The Harvard Law School Forum on Corporate Governance and Financial Regulation
SUPPORTED BY: CSC CORPORATION SERVICE COMPANY

Appeal of No-Action on Proxy Access at Whole Foods Markets

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Shareholders have been engaged in a long struggle to obtain proxy access—the idea that shareowners should be allowed to place their own board nominations on the proxies distributed by management, much as we are allowed to place our own proposals on those proxies. Shareholders should not accept the most recent roadblock, a reactive substitute proposal, by the management of Whole Foods Market (Whole Foods) and acquiescence in the form of a no-action letter from the Securities and Exchange Commission (SEC).

The idea of proxy access certainly is not new. In 1980 Unicare Services included a proposal to allow any three shareowners to nominate and place candidates on the proxy. Shareowners at Mobil proposed a "reasonable number," while those at Union Oil proposed a threshold of "500 or more shareholders" to place nominees on corporate proxies. The California Public Employees' Retirement System (CalPERS) submitted a proposal in 1988 but withdrew it when Texaco agreed to include their nominee.

These early attempts to win proxy access through shareowner resolutions met with the same fate as all other resolutions. They brought attention to issues but failed to obtain majority votes. However, a 1987 proposal by Lewis Gilbert to allow shareowners to ratify the choice of auditors won a majority vote at Chock Full of O'Nuts Corporation. In 1988 Richard Foley's proposal to redeem a poison pill won a majority vote at the Santa Fe Southern Pacific Corporation.

In 1990, without public discussion or a rule change, the SEC began issuing a series of no-action letters on access proposals. Their about-face may have been prompted by fear that "private ordering," through shareowner proposals, was about to begin in earnest.

Tensions over this giant leap backward festered for years, with various attempts to address the issue. In 2002, along with Les Greenberg, I filed a rulemaking petition with the SEC for clear

proxy access authority, which the $3 trillion Council of Institutional Investors credited with “re-energizing the debate.”

Two years later, the American Federation of State, County & Municipal Employees (AFSCME) submitted a bylaw proposal to the American International Group (AIG) requiring that specified nominees be included in the proxy. AIG excluded the proposal after receiving a no-action letter from the SEC and AFSCME filed suit.

In *AFSCME v AIG* (2006) the court ruled the prohibition on shareowner elections contained in Rule 14a-8 applied only to proposals “used to oppose solicitations dealing with an identified board seat in an upcoming election” (also known as contested elections).

The SEC subsequently adopted a rule banning proposals aimed at prospective elections but in 2010 adopted both a widely discussed federal mandate in Rule 14a-11 and less discussed amendments to Rule 14a-8(i)(8) to allow access through private ordering. In 2011 the DC Circuit Court invalidated the mandate, Rule 14a-11 (*Business Roundtable v. SEC)* on the basis that the SEC had failed to conduct an adequate cost-benefit analysis. That leaves us with private ordering, fighting for the right one company at a time.

For the last few years, shareholders have been introducing a small number of proxy access proposals with various thresholds and conditions. I initially favored a very complicated proposal with thresholds ranging from one to two percent, which would have encouraged a role for retail shareholders (Proxy Access: Upcoming Votes at FRX, MDT and HRB). Others, such as Norges Bank put forward proposals with even lower thresholds. (Mid-Season Update on the 2012 Proxy Season).

However, most proposals adopted the three percent held for three years thresholds specified in the overturned Rule 14a-11, as well as other conditions from that rule. While Rule 14a-11-type proposals fared well, others did not. This season, I prepared to file about a dozen proxy access proposals following more closely to the Rule 14a-11.

The CFA Institute issued a report in August 2014 examining the cost-benefit of Rule 14a-11 and found “the results of event studies suggest that proxy access has the potential to enhance board performance and raise overall US market capitalization by between $3.5 billion and $140.3 billion.” (Proxy Access in the US)

More recently, the Comptroller of the City of New York, who oversees pension funds with a combined $160 billion in assets, submitted proxy access shareholder proposals following the Rule 14a-11 model at 75 U.S. public companies as part of its Boardroom Accountability Project.

(The Next Wave of Proxy Access Proposals) I have been contacted by several funds filing additional proposals. The upcoming proxy season promised to be a turning point, with proxy access eventually becoming as ubiquitous as majority vote requirements for directors.

