

VII. *SEC Rule 14a-8(i)(9) & The Whole Foods Proxy Saga*

A. Introduction

On December 1, 2014 the Securities and Exchange Commission (“SEC”) granted no-action relief to Whole Foods Market, Inc. (“Whole Foods”), giving the company permission to exclude a shareholder proxy access proposal under SEC Rule 14a-8(i)(9).¹ Rule 14a-8(i)(9) allows a company to exclude a shareholder’s proposal from the company’s proxy statement if the proposal is in direct conflict with one of management’s own proposals.² However, on January 16, 2015, SEC Chairperson Mary Jo White released a statement asking the SEC to review Rule 14a-8(i)(9), and consider the scope and application of the rule.³ That same day, the SEC’s Division of Corporation Finance (“Division”), the division in charge of granting no-action relief, stated it would “express no views on the application of Rule 14a-8(i)(9) during the current proxy season.”⁴ Also, the Division stated specifically that it reversed its December 1st decision regarding the Whole Foods proxy statement.⁵ The full implications of the SEC’s decision are unclear as companies gear up for spring annual shareholder meetings.⁶

This Article will proceed as follows. Section B discusses background information regarding shareholder proxy access. Section C explains the initial decision by the SEC to grant no-action relief to Whole Foods under Rule 14a-8(i)(9). Section D considers the SEC’s

¹ See Yin Wilczek, *Whole Foods Action Shapes Up Battlefront for Proxy Access Proposals*, 12 Corp. L. & Accountability Rep. (BNA) No. 48, at 1719 (Dec.12, 2014).

² 17 C.F.R. § 240.14a-8(i)(9) (2015); see also Dave Michaels, *SEC to Review Corporate-Ballot Rules after Whole Foods Fight*, BLOOMBERG (Jan. 16, 2015, 8:20 PM), <http://www.bloomberg.com/news/articles/2015-01-17/sec-to-review-corporate-ballot-rules-after-whole-foods-fight>, archived at <http://perma.cc/BQ2S-EF7S>.

³ Press Release, Mary Jo White, Chairperson, Sec. & Exch. Comm’n, Statement from Chair White Directing Staff to Review Commission Rule for Excluding Conflicting Proxy Proposals (Jan. 16, 2015), available at <http://www.sec.gov/news/statement/statement-on-conflicting-proxy-proposals.html#.VL0gmlqYmyg>, archived at <http://perma.cc/QVJ6-PR28>.

⁴ *Id.*

⁵ Michaels, *supra* note 2.

⁶ See Gretchen Morgenson, *S.E.C. Reversal May Clear Way for Shareholders to Challenge Companies*, N.Y. TIMES, Jan. 20, 2015, at B3.

“no view” announcement regarding Rule 14a-8(i)(9). Section E reviews the potential implications of the SEC’s announcement and considers measures companies may take in the wake of the announcement.

B. Background: Rule 14a-8(i)(9) and Increasing Shareholder Proxy Access

Institutional investors and shareholder activists have worked together in recent years to gain greater rights for long-term shareholders, including allowing them to list their own director candidates on a company’s ballot.⁷ Shareholders who want to nominate directors typically submit “proxy access proposals,” which if approved by a majority of shareholders and the company’s board of directors, allow shareholders to place their director nominations on a company’s proxy statement.⁸ If the shareholder cannot get their director nominations included on the company’s proxy materials, the shareholder has to bear the cost of mailing separate ballots and materials to every shareholder with the alternative nominees listed.⁹ Therefore, proxy access proposals are an ideal and attractive option to shareholders who want to nominate directors for a company’s board.¹⁰ Corporations, however, continue to resist changes to their boardrooms by routinely rejecting shareholders’ proxy access proposals.¹¹ By rejecting the proxy access proposals, corporations keep their boards “pro-management” and less accountable to shareholders.¹²

Addressing shareholders’ proxy access concerns, the SEC in 2010 passed Rule 14a-11, which forced proxy access on all companies,

⁷ Robert Murphy et al., *Proxy Access on the Horizon*, LEXOLOGY (Jan. 29, 2015), <http://www.lexology.com/library/detail.aspx?g=2227f750-c854-4d24-ab73-eba6bf742a21>, archived at <http://perma.cc/U9DJ-XNL9>.

⁸ *Id.*

⁹ See Kaja Whitehouse, *Shareholders Threaten Boards Over ‘Proxy Access,’* USA TODAY (Jan. 27, 2015, 12:43 PM), <http://www.usatoday.com/story/money/business/2015/01/27/proxyaccess-investors-businessroundtable-wholefoods/22234271>.

