Simpson Thacher

# Memorandum

## SEC Staff Issues No-Action Responses With Regard to 18 Proxy Access Shareholder Proposals Challenged on "Substantial Implementation" Grounds

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On February 12, 2016, the Staff of the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission ("SEC") issued responses to 18 no-action requests from issuers that sought to omit proxy access shareholder proposals from their proxy materials on the ground that they had substantially implemented the proposal under Rule 14a-8(i)(10).[1] The Staff granted no-action relief to 15 companies but denied relief to three companies whose proxy access bylaw provisions contained a higher eligibility threshold than that requested in the shareholder proposal.

In all 15 cases in which the Staff granted no-action relief, the shareholder proposal requested, in relevant part, that the company adopt proxy access with the following provisions:

- **Ownership threshold and holding period.** The proposal requested proxy access for holders of three percent of the company's outstanding common stock for at least three consecutive years. The proposal specifically noted that "recallable loaned stock" should be counted toward the three-percent ownership.
- **No Aggregation Limit.** The proposal provided that an "unrestricted number of shareholders" should be permitted to form a group for purposes of satisfying the ownership threshold.
- **Cap on Shareholder Nominees.** The proposal requested that the number of shareholder-nominated candidates appearing in the company's proxy materials not exceed the greater of two directors or 25

[1] *See Alaska Air Group, Inc.*; *Baxter International Inc.*; *Capital One Financial Corp.*; *Cognizant Technology Solutions Corp.*; *The Dun & Bradstreet Corp.*; *Flowserve Corp.*; *General Dynamics Corp.*; *Huntington Ingalls Industries, Inc.*; *Illinois Tool Works Inc.*; *Northrop Grumman Corp.*; *NVR, Inc.*; *PPG Industries, Inc.*; *SBA Communications Corp.*; *Science Applications International Corp.*; *Target Corp.*; *Time Warner Inc.*; *UnitedHealth Group, Inc.*; *The Western Union Company* (all *avail.* Feb. 12, 2016).

percent of the board.

- **Information Requirements.** The proposal sought to require the nominating shareholder (or group of shareholders) to provide the company with information required by the company's bylaws and any SEC rules regarding "(i) the nominee, including consent to being named in proxy materials and to serving as director if elected; and (ii) the Nominator, including proof it owns the required shares."
- **Required Shareholder Certifications.** The proposal sought to require the nominating shareholder (or group of shareholders) to certify that "(i) it will assume liability stemming from any legal or regulatory violation arising out of the Nominator's communications with the Company shareholders . . . (ii) it will comply with all applicable laws and regulations if it uses soliciting material other than the Company's proxy materials; and (iii) to the best of its knowledge, the required shares were acquired in the ordinary course of business, not to change or influence control at the Company."
- **"No Additional Restrictions."** The proposal added: "No additional restrictions that do not apply to other board nominees should be placed on these nominations or re-nominations."

In all 15 cases, the proxy access bylaw adopted by the company granted proxy access for holders of three percent of the company's outstanding stock for at least three years and explicitly included loaned shares in the ownership calculation, provided that the lending shareholder has the power to recall the shares within a specified period (and, in some cases, that the shareholder does indeed recall them). Most of the companies' bylaws, however, differed from the proposal in one or more of the following respects:

- **Aggregation Limit.** In 13 cases, the company's bylaws limited the number of shareholders who could be aggregated for purposes of reaching the ownership threshold to 20 shareholders.
- **Cap on Shareholder Nominees.** The bylaws of 11 companies included a lower cap on the number of candidates who may be nominated pursuant to proxy access. These bylaws limited the number of shareholder nominees to either:
  - the greater of two directors or 20 percent of the board, or
  - 20 percent of the board (rounded down to the nearest whole number).

  Whether or not a company's bylaws contained a lower cap on shareholder nominees than that requested by the proposal, the bylaws sometimes specified additional categories of individuals who would be deemed shareholder nominees for purposes of calculating the cap (e.g., individuals nominated pursuant to the company's advance bylaw provision, incumbent director candidates previously nominated through the proxy access mechanism until they have served a specified number of terms, any shareholder nominee whose nomination is subsequently withdrawn or who becomes ineligible).
- **Information and Certification Requirements.** While the bylaws of each of the companies that obtained no-action relief required all of the disclosures and certifications outlined in the proposal, they

also typically required additional disclosures and/or certifications from the shareholder nominees (e.g., a representation that the nominating shareholder intends to continue to own the requisite shares through the date of the annual meeting and/or for at least one year following the date of the annual meeting (subject to limited exceptions), a representation that the nominating shareholder will not distribute any form of proxy for the annual meeting other than the form distributed by the company, a representation that the nominating shareholder will indemnify the company and its directors and officers against specified losses arising from nominations submitted by the shareholder).

- **Additional Restrictions.** While noting that it is not entirely clear what "additional restrictions" the proposal referred to, many of the no-action request letters acknowledged that the company's bylaws impose certain requirements on shareholder-nominated candidates that do not expressly apply to the board's nominees. Examples include requirements that:
  - the shareholder-nominated candidate be independent according to applicable listing standards;
  - the election of the shareholder-nominated candidate not cause the company to violate its governing documents, applicable listing rules or other applicable laws, rules or regulations;
  - the shareholder-nominated candidate not be an officer or director of a competitor; and
  - the shareholder-nominated candidate not be the subject of certain criminal proceedings or be a "bad actor" under SEC rules.

  Many companies took the position that the practical effect of imposing such "additional restrictions on proxy access nominees is to place proxy access candidates and [b]oard nominated candidates on an equal footing," because the board "does not have the opportunity to follow the same vetting process for shareholder-nominated proxy access candidates."[2]

Despite these differences, the Staff granted no-action relief to these companies, specifically noting in each case the company's "representation that the board has adopted a proxy access bylaw that addresses the proposal's essential objective."

