SIMPSON THACHER MEMORANDUM

Three Federal Courts Dismiss Lawsuits Against Chevedden, Citing Lack of Subject Matter Jurisdiction

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This proxy season, rather than following the traditional route of seeking no-action relief from the Securities and Exchange Commission ("SEC") (or, in one instance, after receiving a no-action denial), at least four companies have filed lawsuits against activist investor John Chevedden, in each case requesting declaratory judgment that the company may properly exclude Chevedden's proposed shareholder resolution from the proxy materials for its 2014 annual meeting.[1] While companies have enjoyed judicial victories against Chevedden in the recent past (including during the current proxy season), this month, for the first time, three federal courts dismissed actions against Chevedden, citing lack of subject matter jurisdiction.

I. CASES GRANTING DECLARATORY RELIEF TO COMPANIES SEEKING TO EXCLUDE CHEVEDDEN PROPOSALS

In recent years, a number of companies have succeeded in obtaining declaratory judgment permitting them to exclude Chevedden's proposals from their proxy materials. For example, in *Apache Corp.* v. *Chevedden*, decided in 2010, the United States District Court for the Southern District of Texas granted the company's motion for declaratory judgment, finding that Chevedden failed to meet the stock ownership requirements of Rule 14a-8(b) under the Securities Exchange Act of 1934.[2] A year later, the same court similarly held, in an opinion subsequently affirmed by the Fifth Circuit, that KBR Inc. was entitled to exclude Chevedden's proposal from its proxy materials, also because Chevedden did not properly prove his stock ownership eligibility under Rule 14a-8(b).[3] In 2013, in *Waste Connections, Inc.* v. *Chevedden*, the Southern District of Texas again granted declaratory relief to the requesting company, albeit without issuing a written opinion explaining its decision, and the Fifth Circuit again affirmed the district court's holding.[4] Finally, last month, the United States District Court for the Eastern

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1 *See* Complaint, *Express Scripts Holding Co.* v. *Chevedden*, 4:13-cv-2520 (E.D. Mo. 2013); Complaint, *Chipotle Mexican Grill, Inc.* v. *Chevedden, et al.*, 1:14-cv-00018 (D. Colo. 2014); Complaint, *Omnicom Group Inc.* v. *Chevedden*, 14 Civ. 0386 (S.D.N.Y. 2014); Complaint, *EMC Corp.* v. *Chevedden, et al.*, 1:14-cv-10233-MLW (D. Mass. 2014).

2 *See Apache* v. *Chevedden*, 696 F. Supp. 2d 723 (S.D. Tex. 2010).

3 *See KBR Inc.* v. *Chevedden*, 2011 WL 1463611 (S.D. Tex. Apr. 4, 2011), *aff'd* 478 Fed. Appx. 213 (5th Cir. June 11, 2012).

4 *See Waste Connections Inc.* v. *Chevedden*, 2014 WL 554566 (5th Cir. Feb. 13, 2014).

District of Missouri followed suit, finding that the proposal Chevedden submitted to Express Scripts Holding Co. contained material misstatements, thereby allowing the company to exclude the proposal under Rules 14a-8 and 14a-9.[5]

In a couple of these cases, the court specifically addressed Chevedden's argument that the court lacked subject matter jurisdiction over the dispute since the company bringing the action against him failed to show "a case of actual controversy," as required by the Declaratory Judgment Act.[6] In *KBR*, for example, Chevedden filed a motion to dismiss the complaint, arguing, among other things, that KBR had not "met its burden of demonstrating: (1) an injury in fact that is (a) concrete and particularized and (b) actual or imminent; (2) a causal connection between the injury and the conduct complained of; and (3) the likelihood that a favorable decision will redress the injury."[7] In particular, Chevedden claimed that "the dispute lacks sufficient immediacy and reality to be a justiciable dispute under the Declaratory Judgment Act."[8] Furthermore, Chevedden posited that "there is no injury in fact because he has not filed a suit challenging KBR's exclusion of his proposal" and he promised that he would not file a suit in the future.[9] According to Chevedden, "'if the only relief sought by a plaintiff seeking a declaratory judgment is to remove its apprehension of an imminent lawsuit by the defendant, an unconditional covenant not to sue is sufficient to divest the court of jurisdiction.'"[10]

In a series of opinions, the Southern District of Texas rejected these arguments. The court found that:

1. The case presents an "actual controversy" of "sufficient immediacy" because KBR needed to finalize its proxy statement by the following month and was entitled to be relieved of the "uncertainty" regarding whether it could exclude Chevedden's proposal;[11] and

2. "Chevedden's assertion that he has no present intention to sue if KBR excludes his proposal" does not resolve or nullify the actual controversy, particularly

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5 *See Express Scripts Holding Co.* v. *Chevedden*, 2014 WL 631538 (E.D. Mo. Feb. 18, 2014).