¹⁰ *See id.*

¹¹ *See* Murphy et al., *supra* note 7.

¹² Matthew Heller, *SEC About-Face in Whole Foods Case May Empower Investors*, CFO.COM (Jan. 20, 2015), <http://ww2.cfo.com/governance/2015/01/sec-face-whole-foods-case-may-empower-investors/>, archived at <http://perma.cc/5A5R-XFBX>.

for certain shareholders.¹³ Rule 14a-11 gave “shareholders the right to nominate directors to a company’s board of directors if they held a 3 percent stake in the company for three years.”¹⁴ The D.C. Court of Appeals vacated Rule 14a-11 in 2011, and concluded that the SEC’s decision to implement it was “arbitrary and capricious.”¹⁵ In reaction to the D.C. Court of Appeals’ decision, the SEC made changes to Rule 14a-8 to allow shareholders to make “proxy access proposals,” and “in effect permit[] each company to make its own decision on whether to allow proxy access.”¹⁶

In order to block shareholder proxy access proposals, companies commonly submit “no-action requests” to the SEC under SEC Rule 14a-8(i)(9), which “allows a company to exclude a shareholder proposal that ‘directly conflicts’ with a management proposal.”¹⁷ The two proposals do not have to be “identical in scope or focus” in order for the company to invoke Rule 14a-8(i)(9).¹⁸ Rather, the SEC has interpreted Rule 14a-8(i)(9) broadly, stating that a company may exclude a shareholder proposal if it “would present alternative and conflicting decisions for shareholders and would create the potential for inconsistent and ambiguous results.”¹⁹ However, SEC no-action letters only represent the SEC’s informal view on an issue, and do not protect companies from potential litigation.²⁰

Despite efforts by companies to block shareholder proxy access, shareholders are putting forth proxy access proposals in

¹³ Murphy et al., *supra* note 7.

¹⁴ *Id.*

¹⁵ Bus. Roundtable v. SEC, 647 F.3d 1144, 1146 (D.C. Cir. 2011); *see also* Murphy et al., *supra* note 7.

¹⁶ Murphy et al., *supra* note 7; *see also* 17 C.F.R. § 240.14a-8 (2015).

¹⁷ Scott Lesmes et al., *SEC Suspends Review of Conflicting Shareholder Proposal No-Action Requests*, LEXOLOGY (Jan. 28, 2015), <http://www.lexology.com/library/detail.aspx?g=1302dd52-6aa7-4c62-aa6b-b85bfe247c8d>, archived at <http://perma.cc/64A4-HDLW>; *see also* 17 C.F.R. § 240.14a-8(i)(9).

¹⁸ Lesmes et al., *supra* note 17.

¹⁹ *Id.* (quoting Borg Warner Inc., SEC No-Action Letter, 2014 WL 6999587 (Feb. 6, 2015)) (internal quotation marks omitted).

²⁰ Andrew Brady et al., *SEC Staff Will No Longer Issue No-Action Letters on Conflicting Shareholder Proposals During the 2015 Proxy Season*, JDSUPRA (Jan. 29, 2015), <http://www.jdsupra.com/legalnews/sec-staff-will-no-longer-issue-no-action-23445/>, archived at <http://perma.cc/B4WQ-7LX6>.

increasing numbers.²¹ For example, New York City Pension Funds recently filed proposals at seventy-five different public companies asking for proxy access for three percent shareholders who have held their shares for three years.²² Other companies, looking to cooperate with shareholders, implemented policies allowing “3 percent holders to nominate up to one-quarter of their directors.”²³ Comparing the 2014 proxy season to the 2013 proxy season, shareholders submitted a greater number of proxy access proposals in 2014 and the proposals received a greater percentage of shareholder support in 2014.²⁴

C. The SEC’s Initial Decision on the Whole Foods Proxy Statement

On December 1, 2014 the SEC granted no-action relief to Whole Foods for their exclusion of a shareholder proxy access proposal.²⁵ James McRitchie submitted the proxy access proposal to Whole Foods, which asked Whole Foods to allow three percent shareholders who have held stock for three years “to be able to nominate up to two directors on the company’s proxy.”²⁶ However, Whole Foods also proposed a shareholder proxy access rule with more stringent criteria.²⁷ The Whole Foods proposal stated that any shareholder holding “9 percent or more of the company for five years” could list

²¹ See Murphy et al., *supra* note 7.

