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SEC Proposes Rules on Universal Proxies

On October 26, 2016, the SEC proposed amendments to the proxy rules to require parties in a contested election to use universal proxy cards that would include the names of all board nominees. The amendments would thus allow shareholders to vote by proxy for their preferred combination of company and dissident nominees (i.e., to “split their vote”), similar to the way that shareholders who attend the meeting in person can cast votes. The proposed universal proxy rule (Rule 14a-19) would apply to contested elections other than those involving registered investment companies and business development companies. In addition, the SEC proposed amendments to require that proxy cards clearly specify the applicable shareholder voting options in all director elections and require that proxy statements disclose the effect of a shareholder’s election to withhold votes.

Background

Under the current regime, in a proxy contest, a company’s director nominees are typically presented as one slate in the company’s proxy statement and proxy card, and the dissident’s full or partial slate of nominees is presented in the dissident’s proxy statement and proxy card. Under the “bona fide nominee” rule (Rule 14a-4(d)(1)), one party may not include the other party’s nominees on its proxy card unless the other party’s nominees consent. Because a party’s nominees generally refuse to consent to being named on the opposing party’s proxy card, shareholders voting by proxy are forced to use either the company’s or the dissident’s proxy card to submit their votes. Shareholders voting by proxy generally cannot pick and choose from all of the director nominees by submitting two separate proxy cards (even where the total number of nominees for which the two cards are marked does not exceed the number of directors being elected) because, under state law, a later-dated proxy card typically revokes any earlier-dated one and invalidates the votes on the earlier-dated card.

The existing rules do allow a dissident proposing a “short slate” of nominees to “round out its slate” by soliciting proxy authority to vote for the company’s nominees that were not named on the dissident’s card. In such circumstances, however, shareholders voting on the dissident’s proxy card can vote only for the combination of company and dissident nominees selected by the dissident, rather than any combination of nominees.

Universal Proxy

Following is a summary of key aspects of the proposed rule.

What is a universal proxy card?

A universal proxy card is a proxy card that includes the names of all duly nominated candidates for election (e.g., the company’s nominees, dissident nominees, and any “proxy access” nominees) and would allow shareholders to vote by proxy for any combination of nominees.

To implement universal proxy cards, Rule 14a-19(e), along with a change to the definition of “bona fide nominee” as a person who has consented to being named in “a” proxy statement instead of being named in “the” proxy statement, would require each party in a proxy contest to include on its proxy card all candidates that have consented to being named on a proxy card for the applicable meeting.

When must a universal proxy card be used?

Under the proposed rule, if adopted, universal proxy cards must be used in contested elections except for those involving registered investment companies and business development companies.

Note that the “short slate rule” (Rule 14a-4(d)) would be eliminated under the rule proposal since it would no longer be necessary under a mandatory universal proxy system.

What would the universal proxy card look like?

As proposed, a universal proxy card would be required to:

- provide a means for shareholders to vote FOR the nominees set forth on the card;
- clearly distinguish between the company’s nominees, dissident nominees, and any proxy access nominees;
- within each group of nominees, list the nominees in alphabetical order by last name;
- present all nominees in the same font type, style and size;
- prominently disclose the maximum number of nominees for which authority to vote can be granted; and
- prominently disclose the treatment and effect of over-votes and under-votes.

Where both parties have proposed a full slate of nominees, and there are no proxy access nominees, the proxy card may provide the ability to vote for all of one party’s nominees as a group. No such “group voting” option would be permitted where proxy access nominees appear on the proxy card or where one party is proposing only a partial slate.

Must both sides use identical universal proxy cards?

No, each soliciting party may use its own universal proxy card and design the card how it wishes, subject to the presentation and formatting requirements described above. Thus, for example, while each party’s nominees must be clearly distinguished, the proposed rule does not prohibit the parties from listing their group of nominees first. As a result, the proposed rule will not eliminate the practice of dueling proxy cards in a contested election.