6 The Declaratory Judgment Act states, in relevant part: "In a case of actual controversy within its jurisdiction . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought." 28 U.S.C. § 2201(a).

7 *KBR Inc.* v. *Chevedden*, 776 F. Supp. 2d 415, 426 (S.D. Tex. 2011) (quotations and citations omitted).

8 *KBR Inc.* v. *Chevedden*, 2013 WL 3713420, at *1 (S.D. Tex. July 12, 2013) (quotations and citations omitted).

9 *KBR*, 776 F. Supp. 2d at 426; *see also KBR*, 2011 WL 1463611, at *1; *KBR*, 478 Fed. Appx. at 215.

10 *KBR Inc.* v. *Chevedden*, 2011 WL 6033039, at *2 (S.D. Tex. Dec. 5, 2011) (quoting Chevedden) (internal quotations omitted).

11 *KBR*, 776 F. Supp. 2d at 426-27; *see also KBR*, 2011 WL 1463611, at *2.

since he had demonstrated "a willingness to enforce his rights" by refusing to withdraw his proposal.[12]

The Fifth Circuit, in an unpublished opinion, affirmed the district court's decision, though it articulated the rationales for its finding of subject matter jurisdiction somewhat differently. The Fifth Circuit reasoned that:

1. KBR faced "a choice between spending a significant sum to revise its proxy statement, or excluding Chevedden's proposal and exposing itself to potential litigation," and that such a choice created a justiciable dispute between the parties;[13] and

2. Regardless of the fact that Chevedden asserted that he would not sue the company, (a) KBR's decision would implicate the company's duties to all its shareholders, and (b) wrongfully excluding the proposal could expose KBR to an SEC enforcement action.[14]

Last month, in another unpublished decision, the Fifth Circuit in *Waste Connections* relied on its reasoning in *KBR* and affirmed a denial of Chevedden's motion to dismiss for lack of subject matter jurisdiction, finding "no reason to diverge from [its] prior holding."[15]

II. THREE RECENT DISMISSALS OF COMPLAINTS AGAINST CHEVEDDEN

In three lawsuits brought against Chevedden this proxy season, the presiding court granted Chevedden's motion to dismiss for lack of subject matter jurisdiction. In *EMC Corp.* v. *Chevedden*, where the company sought judicial permission to exclude from its proxy materials a proposal submitted by Chevedden and James McRitchie, the United States District Court for the District of Massachusetts held that "the plaintiff has not borne its burden of demonstrating the

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12 *KBR*, 776 F. Supp. 2d at 427; *KBR*, 2011 WL 1463611, at *2. *See also KBR*, 2011 WL 6033039, at *2 ("Chevedden's statement that he would not sue KBR did not fully resolve the controversy between the parties.").

13 *KBR*, 478 Fed. Appx. at 215.

14 *Id*.

15 *Waste Connections*, 2014 WL 554566, at *2. In *Express Scripts Holding Co.*, although the United States District Court for the Eastern District of Missouri did not engage in a discussion of subject matter jurisdiction, it did note that "[t]he SEC has explicitly stated that '[o]nly a court such as a U.S. District Court can decide whether a company is obligated to include shareholder proposals in its proxy materials,'" ostensibly signaling its belief that the case before it was appropriate for its consideration. 2014 WL 631538, at *3 (quoting SEC Division of Corporation Finance, "Informal Procedures Regarding Shareholder Proposals") (second brackets in original).

existence of a 'case or controversy,' as required by Article III, to permit a judicial decision on a question such as the question presented here."[16] The court found that:

1. "EMC has not carried its burden of demonstrating that, if it decided to exclude the defendants' proposal from its proxy materials, it would face an imminent injury in fact attributable to defendants," since the defendants made an "irrevocable promise" both that they would not sue EMC if their proposal were excluded and that they would not raise the proposal at EMC's annual meeting;[17]

