

# Client Alert

February 2014

## Federal Court Allows Exclusion of Rule 14a-8 Shareholder Proposal from Proxy Materials Due to False Statements

A federal district court in Missouri recently granted [summary judgment](#) to Express Scripts Holding Company (“Express Scripts”), allowing the company to exclude a shareholder proposal submitted under Rule 14a-8 of the Securities and Exchange Act of 1934 (the “Exchange Act”). The court ruled that the proposal could be excluded because it contained false or misleading statements in violation of Rule 14a-9. This ruling is noteworthy because we believe companies will increasingly consider litigating to exclude shareholder proposals rather than seeking no-action relief from the staff of the Securities and Exchange Commission (the “SEC”).

### Background and Court’s Decision

The challenged proposal was submitted by John Chevedden, a well-known shareholder activist. According to Proxy Monitor, Chevedden and certain other shareholders with whom he frequently coordinates submitted 434 proposals between 2006 and 2012 at Fortune 200 companies. The proposal submitted at Express Scripts requested that the company adopt a policy requiring the chairman of the board of directors to be independent of company management.<sup>1</sup> Rather than seek a no-action letter from the SEC, Express Scripts brought suit seeking a declaratory judgment that it could exclude the proposal from its proxy materials under Rule 14a-8.

According to the company, the proposal contained four false or misleading statements regarding executive compensation, corporate governance policies, and prior board of director election results. Specifically, Express Scripts identified these statements that it said were inaccurate for the following reasons:

<i>Statements in the Shareholder Proposal</i>	<i>Express Scripts’ Rebuttal<sup>2</sup></i>
<ul style="list-style-type: none"> <li>Express Scripts’ chief executive officer was paid \$51 million in executive compensation.</li> </ul>	<ul style="list-style-type: none"> <li>Express Scripts’ chief executive officer’s total executive compensation in 2012 was \$12,754,690.</li> </ul>
<ul style="list-style-type: none"> <li>Express Scripts had not adopted a clawback policy to recoup unearned executive pay based on fraud or error.</li> </ul>	<ul style="list-style-type: none"> <li>Express Scripts adopted a clawback policy in 2011, which became effective in the 2012 fiscal year.</li> </ul>

<sup>1</sup> According to Georgeson’s 2013 Annual Corporate Governance Review, 53 proposals to separate the role of chairman and chief executive officer were considered last year. The average support received for these proposals was 35% of the votes cast and 24% of the votes outstanding.

<sup>2</sup> In each case, Express Scripts cited to disclosures in its 2013 proxy statement to rebut the statements contained in the shareholder proposal with the exception of the director election votes, for which Express Scripts cited to a Form 8-K disclosing the final voting results from the 2013 annual stockholder meeting.

<ul style="list-style-type: none"> <li>• Samuel Skinner, a director of Express Scripts, had received the highest number of negative votes at the 2013 annual stockholder meeting.</li> </ul>	<ul style="list-style-type: none"> <li>• Three other directors received more negative votes at the 2013 annual stockholder meeting than Mr. Skinner.</li> </ul>
<ul style="list-style-type: none"> <li>• Express Scripts has plurality voting.</li> </ul>	<ul style="list-style-type: none"> <li>• Express Scripts has adopted a majority voting standard.</li> </ul>

Express Scripts timely responded to Chevedden, specifically identifying the alleged inaccuracies in the proposal and notifying him of the correct information contained in the company’s publicly filed documents. Chevedden did not propose revisions to his proposal until after Express Scripts filed its complaint in the district court.

Rule 14a-8(i)(3) allows a company to exclude a shareholder proposal if it is contrary to any of the SEC’s proxy rules. Rule 14a-9 of the Exchange Act prohibits a company from including any statement in its proxy materials that is materially false or misleading. This includes a statement in the “supporting statement” portion of the proposal.<sup>3</sup> Although Chevedden argued that his supporting statement merely had some “technical errors,” the district court held that Express Scripts could exclude the proposal, finding that the challenged statements were false based on Express Scripts’ public filings and material. It explained that:

[W]hen viewed in the context of soliciting votes in favor of a proposed corporate governance measure, statements in the proxy materials regarding the company’s existing corporate governance practices are important to the stockholder’s decision whether to vote in favor of the proposed measure. As such, the Court finds these misstatements are material and, therefore, not in compliance with SEC rules and regulations.