In September, I filed a proposal at Whole Foods. Less than two weeks later, Whole Foods responded, objecting to my appointment of John Chevedden to act as my agent. This is an old canard but companies, frequently through their own agents, outside counsel, argue that shareholders are not allowed to use agents, at least not John Chevedden. Their letter made no mention of any plans by Whole Foods to submit their own proxy access proposal and failed to provide required notifications to me, such as that I must submit sufficient proof that I continuously held at least $2,000 in market value of the company's securities for at least a year.

The next time I heard from Whole Foods was when they filed a request for a no-action letter "because the Proponent's Proposal directly conflicts with a proposal to be submitted by the Company in the 2015 Proxy Materials," arguing staff could rely on Rule 14a-8(i)(9). In a rebuttal, I pointed out that the rule was not intended to allow companies to simply avoid shareholder proposals by substituting their own proposal on the same subject. I contended that including both proposals would not lead to inconsistent and ambiguous results, designed to be avoided by conflicting proposals under Rule 14a-8(i)(9). The SEC issued a no-action letter and I subsequently appealed to the full Commission.

The SEC's no-action letter in this instance is no less a change in interpreting the rules than the language the SEC relied upon in 1990 when they earlier reversed course on proxy access without providing public notice for a new regulation. That reversal was found to be illegal by the court in *AFSCME v AIG*. The full Commission now has an opportunity to avoid a similar mistake by reversing the no-action letter granted to Whole Foods.

When the SEC added subsection (i)(9) in 1998 the Commission noted that the provision was consistent with the "long-standing interpretation" that permitted "omission of a shareholder proposal if the company demonstrates that its subject matter directly conflicts with all or part of one of management's proposals."

The Proposing Release for subsection (i)(9) cited two no-action letters. In both cases passage of both the shareholder and management proposals would have led to a situation where neither could be implemented because of confusion or uncertainty in actual implementation or where, as a result of incompatibility, implementation of both proposals was impossible. Staff also made it clear that subsection (i)(9) could not be used if a company developed its proposal "in response to" a proposal submitted by shareholders.

In the case of Whole Foods, there would be no ambiguity because their only expressed objection is to the numerical thresholds. To the extent both management's bylaw and my proposal are adopted there will be no actual conflict. The board will simply have additional information that could lead to modification of their bylaw. Shareholders have many occasions to vote on issues involving competing thresholds, such as whether the advisory vote on executive pay should be taken every year, two years or three years. We do so without apparent confusion or uncertainty.

Additionally, the circumstances surrounding the bylaw proposed by Whole Foods suggests it was "in response to" my proposal. When they contacted me, they mentioned I might "cure" my proposal and made no mention of submitting a proposal of their own. They have never shared any specific bylaw language and their no-action request makes no mention of any disagreement with the specifics of my proposal, such as listing board and shareholder nominees together in alphabetical order. I include additional evidence their proposal was "in response to" mine in the full text of my appeal to the full Commission reproduced below.

Download the full appeal as a PDF (**McRitchieAppealNo-action12-23-2014**). Whole Foods recently filed a **preliminary proxy statement** with a **proxy access proposal of 5%/5-years**—not the 9%/5-years that the company had included in its no-action request, in addition to many other substantial differences not mentioned in their correspondence with me or the SEC.

Below is the full text of the appeal.

Appeal of No-Action Letter Whole Foods Market, Inc., December 1, 2014

I am hereby requesting an appeal to the full Commission of the staff's decision to grant Whole Foods Market, Inc. (Whole Foods) a no action letter permitting the omission of a shareholder access proposal that I submitted on the basis of the exemption in subsection (i)(9) of Rule 14a-8. Alternatively, I request that the staff reverse its position and withdraw the no action letter granted to Whole Foods. The issues in this case are novel or highly unique and are therefore appropriate for review by the Commission. *See* 17 CFR 202.1(d).

The staff's position effectively denies shareholders the right to vote on competing proposals involving similar or related topics solely because the proposals contain different terms or thresholds. The interpretation effectively limits shareholders to consideration of proposals sponsored by the board of directors and eliminates any opportunity for shareholders to present alternative criteria. The interpretation is an unnecessary limitation on the shareholder franchise, effectively depriving shareholders of rights that exist under state law, and is inconsistent with the Commission's intent in adopting subsection (i)(9).