Three companies, however, were unsuccessful in obtaining no-action relief in reliance on Rule 14a-8(i)(10). These companies had each adopted proxy access for owners of at least five percent of the company's outstanding common stock, while the shareholder proposals they received called for proxy access at a three-percent ownership threshold.[3] In each of these cases, the Staff concluded that, based on the information

[2] *See, e.g., Alaska Air Group, Inc.* (*avail.* Feb. 12, 2016) (incoming letter).

[3] Two of these proposals were submitted by the New York City Comptroller's office to companies that had received the Comptroller's proposal last year. Last year, one of these companies opposed the shareholder proposal, and the proposal failed to garner majority support. The other company submitted a dueling management proposal to shareholders last year alongside the Comptroller's proposal; the management proposal, which provided for proxy access at the five-percent threshold, passed, while the Comptroller's proposal did not.

presented by the company in its no-action request, "it appears that [the company's] policies, practices and procedures do not compare favorably with the guidelines of the proposal and that [the company] has not, therefore, substantially implemented the proposal."

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

After the Division of Corporation Finance suggested four months ago, with its issuance of Staff Legal Bulletin No. 14H, that Rule 14a-8(i)(9) will no longer be available in most cases to issuers seeking to exclude proxy access shareholder proposals, companies began to turn to Rule 14a-8(i)(10) this proxy season as a basis for exclusion – particularly as an unprecedented number of companies have adopted proxy access over the past year.[4] However, it was uncertain to what extent they would prevail. While it is well settled that Rule 14a-8(i)(10) does not require companies to implement every detail of the proposal so long as the company's prior actions "compare favorably with the guidelines of the proposal" and address the essential objectives of the proposal, the application of this principle to proxy access had seldom been tested prior to this proxy season, given the relatively new phenomenon of proxy access shareholder proposals.[5]

Last year, the Staff granted no-action relief to General Electric under Rule 14a-8(i)(10).[6] In that case, the company had implemented proxy access with the same ownership threshold, holding period, and cap on shareholder nominees as requested by the proposal but added a group limit of 20 shareholders, while the shareholder proposal was silent on the issue of group size limits. In 2012, the Staff declined to offer no-action relief to KSW, Inc. where the company had adopted proxy access for owners of at least five percent of the company's outstanding common stock, while the shareholder proposal requested a two-percent ownership threshold.[7] These letters, however, left several questions open with regard to the scope of the "substantial implementation" exclusion in the proxy access context.

The Staff's recent series of no-action responses clarifies the availability of Rule 14a-8(i)(10) to exclude a proxy access shareholder proposal. Specifically, the no-action responses suggest the following:

- **Alignment between the ownership threshold adopted by the company and that requested in the shareholder proposal is crucial for obtaining no-action relief.** The key factor dividing the companies that were successful in obtaining no-action relief under Rule 14a-8(i)(10) from those that

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[4] For more information on Staff Legal Bulletin No. 14H, *see* Simpson Thacher & Bartlett LLP, "SEC's Division of Corporation Finance Issues Guidance on Rule 14a-8's 'Directly Conflicting' and 'Ordinary Business' Exclusions" (Oct. 27, 2015).

[5] *Texaco, Inc.* (*avail.* Mar. 28, 1991).

[6] *See General Electric Co.* (*avail.* Mar. 3, 2015).

[7] *See KSW, Inc.* (*avail.* Mar. 7, 2012).

were unsuccessful appears to be whether the company had adopted proxy access at the ownership threshold requested by the proponent.

- **An aggregation limit (or at least an aggregation limit of 20 shareholders) will generally not preclude a finding that the proposal has been substantially implemented.** While the no-action letter issued to General Electric last year suggested that imposing a group limit of 20 shareholders will not preclude no-action relief under Rule 14a-8(i)(10) where the proposal simply referred to an eligible "shareholder or group thereof," the Staff's recent responses clarify that the same limit will not preclude relief even where the proposal specifically requests that proxy access be available to a group consisting of "an unrestricted number of shareholders." It is unclear whether the Staff would reach the same result with regard to a company that does not permit any aggregation for purposes of reaching the ownership threshold (or provides for a lower aggregation limit than 20 shareholders).
- **A lower cap on shareholder nominees (or at least a cap of 20% of the board) will generally not preclude a finding that the proposal has been substantially implemented.** This appears to be the case without regard to whether the company's proxy access bylaw guarantees a minimum of two shareholder-nominated directors, even where the shareholder proposal calls for a cap of the greater of two directors or 25 percent of the board. Moreover, the categories of individuals considered under the company's bylaws in determining the cap do not appear to impact the Staff's determination on substantial implementation.
- **The addition of disclosure and/or certification requirements not included in the proposal and the imposition of additional, reasonable qualification requirements for shareholder nominees will generally not preclude a finding that the proposal has been substantially implemented.**

Going forward, the Staff's recent no-action letters may result in fewer shareholder proposals submitted to issuers that have already adopted proxy access at the three-percent / three-year thresholds. Either way, in light of the Staff's no-action letters, public companies that have implemented – or are considering implementing – proxy access at the three-percent / three-year thresholds should take note that the "bells and whistles" in their bylaw provisions are unlikely to be successfully challenged via a shareholder proposal. Those issuers that have not yet adopted proxy access but are considering doing so should familiarize themselves with the views of their large shareholders and engage with them regarding the various provisions they are considering for their proxy access mechanism. To the extent these companies determine to adopt proxy access, they should be comfortable adopting the proxy access provisions (within generally accepted market practice) that they ultimately determine are in the best interests of the company and its shareholders.

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, any other member of the Firm's Public Company Advisory Practice.


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