The court also refused to permit Chevedden to revise his proposal, noting that the deadline had expired and that his proposed revisions were still inaccurate.

### Implications

Most companies have tried to exclude shareholder proposals by seeking no-action letters from the SEC. When the issue is whether the proposal may be excluded because it violates Rule 14a-9, the SEC has required issuers to demonstrate objectively that the statements are materially false or misleading.<sup>4</sup> A review of the SEC’s responses to no-action requests on this point indicates that the SEC staff often decides in favor of shareholders.<sup>5</sup> The staff has indicated that companies should instead respond to the alleged false or misleading statements in their “opposition statements” in the definitive proxy materials.<sup>6</sup> The SEC staff has also noted that issuers are not responsible for the accuracy of shareholder proposals included under Rule 14a-8.<sup>7</sup> In addition, the SEC staff has specifically cited its concern about the amount of time it has had to spend reviewing companies’ objections that claim shareholder proposals violate the

<sup>3</sup> Per Rule 14a-8(i)(3), a shareholder proposal can be excluded if “the proposal or supporting statement is contrary to any of the Commission’s proxy rules, including § 240.14a-9, which prohibits materially false or misleading statements in proxy soliciting materials.”

<sup>4</sup> See SEC Staff Legal Bulletin No. 14B (Sept. 15, 2004).

<sup>5</sup> For recent examples, see the following SEC responses to requests for no-action letters: *The Walt Disney Company* (Dec. 6, 2013) and *Starbucks Corporation* (Dec. 23, 2013).

<sup>6</sup> See SEC Staff Legal Bulletin No. 14B (Sept. 15, 2004).

<sup>7</sup> See Rule 14a-8(l)(2).

SEC proxy rules.<sup>8</sup> Presumably, the SEC staff is trying to avoid “refereeing” a high volume of contextual disputes, even if that means a deferential approach in dealing with false and misleading statements.

The difficulty in excluding shareholder proposals on this basis has been frustrating to many companies. Regardless of whether the company has liability for any statements included in the proposal, the statements may influence shareholders on how they vote on the shareholder proposal and potentially other proposals being considered. Moreover, shareholders should be held accountable for the content of their proposals. Without adequate oversight, shareholders are subject to little constraints and arguably can engage in “free-writing.” A related source of frustration is that Chevedden and other shareholder activists are increasingly attributing the content of their proposals to non-public sources that companies cannot review for accuracy, and which attributions may be false or taken out of context.

In the past, seeking a judicial declaration to exclude a shareholder proposal has not been common.<sup>9</sup> It is usually more expensive than seeking a no-action letter, although this depends on the extent to which the shareholder defends the litigation. Whether a quick resolution can be achieved can also be dependent on numerous factors, including the court’s docket. Some issuers may also be concerned that litigation appears “heavy-handed,” although a favorable result should justify the company’s actions.

The district court’s grant of summary judgment in *Express Scripts* should encourage more companies to seek judicial relief rather than request a no-action letter from the SEC staff. It also bears noting that the *Express Scripts* ruling was obtained promptly – the proposal was received on November 11, 2013, the complaint was filed on December 18, 2013, and the court’s ruling was issued on February 18, 2014. In addition, federal courts may be more likely to construe Rule 14a-9 strictly. It appears that the Rule 14a-8 process is being increasingly abused by shareholder activists, particularly with respect to statements that are false, misleading, and/or unsubstantiated. Thus, it would be a welcome development for federal courts to hold shareholders more accountable over the content of their proposals.

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<sup>8</sup> See SEC Staff Legal Bulletin No. 14B (Sept. 15, 2004).

<sup>9</sup> For examples, see *Apache Corp. v. Chevedden*, 696 F. Supp. 2d 723 (S.D. Tex. 2010); *KBR Inc. v. Chevedden*, 2011 WL 1463611 (S.D. Tex. April 4, 2011), *aff’d sub nom* 478 Fed. Appx. 213 (5<sup>th</sup> Cir. 2012); *Waste Connections Inc. v. Chevedden*, No. 4:13-cv-00176 (S.D. Tex. June 3, 2013).