

# Memorandum

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## SEC Staff Confirms Its Approach to “Substantial Implementation” In the Context of Proxy Access

October 13, 2016

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In July of 2016, the staff of the Securities and Exchange Commission (“SEC”) determined that H&R Block, Inc. did not, by virtue of its previous adoption of proxy access at the 3-percent/3-year thresholds, substantially implement a shareholder proposal requesting four specific revisions to the company’s proxy access bylaw.<sup>1</sup> After granting no-action relief earlier this year to dozens of companies that had received proxy access shareholder proposals and thereafter adopted proxy access at the 3-percent/3-year thresholds, the Staff’s no-action denial to H&R Block suggested that, when it comes to applying the “substantial implementation” exclusion under Rule 14a-8(i)(10), there is a crucial distinction between a shareholder proposal that seeks the adoption of proxy access with specified provisions and one that requests enumerated revisions to the company’s existing proxy access bylaw.<sup>2</sup> On September 27, 2016, the Staff issued three no-action responses that confirm and refine its view with regard to the application of the “substantial implementation” exclusion to proxy access proposals.

In two of its no-action letters – issued to Cisco Systems, Inc. and WD-40 Company – the Staff granted no-action relief with regard to a substantially identical shareholder proposal. The proposal requested that the company’s board of directors adopt and present for shareholder approval a proxy access bylaw with certain

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<sup>1</sup> For more information about the Staff’s no-action denial to H&R Block, see Simpson Thacher & Bartlett LLP, [“SEC Staff Denies No-Action Relief With Regard to 3/3 Proxy Access Proposal Challenged on ‘Substantial Implementation’ Grounds”](#) (Aug. 2, 2016).

<sup>2</sup> For more information regarding the first group of no-action responses to issuers that had adopted proxy access and consequently sought to exclude proxy access shareholder proposals under Rule 14a-8(i)(10), see Simpson Thacher & Bartlett LLP, [“SEC Staff Issues No-Action Responses With Regard to 18 Proxy Access Shareholder Proposals Challenged on ‘Substantial Implementation’ Grounds”](#) (Mar. 1, 2016).

“essential elements for substantial implementation.”<sup>3</sup> Among these “essential elements” were that:

1. there be an “unlimited number of shareholders” who can be aggregated to form a group;
2. the maximum “number of shareholder-nominated candidates appearing in proxy materials shall be one quarter of the directors then serving or two, whichever is greater”; and
3. “[n]o additional restrictions shall be imposed on re-nominations when nominees fail to receive a specific percentage of votes.”

While Cisco and WD-40 Company amended their respective bylaws to adopt proxy access at the 3-percent/3-year thresholds, they did not implement each element listed in the shareholder proposal. In their requests for no-action relief, the two issuers asserted that “the Proposal’s emphasis, in italicized font, of the words ‘essential elements for substantial implementation’ in the lead-in paragraph and its similar emphasis” of other phrases in the proposal imply “that the Proposal cannot be substantially implemented without fully addressing each and every one of those particular elements of the Proposal.”<sup>4</sup> The issuers argued that the SEC, however, has “specifically rejected the notion that the actions requested by a proposal need to be fully effected in each and every respect for that proposal to be substantially implemented.” Rather, they explained, “a proposal is substantially implemented when its essential objective is satisfied, even if the proposal has not been implemented exactly as proposed.” Cisco and WD-40 Company took the position, therefore, that although they had not implemented the proposal exactly as proposed, they substantially implemented the proposal under Rule 14a-8(i)(10). The Staff concurred with the issuers, permitting exclusion of the proposal in reliance on Rule 14a-8(i)(10).

Consistent with its decision in the H&R Block letter, however, the Staff denied no-action relief to Microsoft Corporation with regard to a shareholder proposal that sought specific revisions to the company’s existing proxy access bylaw. Microsoft, which had adopted proxy access last year, received a shareholder proposal phrased as a request that the company’s board “adopt, and present for shareholder approval, an enhancement package of its Proxy Access for Director Nomination bylaw, with *essential elements for substantial implementation*” similar to the elements described above.<sup>5</sup> In its request for no-action relief, Microsoft argued that although the shareholder proposal “is more narrowly focused on specific aspects of proxy access than those considered in the Staff’s precedent for adoption of proxy access,” its proxy access bylaw “nevertheless satisfies the ‘substantial implementation’ standard because it achieves the Proposal’s

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<sup>3</sup> [Cisco Systems, Inc.](#) (avail. Sept. 27, 2016) (emphasis in original); [WD-40 Company](#) (avail. Sept. 27, 2016) (emphasis in original).

<sup>4</sup> [WD-40 Company](#) (avail. Sept. 27, 2016), request letter dated Aug. 4, 2016, at 10; see also [Cisco Systems, Inc.](#) (avail. Sept. 27, 2016), issuer’s letter dated Aug. 19, 2016, at 2.

<sup>5</sup> [Microsoft Corp.](#) (avail. Sept. 27, 2016).

essential purpose.” Advancing a policy argument, Microsoft added:

Given the complexity of proxy access, the Staff’s failure to concur in [the company’s] view that the Proposal may be excluded would result in endless nitpicking over collateral aspects of bylaws and involve impossible line-drawing. Indeed, allowing shareholders to tweak the endless variations of lengthy proxy access provisions would be counter to the “substantial implementation” standard at the heart of Rule 14a-8(i)(10).

The Staff declined to extend no-action relief to Microsoft, stating that it was “unable to conclude that Microsoft’s proxy access bylaw compares favorably with the guidelines of the proposal.”

### Implications of the Staff’s No-Action Responses

The Staff’s recent no-action responses reiterate the Staff’s view of substantial implementation in the proxy access context. The letters confirm that where a shareholder proposal requests that an issuer *adopt* proxy access with specified provisions, alignment between the ownership threshold adopted by the company and that requested in the shareholder proposal is generally sufficient for obtaining no-action relief, despite variations between the company’s bylaw and the proposal. The Staff’s recent no-action letters to Cisco and WD-40 Company clarify that the labeling of certain provisions as “essential elements for substantial implementation” does not change this result. Where a shareholder proposal requests that the company *amend* an existing proxy access bylaw in certain respects, however, the previous adoption of the bylaw is unlikely to be viewed as “comparing favorably with the guidelines of the proposal.”

We continue to believe that the Staff’s approach is likely to result in the submission of more shareholder proposals over the coming proxy season that request specific revisions to issuers’ existing proxy access bylaws. As with other proposals, issuers receiving such proposals should ensure that they are familiar with the views of their large shareholders before determining how to respond. They should also keep in mind the following:

1. In 2016, in each case in which an issuer had already adopted proxy access at the 3-percent/3-year thresholds but nonetheless received and submitted to a vote a shareholder proposal on proxy access, the shareholder proposal failed. This includes the proposal that was submitted to a vote at H&R Block, which received 30% shareholder support.
2. Microsoft’s existing bylaw provisions that were targeted by the shareholder proposal— namely, a cap on shareholder nominees set at the greater of two directors or 20% of the board, an aggregation limit of 20 shareholders, and a disqualification for the next two annual meetings of any shareholder nominee who did not receive at least 25% of the votes cast – have already been established as market practice and appear to be backed by many institutional investors.

While it remains to be seen how Microsoft's proposal fares, for these reasons we believe issuers should feel comfortable standing firm on those aspects of their existing proxy access bylaws (within generally accepted market practice) that they believe are in the best interests of the company and its shareholders.

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If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or [yafit.cohn@stblaw.com](mailto:yafit.cohn@stblaw.com), or any other member of the Firm's Public Company Advisory Practice.

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