Recent SEC No-Action Positions Provide Further Support for Market-Standard Proxy Access Terms

SEC Staff Rejects Proponent’s Attempt to Define Which Ancillary Provisions are “Essential” for Substantial Implementation

SUMMARY

Two new no-action letters by the staff of the Securities and Exchange Commission confirm that companies can exclude a typical Rule 14a-8 proxy access shareholder proposal as “substantially implemented” if the company subsequently adopts a proxy access bylaw with current market-standard terms for large-cap companies – specifically, allowing groups of up to 20 shareholders who have held 3% of the stock for 3 years to nominate up to 20% of the board. The new letters, issued to Cisco Systems, Inc. and WD-40 Company, are consistent with no-action letters issued earlier in 2016 and make clear that a proxy access proposal may be substantially implemented even if the adopted bylaw excludes various ancillary terms highlighted in the proposal as “essential elements for substantial implementation.”

On the same day, the staff issued a no-action response to Microsoft Corporation denying the exclusion of a proposal to amend ancillary terms of the company’s previously adopted bylaw. This conclusion is consistent with letters issued by the staff earlier in 2016 denying the exclusion of a proposal to amend a previously adopted proxy access bylaw, even on non-core terms, as substantially implemented in situations where the company did not take some new responsive action.

For companies contemplating whether or when to adopt proxy access, the SEC staff’s positions may strengthen the argument for waiting until a shareholder proposal is received. If a company receives a typical shareholder proposal to adopt proxy access and adopts a market-standard proxy access bylaw in response, the proposal should be excludable as substantially implemented. But if a company adopts a
market-standard proxy access provision and then receives a shareholder proposal to amend certain aspects of the bylaw, it does not appear that the staff would permit exclusion of the proposal as substantially implemented by the existing bylaw. On the other hand, there is a chance that proactive adoption of a market-standard proxy access bylaw would reduce the likelihood of receiving an amendment proposal—to date, the small number of amendment proposals of which we are aware have been at companies that adopted proxy access following receipt of a shareholder proposal.

**DISCUSSION**

Proxy access continues to be one of the major corporate governance issues facing large publicly listed companies in the United States. In 2016, one of the common responses to a shareholder proposal seeking adoption of a proxy access bylaw has been for the company to adopt its own proxy access bylaw and seek no-action relief from the SEC staff to exclude the shareholder proposal from the company’s proxy materials on the basis that it has been substantially implemented under Rule 14(a)-8(i)(10).

Beginning in February 2016, the SEC staff issued no-action letters to a number of companies permitting this exclusion, even where the company-adopted bylaw deviated from the express terms of the proposal in various ways, under the staff’s general view that Rule 14a-8(i)(10) requires only that the “essential objective” of the proposal be implemented, not every detail. One proponent, James McRitchie, responded this summer by submitting proxy access proposals that were specifically designed to force a different conclusion—these proposals italicized certain terms and expressly indicated that they were “essential elements for substantial implementation.” The staff’s letters to Cisco and WD-40 amount to a rejection of the ability of proponents to dictate which elements of a proposal should be considered essential for these purposes.

---

1 For a further discussion of these earlier no-action letters, and for a discussion of the development of market-standard proxy access terms, see our publication, dated July 11, 2016, entitled “2016 Proxy Season Review” and our publication, dated April 8, 2016, entitled “Proxy Access: Developments in Market Practice,” which includes a standard form proxy access bylaw that is consistent with the current market standard.

For a comprehensive discussion of proxy access and other shareholder proposals, as well as public company governance, compensation and disclosure more generally, see the Public Company Deskbook: Complying with Federal Governance and Disclosure Requirements (Practising Law Institute) by our partners Bob Buckholz, Marc Trevino and Glen Schleyer, available at 1-800-260-4754 (1-212-824-5700 from outside the United States) or www.pli.edu.

2 The no-action letters discussed in this publication were issued on September 27, 2016, and are available at [https://www.sec.gov/divisions/corpfin/cf-noaction/2016_14a-8.shtml](https://www.sec.gov/divisions/corpfin/cf-noaction/2016_14a-8.shtml).

3 The staff has made clear that adoption of a 5% proxy access bylaw is not substantial implementation of a 3% proposal. See, e.g., Flowserve Corp. (Feb. 12, 2016); SBA Communications Corp. (Feb. 12, 2016). Although all of the proxy access bylaws adopted to date in 2016 had a 3%/3-year ownership level, it is worth noting that these were adopted primarily at large-cap companies. As more mid-size and smaller companies adopt proxy access, different “market-standard” provisions may develop that are more appropriate for their shareholder base and market cap, including an ownership threshold that is high enough to ensure that a nominating shareholder or group has a significant investment.