I. Analysis

A. The Requirements of Rule 14a-8(i)(9)

Rule 14a-8(i)(9) allows for the exclusion of proposals that "conflict with one of the company's own proposals. . . " 17 CFR 240.14a-8(i)(9). The provision was never intended to bar shareholders from considering alternative proposals on a similar topic, even when the competing proposals contained different terms.

The current iteration of subsection (i)(9) was added in 1998. *See* Exchange Act Release No. 40018 (May 21, 1998) (adopting release). In proposing the language, the Commission noted that the provision was consistent with the "long-standing interpretation" that permitted "omission of a shareholder proposal if the company demonstrates that its subject matter directly conflicts with all or part of one of management's proposals." Exchange Act Release No. 40018 (May 21, 1998) (adopting release). In providing examples of the "long-standing interpretation" the Proposing Release cited two no action letters: *General Electric Corporation* (Jan. 28, 1997) and *Northern States Power Co* . (July 25, 1995).

In *General Electric*, the "conflict" arose out of two proposals that affected stock option plans. The shareholder proposal called for the mandatory indexing of the exercise price. In contrast, the Company proposal assigned to the board the discretion to determine the exercise price so long as the exercise price was not less than the market price. If adopted, therefore, the company

would be confronted with pricing formulas that were inconsistent. As a result, the staff agreed that the proposal could be excluded.

In *Northern States Power Co.* (July 25, 1995), the company intended to submit a merger agreement to shareholders. The shareholder proposal at issue would have mandated that management negotiate a more equitable merger agreement, specifically the payment of alternative consideration. To the extent that both passed, neither could be implemented. *See Id.* ("An affirmative shareholder vote on both the Board's proposal and the Proponents' proposal would present the Board with an inconsistent mandate. The Board could not both enter into the merger agreement and negotiate a different agreement."). As a result, the staff permitted the exclusion of the proposal.

These letters illustrate that, at the time of the adoption of the current version of subsection (i)(9) by the full Commission, proposals could be excluded only in very narrow circumstances and only where adoption of competing proposals could be harmful to shareholders. As *General Electric* and *Northern States* demonstrated, proposals could be excluded where adoption resulted in confusion or uncertainty in actual implementation or where, as a result of incompatibility, implementation of both proposals was impossible.[1]

The staff also made clear that subsection (i)(9) could not be used as a tactical weapon in order to exclude shareholder proposals. To the extent company proposals were developed "in response to" a proposal submitted by shareholders, the subsection was unavailable.[2] Finally, the staff only allowed for the exclusion of proposals that raised actual and immediate concerns. The proposals at issue in *General Electric* and *Northern States* were both mandatory and not precatory and, as a result, they raised clear and unavoidable issues with respect to implementation.

B. The Whole Foods Analysis

Whole Foods contends that the adoption of management's bylaw and the shareholder proposal would result in "inconsistent and ambiguous" results. In making this assertion, the Company has pointed to three differences in the two proposals: "(i) the number of shareholders able to nominate a candidate, (ii) the required share ownership percentage and holding period and (iii)

[1] This is consistent with other no action letters during the relevant period. *See Chevron Corporation* (Feb. 27, 1991) ("if both the Chevron Proposal and the Subscription Proposal were approved by Stockholders at the 1991 Annual Meeting, it would be impossible for Chevron to implement both proposals.").

[2] *See Cypress Semiconductor Corporation* (March 11, 1998) ("The Division is unable to concur in your view that the proposal may be excluded under rule 14a-8(c)(9). Among other factors that the staff considered in reaching this result, the staff notes that it appears that the Company prepared its proposal on the same subject matter significant part in response to the Mercy Health Services proposal."); *see also Genzyme Corporation* (March 20, 2007) ("We are unable to concur in your view that Genzyme may exclude the proposal under rule 14a-8(i)(9). Among other factors that we considered in reaching this result, we note your representation that you decided to submit the company proposal on the same subject matter to shareholders, in part, in response to your receipt of the AFL-CIO Reserve Fund proposal.").

the number of directors that can be nominated." These differences in the two proposals do not raise the types of concerns that subsection (i)(9) was intended to address.

i. Ambiguity

The two proposals are, apparently, identical except for numerical thresholds "set at different levels."[3] These thresholds are clear and unambiguous. As a result, the shareholder proposal does not generate confusion or concern over ambiguity.