As is currently the case, the use of separate proxy cards would give each party control over the dissemination of its proxy card and insight into the preliminary results of the solicitation before the annual meeting. It would also avoid empowering only one party with discretionary authority over certain voting matters.

What are the eligibility requirements for a dissident to use universal proxy cards?

The proposed rule imposes three main requirements on dissidents seeking to use universal proxy cards: (i) timely notice to the company, (ii) timely filing of a definitive proxy statement, and (iii) a minimum solicitation requirement.

- **Notice Requirement.** A dissident must notify the company of its intent to solicit proxies in support of its director nominees and the names of its nominees, (a) no later than 60 calendar days prior to the anniversary of the previous year’s annual meeting date, or (b) if the company did not hold an annual meeting during the previous year or if the date of the meeting has changed by more than 30 calendar days from the previous year, then the later of 60 calendar days prior to the annual meeting date or the 10th calendar day following the date of company’s public announcement of the annual meeting date. A dissident’s obligation to comply with this notice requirement would be in addition to the dissident’s obligation to comply with any applicable advance notice provision contained in a company’s bylaws. The proposed rule would effectively preclude a dissident

from launching a proxy contest less than 60 days prior to a company's annual meeting, even if the company's bylaws did not require advance notice by that date.

- **Filing Requirement.** A dissident must file its definitive proxy statement with the SEC by the later of (a) 25 calendar days prior to the annual meeting date or (b) five calendar days after the company files its definitive proxy statement.
- **Solicitation Requirement.** A dissident must solicit the shareholders representing at least a majority of the voting power of shares entitled to vote on the election of directors. While a dissident must promptly notify the company of any change to its intent to comply with the minimum solicitation threshold, the proposed rule would not require the dissident to provide any evidence of its compliance with the minimum solicitation requirement.

What happens if a party that has already provided the required notice of its nominees to the opposing party later changes its nominees?

Under the proposed rule, each soliciting party would be required to promptly notify the opposing party of any change with respect to the names of its director nominees. If there is a change in one party's nominees after the opposing party has disseminated a universal proxy card, the opposing party could elect, but would not be required, to disseminate a new universal proxy card reflecting the change in other party's nominees.

What if a dissident fails to comply with Rule 14a-19?

Because a company may have disseminated its universal proxy card before becoming aware of a dissident's non-compliance with Rule 14a-19, the company would be required to include disclosure in its proxy statement advising shareholders how it intends to treat proxy authority granted in favor of dissident nominees in the event the dissident abandons its solicitation or fails to comply with the rule. In those instances, the company could elect to disseminate a new, non-universal proxy card including only the names of the company's nominees.

What are a company's other obligations under a universal proxy system?

Under the rule proposal, Rule 14a-5(e) would be amended to require that companies disclose in their proxy statements the deadline by which a dissident must provide notice of intent to solicit proxies for its nominees at the next annual meeting.

If a company receives notice from a dissident of its intent to run a proxy contest, then the company would be required to notify the dissident of the names of the company nominees unless the names have already been provided in a preliminary or definitive proxy statement filed by the company. The company's notice must be provided to the dissident no later than 50 calendar days prior to the anniversary of the previous year's annual meeting date or, if the company did not hold an annual meeting during the previous year, or if the annual meeting date has changed by more than 30 calendar days from the previous year, then notice must be provided no later than 50 calendar days prior to the annual meeting date.

Will a company be required to include detailed information about a dissident's director nominees in the company's proxy statement?

No, new Item 7(h) of Schedule 14A would require each soliciting party to refer shareholders to the other party's proxy statement for information about the other party's nominees (e.g., ages, business experience, and involvement in certain types of judicial and administrative proceedings) and explain that shareholders can access the other party's proxy statement for free on the SEC's website. In addition, Rule 14a-5(c) would be amended to permit parties to refer to information that would be furnished in a filing of the other party to satisfy their disclosure obligations.