Recent SEC No-Action Positions Provide Further Support for Market-Standard Proxy Access Terms
October 4, 2016
The Cisco and WD-40 shareholder proposals flagged the following ancillary terms as essential:

- **No restriction on number of shareholders forming a group.** Both companies limited group size to 20, which is consistent with 90% of the proxy access bylaws that U.S. companies have adopted in 2016.

- **Director cap of 25% of the board.** Both companies used a 20% cap, which is consistent with 86% of the proxy access bylaws that U.S. companies have adopted in 2016.  

- **No restriction on renomination of candidates following failed vote.** WD-40 prohibited renomination for two years if the candidate received less than 25% support. Nearly 70% of proxy access bylaws adopted in 2016 have limitations on renominating access candidates who had support levels below a certain threshold, usually 25%.

Microsoft received a similar proposal as Cisco and WD-40, but in that case it was a proposal to **amend** the ancillary provisions of the 3%/3-year proxy access bylaw that Microsoft adopted in 2015 to conform to the same “essential elements” discussed above – that is, no limit on group size, director cap of 25% of the board or two directors, and no restriction on renomination of candidates following a failed vote. Microsoft’s no-action request did not indicate that the company intended to take any action to implement the proposal, but relied on the argument that the previously adopted bylaw substantially implemented the proposal.  

The staff disagreed, as it had disagreed with a similar argument in H&R Block, Inc. (July 21, 2016). The staff’s positions suggest that a company that adopts a market-standard proxy access bylaw generally will not be able to exclude a proposal to amend that bylaw, even in ancillary ways, without taking some form of responsive action.

It should be noted that, in 2016, companies that adopted or proposed a 3%/3-year proxy access bylaw have been universally successful in defeating a vote on a 3%/3-year shareholder proposal. It is yet unclear whether excluding a shareholder proposal as substantially implemented, as opposed to having the proposal go to a vote and fail, will have any effect on the likelihood of receiving a proposal to amend. We expect that over the next year or so, a number of shareholder proposals to amend ancillary provisions of proxy access bylaws will come to a vote at annual meetings. The success levels of these proposals will be a significant determinant of the continued development of market practice, but the limited information to date suggests that proposals to amend a bylaw with market-standard terms to increase the director cap

---

4 Both companies also provide for a minimum of two proxy access nominees, even if the 20% calculation would yield a lower number. While this is a common provision, occurring in 81% of the proxy access bylaws adopted in 2016, the SEC staff has not considered it an essential element of proxy access for substantial implementation purposes. See General Dynamics Corp. (Feb. 12, 2016) (no minimum); Eastman Chemical Co. (Mar. 9, 2016) (minimum of one).

5 While this was not part of the record reviewed by the staff, Microsoft did amend its proxy access provision on September 20, 2016, to make various changes in ancillary terms, including to reduce the 25% renomination threshold to 15%. The other changes were to clarify when groups of funds count as a single shareholder under the group limit, increase the timing for recalling loaned shares from three to five business days, and eliminate the requirement that loaned shares be recalled at the time a nominating shareholder provides notice. See Microsoft Corp. Current Report on Form 8-K, filed with the SEC on September 22, 2016.
Recent SEC No-Action Positions Provide Further Support for Market Standard Proxy Access Terms

October 4, 2016

to 25%, eliminate the group limitation of 20 or make other ancillary changes will probably not be successful.\textsuperscript{6} Issuers that receive an amendment proposal should consider whether there are certain elements of the proposal (such as the treatment of loaned shares or the clarification on groups of funds constituting one shareholder) that could be made to lessen the probability of success of an amendment proposal.

\textsuperscript{* * *}

\textsuperscript{6} Such shareholder proposals failed at H&R Block, Inc. with 30% support of votes cast and at Whole Foods Market, Inc. with 40% support of votes cast.

Copyright © Sullivan & Cromwell LLP 2016 -4-
Recent SEC No-Action Positions Provide Further Support for Market-Standard Proxy Access Terms
October 4, 2016
Recent SEC No-Action Positions Provide Further Support for Market-Standard Proxy Access Terms

October 4, 2016
Recent SEC No-Action Positions Provide Further Support for Market-Standard Proxy Access Terms

October 4, 2016
SC1-#4243300-v10