermarket's business). Ultimately, the Appeals Court determined that deciding what products to put on its shelves is the core of a retailer's business. In this particular case, the Appeals Court noted that "Wal-Mart serves different Americas with different values," and that it is management's role to resolve how to deal with differing, and potentially conflicting, desires.

The Appeals Court criticizes the SEC for having "hard-to-define exclusions to their rules and exceptions to those exclusions" and suggests that the SEC consider revising its regulation and issue new guidance. They stated that "[f]or those who labor with the ordinary business exclusion and social-policy exception that requires not only significance but

'transcendence,' we empathize."

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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