

SEC Proposes Rules Requiring the Use of Universal Proxy Cards in Contested Director Elections

December 6, 2016

Capital Markets and Securities

In late October, the U.S. Securities and Exchange Commission (SEC) proposed long-awaited changes to the proxy rules that would require parties in a contested election of directors to distribute universal proxy cards, i.e., a proxy card that includes director candidates nominated by a company's management as well as those nominated by a shareholder.¹ Under current rules, companies and dissidents use competing proxy cards. This prevents shareholders from voting by proxy for their chosen mix of director candidates by effectively requiring them to choose either management's slate of nominees or the dissident's mix of their nominees and their preferred management nominees. The SEC proposed the new rules in order to more closely align the process of voting by proxy with the way a shareholder would vote in person at a shareholder meeting.

Background

Universal proxy cards have been sought by shareholder activists for many years. The SEC has also long had the universal ballot on its radar, having considered the issue as early as 1992.² In more recent years, the Investor Advisory Committee of the SEC and the Council of Institutional Investors have encouraged the SEC to revisit the topic and explore the implementation of universal proxy cards. Industry commentators have long expected the proposed changes since SEC Chair Mary Jo White asked the SEC staff in June 2015 to draft appropriate rulemaking recommendations on universal proxy ballots.³

¹ The proposed changes include a new Rule 14a-19 under the Securities Exchange Act of 1934 ("Exchange Act") and amendments to the current Rules 14a-2, 14a-3, 14a-4, 14a-5, 14a-6, and 14a-101 under the Exchange Act. The proposing release is available at <https://www.sec.gov/rules/proposed/2016/34-79164.pdf>.

² In 1992, the SEC amended the proxy rules to implement what is known as the "short slate rule," which allows a dissident seeking to elect a minority of the board to "round out its slate" by identifying management nominees that the dissident would not vote for, resulting in the dissident's remaining votes being cast for the management nominees not named by the dissident.

³ See "Building Meaningful Communication and Engagement with Shareholders," June 25, 2015, available at <https://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html>.

Under current proxy rules, a director nominee may only be listed on a proxy card if he or she is a “bona fide” nominee—that is, if he or she specifically consents to being named in the related proxy materials. This means that in contested director elections, one party’s nominee may not be included on the opposing party’s proxy card unless the nominee gives his or her consent to the opposing party. As a practical matter, management director nominees are unlikely to consent to being included on a dissident’s proxy card, and a company is unlikely to seek to include the dissident’s nominees on its proxy card. In a contested election this results in two separate proxy cards. Since, a later-dated proxy card invalidates an earlier-dated proxy card under the corporate law of most states, shareholders voting by proxy in a contested election are effectively limited to choosing either the slate of nominees put forward by management or the slate of nominees put forward by the dissident group. In order to split the vote between management and dissident nominees, shareholders generally would be required to vote in person at the shareholder meeting or appoint a representative to attend the meeting and vote on the shareholder’s behalf.

Highlights of the Proposed Rules

Mandatory Use and Applicable Solicitations: Under the proposed rules, use of a universal proxy card would be mandatory in all non-exempt solicitations in connection with contested elections.⁴ A universal proxy card would be required to include the names of all nominees put forth by both parties. Under the proposal, the definition of “bona fide nominee” in Rule 14a-4(d) would be revised to mean any person who has consented to being named in any proxy statement, whether that of the company or a dissident, relating to the company’s next meeting of shareholders at which directors are to be elected. Under the proposed rules, nominees would still be required to consent to serve if elected. If a nominee intends to serve only if his or her nominating party’s slate is elected, the applicable proxy statement must disclose that fact.

Elimination of the Short Slate Rule: The proposed rules would eliminate the “short slate” rules because universal proxy cards would make it unnecessary for dissidents to round out their partial slates with management nominees. However, dissidents would still be able to recommend their preferred management nominees in the dissident’s proxy materials.

Triggering Notice, Timing Considerations and Filing Requirements: The proposed rules contain various notice and filing requirements, including the following:

- The universal proxy card rules would be triggered only if the dissident notifies the company of its plans to solicit holders of shares representing at least a majority of the voting power of shares entitled to vote on the election of directors;⁵

⁴ The requirement for universal proxy cards would not apply to non-exempt solicitations, including Rule 14a-2(b)(1), which exempts solicitations by any person who does not directly or indirectly seek authority to act as proxy and does not furnish or request a form of revocation, abstention, consent or revocation; and Rule 14a-2(b)(2), which exempts solicitations, other than on behalf of the registrant, where the aggregate number of persons solicited is not more than ten. The proposing release requests comments on whether the proposed rules should apply to all meetings of shareholders, including special meetings.