Indeed, any confusion arises directly from the decision to omit the proposal. Rather than providing shareholders with meaningful and unambiguous alternatives, the staff decision puts shareholders in the confusing situation of having to decide whether to oppose or favor a bylaw that provides for access but makes its use "unlikely." To the extent that shareholders had more than one proposal with different thresholds, they could avoid the potential for a Hobson's choice and vote for the proposal that was the most consistent with their actual position on access.

Indeed, shareholders have on other occasions confronted multiple proposals on identical topics that differed only on numerical thresholds with little confusion. The proxy rules require companies to ask shareholders about the frequency of the advisory vote on executive compensation. *See* Rule 14a-21(b), 17 CFR 240.14a-21(b). Shareholders must decide whether the vote should be every year, two years or three years. In adopting the requirement, investor confusion was not raised as a concern over the requirement. *See* Exchange Act Release No. 63768 (Jan. 25, 2011).

ii. Inconsistency

There is no conflict between the two proposals. Unlike *Northern States* and *General Electric*, the proposal at issue in this case is precatory, merely "ask[ing]" the board to adopt an access proposal with 3%/3 year periods.[4] Thus, to the extent both the management bylaw and shareholder proposal are adopted, there will be no actual conflict.[5]

Indeed, a vote on the shareholder proposal submitted in this case benefits the board. The results will provide directors with additional information about the views of shareholders. Because bylaws

[3] Letter from A.J. Ericksen, Baker Botts, Oct. 23, 2014, *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/jamesmcritchie120114.pdf.

[4] As Whole Foods has acknowledged, the proposal is "a non-binding shareholder resolution." *See also The Next Wave of Proxy Access Proposals: What Issuers Should Know and How They Can Prepare, WSGR Alert, Nov. 13, 2014* ("Approval of such a [precatory] proposal by shareholders *does not* implement proxy access at a company. If the Comptroller's proposal passes, a company's board is entitled, in the exercise of its business judgment, to decline to adopt a proxy access bylaw.").

[5] Moreover, had both proposals been mandatory, their adoption would not have presented the type of conflict that subsection (i)(9) was attended to address. The higher thresholds set out in the management bylaw did not preclude or prohibit a proposal with lower thresholds. As a result, adoption of the two sets of requirements would not have prevented their implementation.

can be amended unilaterally by directors, including bylaws adopted by shareholders, the level of support for the bylaw submitted in this case will provide directors with information on shareholder views that may lead to modifications of the bylaw.

Nor is the authority cited by Whole Foods to the contrary. The Company acknowledged that there was no authority directly on point.[6] Instead, the Company relied on nine "analogous" no action letters involving proposals relating to special meetings. Although the shareholders proposals were precatory, the letters did not address the impact of precatory proposals on any purported conflict that could arise with management proposals. As a result, the staff did not have the issue before it when considering the requested no action letters.[7]

iii. Prepared "In Response To" the Shareholder Proposal

Exclusion also cannot occur where the bylaw has been adopted "in response to" a shareholder proposal. The circumstances surrounding the bylaw proposed by Whole Foods suggests that it was adopted "in response to" the proposal submitted in this case.

First, the timing suggests that the bylaw was a reaction to the shareholder proposal. Whole Foods made no mention of an access bylaw until after receiving the shareholder proposal at issue in this case. For example, see attached letter from Whole Foods objecting to my appointment of John Chevedden to act as my agent, indicating the "Company does not currently plan to include the Proposal in its proxy statement for the 2015 Annual Meeting," and specifying action I might take to cure that objection but making no mention of their intent to submit an access bylaw.[8]

Second, the terms indicate that the bylaw was a reaction to the shareholder proposal at issue in this case. The Company did not provide any text of its proposed bylaw. Nonetheless, in pointing to differences in the two proposals, the Company made no objection to most of the language contained in the shareholder proposal aside from the numerical thresholds. This suggests that the

[6] Letter from A.J. Ericksen, Baker Botts, Oct. 23, 2014, *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2014/jamesmcritchie120114.pdf ("We are unaware of instances where a company has sought no-action relief under Rule 14a-8(i)(9) with respect a shareholder-sponsored proxy access proposal that conflicts with a company-sponsored proxy access proposal.").