²² *Id.*

²³ *Id.* Companies implementing such policies include CenturyLink, Chesapeake Energy, Hewlett-Packard, McKesson, Verizon, and Western Union. *Id.*

²⁴ See Andrew Ackerman & Joann S. Lublin, *Whole Foods Dispute Prompts SEC Review of Corporate Ballots*, WALL ST. J. (Jan. 19, 2015, 5:49 PM), <http://www.wsj.com/articles/in-reversal-sec-wont-allow-whole-foods-to-exclude-nonbinding-shareholder-proposal-1421450999> (“Seventeen such measures reached a vote during annual meetings last year, winning an average of 33.9% of shares cast, said Institutional Shareholder Services, the biggest U.S. proxy-advisory firm. . . . By contrast, the 13 proxy access proposals voted on during 2013 garnered an average of 32.5% support.”).

²⁵ Lesmes et al., *supra* note 17.

²⁶ Ross Kerber & Tanvi Mehta, *SEC Steps Back After Challenge on Whole Foods Proxy Access*, REUTERS (Jan. 20, 2015, 7:40 AM), <http://www.reuters.com/article/2015/01/20/whole-foods-mrkt-sec-idUSL1N0UZ0PS20150120>, archived at <http://perma.cc/CUR9-ZB3C>.

²⁷ *Id.*

director candidates on Whole Foods' proxy.²⁸ Whole Foods "subsequently lowered that threshold to 5%, though investor advocates warned that bar was still too high."²⁹ The SEC concluded that the two proxy access proposals overlapped, and that Whole Foods could exclude McRitchie's proposal under Rule 14a-8(i)(9).³⁰

Following Whole Foods' successful exclusion of McRitchie's proxy access proposal, the SEC received over twenty no-action requests from companies looking to preclude shareholder proxy access through Rule 14a-8(i)(9), in a manner similar to Whole Foods.³¹ Those requests mirrored the Whole Foods no-action request, and sought to exclude "shareholder [proxy access] proposals on the basis that they conflicted with the company's own more restrictive proxy access proposal."³² At the same time, shareholder activists and investors grew enraged over the SEC's decision.³³ Some investors suggested that the SEC's decision served as a loophole, and that corporations could use the loophole to block shareholder proxy access proposals by simply proposing a "watered-down" version of the shareholder proposal.³⁴ Following their Whole Foods decision, the SEC encountered increasing pressure from institutional investors and investor groups who wanted the SEC to review the decision.³⁵ McRitchie also asked the SEC to reconsider its ruling, stating that "[t]he interpretation effectively limits shareholders to consideration of proposals sponsored by the board of directors and eliminates any opportunity for shareholders to present alternative criteria."³⁶

²⁸ *Id.*

²⁹ Ackerman & Lublin, *supra* note 24.

³⁰ Brady et al., *supra* note 20.

³¹ *Id.*

³² *Id.*; Taavi Annus et al., *Chair White Directs Staff to Review Rule 14a-8 Conflicting Proposal Exclusion*, LEXOLOGY (Jan. 20, 2015), <http://www.lexology.com/library/detail.aspx?g=25785de2-fef2-4fe1-9e13-bc2b21576c96>, archived at <http://perma.cc/CY3X-J5SZ>.

³³ Morgenson, *supra* note 6.

³⁴ *Id.*

³⁵ *See id.*; Brady et al., *supra* note 20.

³⁶ Kat Greene, *SEC Changes Course on Whole Foods Shareholder Proposal*, LAW360 (Jan. 16, 2015, 9:55 PM), <http://www.law360.com/articles/612823/sec-changes-course-on-whole-foods-shareholder-proposal>.

D. The SEC Subsequently Reverses its Decision

On January 16, 2015, SEC Chairperson White directed the SEC to review Rule 14a-8(i)(9), “[d]ue to questions that have arisen about the proper scope and application of [the rule].”³⁷ Consequently, the Division announced that it would “express no views on the application of Rule 14a-8(i)(9) during the current proxy season.”³⁸ On the same day, the Division released a letter to James McRitchie, rescinding their December no-action letter.³⁹

E. Implications of the Whole Foods Proxy Saga

According to many observers, the SEC’s reversal of its initial Whole Foods decision was atypical, as the SEC does not usually overturn no-action letters.⁴⁰ On one side of the controversy, pro-management advocates feel shareholder activists “have ‘hijacked’ the shareholder-proposal system.”⁴¹ Conversely, those seeking to increase shareholder proxy access celebrate the SEC’s reversal, and allege that companies had “begun to ‘game’ the proxy process.”⁴² Others suggest that the SEC’s “no view” on Rule 14a-8(i)(9) will “clear[] the way for [corporate governance] challenges to spread at annual shareholder meetings.”⁴³

With the SEC’s announcement that it would take “no view” on Rule 14a-8(i)(9), companies and investors began strategizing options for the upcoming proxy season.⁴⁴ In this current proxy season,

³⁷ Press Release, Mary Jo White, *supra* note 3.