Under a universal proxy system, while a company’s universal proxy card would include the names of dissident nominees, the company’s proxy statement can and likely would include disclosure arguing against a vote for the dissident nominees.

How does proxy access differ from a universal proxy system?

The below chart briefly compares the proxy process under a “typical” proxy access bylaw provision and the SEC’s proposed rule requiring universal proxy cards:

Provision/Feature	“Typical” Proxy Access Bylaw (3%/3 Yrs/2 or 20%/20)	Universal Proxy (under SEC rule proposal)
<i>How would nominee(s) appear on proxy card?</i>	Proxy access nominees would be included on company’s proxy card; typically no additional presentation or formatting requirements beyond what is required under Rule 14a-4	Dissident nominees would be included on universal proxy card, subject to certain presentation and formatting requirements in addition to Rule 14a-4 requirements
<i>Would information about nominee(s) appear in a company’s proxy statement?</i>	Yes	No, but a company must refer shareholders to the dissident’s proxy statement for information about dissident nominees; dissident must produce and disseminate its own proxy materials
<i>Who would primarily bear the costs of solicitation?</i>	Company (proxy access nominees would be included in the company’s proxy materials)	Both the company and the dissident (dissident must solicit at least a majority of the shareholders)
<i>Any limitations on the number of nominees?</i>	Yes, typically limited to 20% of the board or at least two directors; ability for proponent to obtain control of a majority of a company’s board would be limited	No, a dissident may propose a full slate; assuming annual election of all directors, proponent would have the ability to potentially obtain control of a majority of a company’s board
<i>By when must a proponent notify the company?</i>	Typically, 120-150 days before the anniversary of the date that the company issued its proxy statement for the previous year’s annual meeting or, if the annual meeting date has changed by more than 30 days earlier or more than 60 days later than the anniversary date of the annual meeting, then not later than the 10 th day following the company’s announcement of the annual meeting date	No later than 60 days before the anniversary of the previous year’s annual meeting date or, if the company did not hold an annual meeting or if the meeting date has changed by more than 30 days from the previous year, then by the later of 60 days prior to the annual meeting date or the 10 th day following the company’s announcement of the annual meeting date

Note that the mandatory universal proxy system, as proposed, would not apply to an election of directors involving only company and proxy access nominees.

Director Election Voting Standards Disclosures and Voting Options

While the federal proxy rules do not govern the voting standard used in director elections, they do set forth the requirements for the form of proxy used in, and the disclosure of the voting procedures for, director elections. Under the rule proposal, Rule 14a-4(b) would be amended to (i) require the inclusion of an AGAINST voting option in lieu of a WITHHOLD option on the proxy card where there is a legal effect to such a vote, and (ii) provide shareholders with an ABSTAIN voting option in a director election governed by a majority voting standard. Thus, if state law gives legal effect to votes cast against a nominee (which is the case under a majority voting standard), the proxy card must include the options to vote AGAINST the nominee and to ABSTAIN from voting. In addition, Item 21(b) of Schedule 14A would be amended to expressly require the disclosure of the effect of a WITHHOLD vote in a director election.

Comment Period

Interested stakeholders are encouraged to share their views with the SEC on the rule proposal, which contains 105 numbered questions, including, but not limited to, whether universal proxies should be mandatory or optional, whether the use of a universal proxy card could lead to an increase or decrease in the number of proxy contests, and whether the use of universal proxies should be applied to investment companies. Comments are due within 60 days following the publication of the proposed rule in the Federal Register.

The SEC is unlikely to adopt any final rules on universal proxy cards before the 2017 proxy season. Whether or not the SEC adopts this rule proposal, however, companies should review their existing proxy disclosure regarding voting standards in director elections and the voting options on their proxy cards for the upcoming proxy season. The changes in this area included in the rule proposal arose from staff concerns that some proxy statements contain ambiguous or inaccurate disclosures and that some proxy cards have presented incorrect voting options.

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If you have any questions or would like to learn more about this proposed rule, please contact your usual legal advisor at Ropes & Gray.