[7] There are other reasons why a number of the letters cited by Whole Foods are inapplicable. Many of the cases involved proposals by management to amend the articles of incorporation or other "foundational documents." Amendments require approval by both the board and shareholders. As a result, the board could not unilaterally alter an amendment to the articles that was adopted by shareholders to reflect the substance of a precatory proposal passed at the same time. In this case, however, the board has proposed an access bylaw, not an amendment to the articles. As a result, the board has the authority to amend the bylaw to reflect the substance of the precatory proposal. *See supra* note 4.

[8] Letter from Albert Percival, Senior Securities, Finance and Governance Counsel, Whole Foods, Sept. 22, 2014, attached.

Company worked off the shareholder version and was, therefore, responding to the shareholder proposal.[9]

Third, the bylaw proposed by the Company apparently makes exercise of the right to access "unlikely."[10] The bylaw, therefore, can be seen as a response to, and an effort to negate, a proposal designed to provide shareholders with a meaningful right of access.

Finally, the board could have adopted the access bylaw without submission to shareholders. Unlike an amendment to the articles of incorporation, shareholder approval is not a precondition for the adoption of a bylaw. While the decision to submit the matter was not necessary under state law, it did provide for a basis for exclusion of the proposal. This suggests that the bylaw and the terms of approval were determined as a "response to" the proposal at issue in this case.

iv. Interference with the Shareholder Franchise

The interpretation of subsection (i)(9) by the staff directly interferes with the shareholder franchise and effectively denies shareholders rights that exist under state law. Under state law, shareholders have the right to propose bylaws.[11] Moreover, in at least some jurisdictions, they have the express right to propose bylaws that provide for shareholder access.[12] Without the ability to include a proposal in the proxy statement, shareholders are effectively denied the right to adopt bylaws.[13]

The staff's approach also interferes with private ordering with respect to shareholder access.[14] Shareholders are limited to the version proposed by management and cannot propose and vote on competing proposals with different numerical thresholds. This is true even where the management bylaw actually makes the exercise of the rights at issue "unlikely." Moreover, to the extent that shareholders express opposition to a management bylaw and the bylaw does not pass, management can presumably resubmit the proposal the following year and again use

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[9] Thus for example the Company did not object to the portions of the shareholder proposal that included the requirement that directors be listed alphabetically, that board members or officers be excluded from any group submitting proposals, that shareholders have the right to provide a 500 word statement, and that proxy statements include instructions for submitting nominations.

[10] Pamelay Park, *SEC grants Whole Foods no-action relief for proxy access proposal*, Westlaw Corporate Governance Daily Briefing, 2014 WL 6779097 ("The ownership thresholds in Whole Foods' proposal are so high that it is unlikely any shareholder will meet the standards required to include director nominees in the company's proxy materials.").

[11] *See* Texas Bus. Organ. Code Sec. 21.058.

[12] *See* DGCL 112.

[13] The Honorable Henry duPont Ridgely, Justice, Supreme Court of Delaware, *The Emerging Role of Bylaws in Corporate Governance*, at 7 ("For public companies, a shareholder vote to approve a bylaw requires proxy access."), *available at* http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance-copy.pdf.

[14] *See* Troy A. Paredes, *Statement at Open Meeting to Propose Amendments Regarding Facilitating Shareholder Director Nominations*, SEC, Washington DC, May 20, 2009, *available at* http://www.sec.gov/news/speech/2009/spch052009tap.htm.

subsection (i)(9) to block any meaningful role of shareholders in determining the applicable standards.

II. Conclusion

Whole Foods has not carried the burden of demonstrating how the shareholder proposal at issue in this case will result in actual confusion in implementation or result in an incompatibility that makes implementation of either proposal impossible. As a result, the Company has not established the availability of subsection (i)(9).

Attachment

cc: Hon. Mary Jo White, Chair

Hon. Luis A. Aguilar, Commissioner

Hon. Daniel M. Gallagher, Commissioner

Hon. Kara M. Stein, Commissioner

Hon. Michael S. Piwowar, Commissioner

Mr. Keith F. Higgins, Director, Division of Corporation Finance

Mr. A.J. Eriksen, Baker Botts, L.L.P.

Mr. John Chevedden