Simpson Thacher

Memorandum

SEC Staff Denies No-Action Relief With Regard to 3/3 Proxy Access Proposal Challenged on "Substantial Implementation" Grounds

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During the 2016 proxy season, the Staff of the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission ("SEC") granted no-action relief to 36 issuers with regard to proxy access shareholder proposals on the ground that they had substantially implemented the proposal under Rule 14a-8(i)(10).[1] In each of these instances, 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, as requested by the shareholder proposal. The Staff granted no-action relief despite the fact that in most of these cases, the company's bylaws differed from the shareholder proposal with regard to the number of shareholders who could be aggregated to form a group, the cap on the number of candidates who may be nominated pursuant to proxy access, and/or the specific disclosures and certifications required from nominating shareholders. On July 21, 2016, for the first time, the Staff denied no-action relief under Rule 14a-8(i)(10) to a company that had adopted proxy access at the 3%/3-year thresholds.[2]

The no-action denial was issued to H&R Block, Inc., whose proxy access bylaw, adopted last year, permits a shareholder or a group of up to 20 shareholders owning three percent or more of the company's outstanding stock continuously for at least three years to nominate and include in the company's proxy materials director nominees constituting up to 20 percent of the board. The shareholder proposal submitted to the company by James McRitchie and Myra K. Young was phrased as a request that the company's board adopt and present for shareholder approval specific revisions to the company's existing proxy access bylaw. Specifically, the shareholder proposal requested that the company's bylaws be revised to "ensure the following:

[1] For more information regarding the initial group of no-action responses issued to 18 issuers on February 12, 2016, *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).

[2] *See H&R Block, Inc.* (*avail.* July 21, 2016).

1. The number of shareholder-nominated candidates eligible to appear in proxy materials should be one quarter of the directors then serving or two, whichever is greater.

2. Loaned securities should be counted toward the ownership threshold if the nominating shareholder or group represents that it has the legal right to recall those securities for voting purposes, will vote the securities at the annual meeting, and will hold those securities through the date of that meeting.

3. There should be no limitations on the number of shareholders that can aggregate their shares to achieve the required 3% ownership to be an 'Eligible Shareholder.'

4. There should be no limitation on the renomination of shareholder nominees based on the number of percentage votes received in any election."

Citing the group of no-action letters issued earlier this year with regard to proxy access proposals under Rule 14a-8(i)(10), H&R Block asserted that "[t]he Staff has concluded that proposals calling for a shareholder proxy access bylaw could be excluded as substantially implemented where the company had adopted a bylaw with the same stock ownership amount and length of ownership called for by the proposal, even though the company's bylaw included certain procedural limitations or restrictions that were inconsistent with or not contemplated by the proposal." The company took the position that, under this standard, it too has substantially implemented the proposal it had received.

Proponent James McRitchie, on the other hand, argued, among other things, that the no-action letters cited by the company "provide no evidence why 3% of shares is considered an essential element to proxy access but having no cap on the number allowed to form a group is not. There is a world of difference between a group of twenty . . . and an unlimited group." Perhaps more importantly, the proponent drew a distinction between proposals seeking the adoption of proxy access bylaws and those seeking "revisions to existing proxy access bylaws," arguing that "once bylaws have been adopted, shareholders must be able to recommend substantive changes." McRitchie asserted: "If I ask a company to amend its bylaws to provide for proxy access, listing several suggested provisions and they implement most of them, I can understand how one might reasonably argue the request has been substantially implemented. However, if a company has already adopted proxy access bylaws and I ask that four revisions be made, it is not substantial implementation *of the second request* if the company has implemented none of those suggested revisions."

The Staff ultimately denied H&R Block's request for no-action relief, noting that the it was "unable to conclude that H&R Block's proxy access bylaw compares favorably with the guidelines of the proposal."

Implications of the Staff's No-Action Response

The Staff's no-action response to H&R Block further clarifies the Staff's view of substantial implementation in the proxy access context. The Staff's recent letter suggests that, when it comes to the application of 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. It appears that while, in the former case, 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 any differences between the company's bylaw and the proposal), in the latter case, the previous adoption of a proxy access bylaw is unlikely to be viewed as "comparing favorably with the guidelines of the proposal."

Given the Staff's denial of H&R Block's no-action request – and its provision of no-action relief earlier this year to dozens of companies faced with proposals requesting the adoption of proxy access – the issuer community should expect to see more shareholder proposals next proxy season that request specific revisions to issuers' existing proxy access bylaws. If this year's proxy access voting results are any indication, however, these proposals may not have much success. As observed during the 2016 proxy season, the major factor determining the vote results with regard to proxy access shareholder proposals seemed to be whether the company had already adopted proxy access. In each of the 19 cases this year in which the company had already adopted proxy access at the 3%/3-year thresholds but nonetheless received and submitted to a vote a shareholder proposal on proxy access, the shareholder proposal failed.

For this same reason, we believe that this development should not impact the decisions of those issuers who have not yet adopted proxy access. Those companies considering the adoption of proxy access should familiarize themselves with the views of their large shareholders and engage with them regarding the various potential provisions of their proxy access mechanism. To the extent these companies determine to adopt proxy access, they should adopt 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, or any other member of the Firm's Public Company Advisory Practice.

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