³⁸ *Id.*

³⁹ See Letter from David R. Fredrickson, Chief Counsel, Sec. & Exch. Comm’n, to James McRitchie (Jan. 16, 2015), *available at* <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/jamesmcritchiecheveddenrecon011615-14a8.pdf>, *archived at* <http://perma.cc/X64R-L42F>.

⁴⁰ See Andrew Ackerman & Joann S. Lublin, *SEC Reverses Decision on Shareholder Proposal—Update*, NASDAQ (Jan. 16, 2015, 8:58 PM), <http://www.nasdaq.com/article/sec-reverses-decision-on-shareholder-proposalupdate-20150116-00699>.

⁴¹ *Id.*

⁴² *Id.*

⁴³ Morgenson, *supra* note 6.

⁴⁴ *Id.*; see also R. Douglas Harmon, *SEC Reverses Course on Proxy Exclusions for Certain Shareholder Proposals*, JDSUPRA (Jan. 21, 2015), <http://www.>

companies must decide how they will proceed with shareholder proxy access proposals, despite the lack of guidance from the SEC.⁴⁵ The SEC has indicated, however, that “although the [SEC] Staff has no capacity to comment on—or grant no-action relief pursuant to—[Rule 14a-8(i)(9)] this proxy season, the exclusion survives.”⁴⁶

Companies will undoubtedly take a variety of approaches towards shareholder proxy access proposals this proxy season.⁴⁷ In the words of one observer, companies have five alternatives:

[Companies] could: (1) include both the shareholder proposal and the management proposal in the proxy statement, with an explanation to shareholders regarding any differences in scope or applicability; (2) include the shareholder proposal with a recommendation that it not be approved by shareholders; (3) negotiate with the [proxy access] proponent to withdraw its proposal in light of the management proposal to be included in the proxy materials; (4) rely on existing [SEC] Staff precedent to exclude the proposal under Rule 14a-8(i)(9) after submitting a notice of such intention to the [SEC] pursuant to Rule 14a-8(j) and including the management proposal in proxy materials, subject to the risk that a shareholder might seek to challenge such action in federal court; or (5) seek a declaratory judgment from a federal court that a shareholder proposal may be excluded under Rule 14a-8(i)(9).⁴⁸

Importantly, SEC rules do not forbid a company from excluding a shareholder proposal without first seeking an SEC no-action letter, but the company must file its justification for excluding the shareholder proposal with the SEC “no later than 80 calendar days before the definitive proxy statement is filed.”⁴⁹ Each of the above-listed options comes with a degree of uncertainty, and companies must weigh

jdsupra.com/legalnews/sec-reverses-course-on-proxy-exclusions-49528/,
archived at <http://perma.cc/57ML-QX42>.

⁴⁵ Harmon, *supra* note 44.

⁴⁶ Lesmes et al., *supra* note 17.

⁴⁷ *See id.*

⁴⁸ *Id.*

⁴⁹ Annus et al., *supra* note 32.

whether leaving a shareholder proposal off their proxy materials is worth the litigation risks and costs.⁵⁰ In deciding which course to take, companies will likely consider “the parameters of the [shareholder’s] proposal and its potential impact on the company,” and “the proposal’s likelihood of success if submitted to a vote of the shareholders.”⁵¹

In the long run, companies can avoid tough proxy access issues by taking certain preventative measures.⁵² For example, a company can remain aware of its shareholders’ needs by “maintaining a dialogue with key shareholders and monitoring market trends.”⁵³ Alternatively, a company may decide to propose a proxy access provision that is generally acceptable to its shareholders, thereby keeping shareholders content.⁵⁴ At the very least, companies should plan ahead, and consider a more shareholder-friendly proxy access provision “to propose to shareholders in the event the company receives a [shareholder] proxy access proposal.”⁵⁵

F. Conclusion

The SEC’s decision regarding Rule 14a-8(i)(9) came amid a growing struggle between companies and shareholders for proxy access.⁵⁶ Most companies still adamantly oppose shareholder proxy access proposals, but shareholders are firing back and submitting proxy access proposals in increasing numbers.⁵⁷ Given the variety of options for both shareholders and companies, it remains unclear what impact the Whole Foods proxy saga will have on the upcoming proxy season and proxy seasons many years in the future.

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⁵⁰ *Id.*

⁵¹ Brady et al., *supra* note 20.

⁵² Murphy et al., *supra* note 7.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *See supra* text accompanying notes 7-24.

⁵⁷ *See supra* text accompanying notes 7-12.

⁵⁸ Student, Boston University School of Law (J.D. 2016).