2. EMC did not present evidence supporting its contention that there is "still a substantial risk that the SEC or other shareholders would bring an action if the proposal is excluded" (especially in light of the defendants' claim that the SEC has brought only one enforcement action under Rule 14a-8 in the 72-year history of the rule), and thus the court cannot conclude that EMC has established "imminent injury in fact;"[18] and

3. Even if EMC proved that there was a genuine risk of an SEC enforcement action or a lawsuit by other shareholders, declaratory judgment would not redress any such purported imminent injury, because those parties, who were not parties to the present suit, would not be bound by the court's decision.[19]

Several days later, the United States District Court for the Southern District of New York dismissed the lawsuit that Omnicom Group, Inc. brought against Chevedden, similarly citing the court's lack of subject matter jurisdiction. The court in *Omnicom* noted that Chevedden promised the company not to sue if the company excluded his proposal from its proxy materials. The company had argued that "its injury is imminent because, even though Mr. Chevedden has promised not to sue, 'the proposal remains pending, still requiring Omnicom to decide whether or not it is required to include the proposal in its proxy statement (and face all the legal consequences of that decision).'"[20] The court rejected this position, holding that any potential future "legal consequences" are not "actual or imminent": Omnicom would not face a lawsuit from Chevedden if it excluded his proposal, and "the possibility of SEC investigation or action is remote."[21]

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16 Transcript of Hearing on Motions at 40, *EMC Corp.* v. *Chevedden, et al.* (Mar. 7, 2014).

17 *Id*. at 46-47. The court noted the "critical distinction" between a defendant's statement that it did not *intend* to sue and a statement that it *would not* sue, finding that an irrevocable promise not to sue eliminates any justiciable case or controversy between the litigants. *Id*. at 48.

18 *Id*. at 48-49.

19 *Id*. at 50-51. In addition, the court opined that the statement of the Division of Corporation Finance that only a court can decide whether a company is obligated to include a shareholder proposal in its proxy materials "is made in the context of the SEC's explanation that individual shareholders may file suit to have their proposals included notwithstanding a no-action letter from the SEC." *Id*. at 52.

20 Memorandum and Order at 2-3, *Omnicom Group, Inc.* v. *Chevedden* (Mar. 11, 2014) (Dkt. 24) (quoting plaintiff).

21 *Id*. at 3.

Finally, just days later, the United States District Court for the District of Colorado expressly followed the reasoning of *EMC* and *Omnicom* in its dismissal of the case Chipotle Mexican Grill, Inc. filed against Chevedden and other activist shareholders. In *Chipotle*, the court agreed with the defendants that the future potential injuries claimed by the plaintiff "fail to meet the 'certainly impending' standard necessary to establish standing."[22] According to the court, neither the prospect of the defendants breaking their "irrevocable promise" not to sue Chipotle, nor the possibility of a lawsuit by another shareholder or an SEC enforcement action is "certainly impending," and thus, the "injury in fact" requirement was not met.[23] The court added that even if Chipotle had established injury in fact, it could not show that a declaratory judgment "would redress its injury as against a third party over whom [the presiding court] has no jurisdiction."[24]

III. IMPLICATIONS OF THE EMC, OMNICOM, AND CHIPOTLE DECISIONS

This year's proxy season seemed to reflect an emerging trend of registrants – perhaps emboldened by victories in the Southern District of Texas and the Fifth Circuit – turning to the courts to adjudicate their disputes with activist shareholders regarding whether they may exclude these shareholders' proposals from their proxy materials. But the recent decisions in *EMC*, *Omnicom*, and *Chipotle* demonstrate that despite the perception of some companies that they are more likely to succeed in court than before the SEC staff, a court victory is far from certain. With three federal courts finding that suits against Chevedden do not present an adjudicable "case or controversy" (at least where Chevedden promises not to sue the registrant if it excludes his proposal), it is likely that fewer companies, if any, will initiate lawsuits against Rule 14a-8 shareholder proponents.

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If you have any questions or would like additional information, please do not hesitate to contact Yafit Cohn at (212) 455-3815 or yafit.cohn@stblaw.com, or any other member of the Firm's Public Company Advisory Practice.

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22 Order Granting Defendants' Motion to Dismiss at 5, *Chipotle Mexican Grill, Inc.* v. *Chevedden, et al.* (Mar. 14, 2014) (Dkt. 26).

23 *Id*. at 5-6.

24 *Id*. at 6.

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