⁵ Proposed Rule 14a-19 would also require a dissident to state in its proxy materials that it will solicit the holders of shares representing at least a majority of the voting power of shares entitled to vote on the

- The dissident in a contested election must provide notice to the company of its intent to nominate its own director nominees and the names of such nominees no later than 60 calendar days prior to the anniversary of the date of the previous year's annual meeting;⁶
- The company would be required to provide the names of its nominees to the dissident no later than 50 calendar days prior to the anniversary of the date of the prior year's annual meeting;
- The dissident would be required to file its definitive proxy statement with the SEC by the later of 25 calendar days before the meeting date or five calendar days after the company files its definitive proxy statement; and
- Both parties would be required to refer shareholders to the other party's proxy statement for information about the opposing party's nominees and explain that shareholders can access the other party's proxy statement for free on the SEC's website.

Proxy card presentation: Each party would be required to prepare its own universal proxy card. The proposed rules would not require the proxy cards to be identical; rather, each party would be permitted to design its own proxy card so long as the content, format and presentation complies with certain criteria, including:

- The proxy card must clearly distinguish between management nominees, dissident nominees, and any proxy access nominees;
- Within each group of nominees, the nominees must be listed in alphabetical order by last name;
- The same font, style and size must be used to present all nominees;
- The proxy card must prominently disclose the maximum number of nominees for which authority to vote can be granted;
- The proxy card must prominently disclose the treatment and effect of a proxy executed in a manner that grants authority to vote for more, or fewer, nominees than the number of directors being elected, or does not grant authority to vote for any nominees; and
- The proxy card would be permitted to offer the ability to vote for all management nominees or dissident nominees as a group as long as both parties have proposed a full slate of nominees and there are no proxy access candidates.

election of directors. This requirement would mean dissidents must expend their own resources in order to trigger use of the mandatory universal proxy card. The proposing release requests comments on whether the SEC should instead require a dissident to solicit (i) the holders of shares representing at least a majority of the outstanding voting power or (ii) all shareholders, as retail investors holding smaller positions likely would be most impacted by the proposed rules. The proposing release also requests comments on whether dissidents should be required to provide public access to all proxy materials outside of the SEC's EDGAR system.

⁶ Under the proposed rules, the company would be required to include this deadline in its proxy materials, similar to the existing requirement to provide the Rule 14a-8 deadline for shareholder proposals.

Amendments to voting standards disclosure and voting options: The SEC also proposed rules regarding disclosure of voting standards and voting options that would apply to all meetings, not just contested situations, for the election of directors. Specifically, while noting inconsistent and inaccurate disclosures in the way companies presented voting options under plurality or majority voting standards in proxy statements, the SEC proposed amendments to the proxy rules that would mandate changes to proxy cards and the disclosure of these voting standards. For example, if a company has a majority voting standard for the election of directors, the company would have to include an “against” vote on the proxy card instead of an option to “withhold.” In addition, the company would be required to provide shareholders with an “abstain” voting option to address the possibility that the shareholder does not wish to support or oppose a particular nominee. The amendments would also require the proxy statement to spell out the treatment of any “withhold” vote. If a company utilizes the plurality voting standard for the election of directors, the company would be required to disclose in its proxy statement the treatment and effect of a “withhold” vote—specifically, that “withholds” have no legal effect.

Applicable Registrants: The proposed rules would apply to all registrants that have a class of equity securities registered under Section 12 of the Exchange Act and are thereby subject to the proxy rules, but would not apply to registered investment companies or business development companies.

Universal Proxy Card v. Proxy Access

Over the past few years, many companies have adopted proxy access bylaw provisions that permit shareholders meeting certain ownership and other requirements to include their nominees to a company’s board of directors in a company’s proxy materials. The proposed mandatory universal proxy card system differs in material respects from proxy access. The principal distinction between the universal proxy rules and proxy access bylaws is that the proposed universal proxy rules do not provide shareholders or their nominees with access to a company’s proxy materials in the same manner and extent provided by most proxy access bylaws. For example, in addition to the names of their nominees, the typical proxy access bylaw allows a nominating shareholder to include biographical information about their nominee in a company’s proxy materials in addition to a statement in support of their nominee. In contrast, nominees of a dissident shareholder in a contested director election are not included in the company’s proxy materials; the dissident must prepare and file its own proxy materials with the SEC and conduct its own solicitation of shareholders at its own expense. Instead, a company would only be required to include the names of the dissident nominees on its proxy card, not in its proxy statement.⁷

⁷ The company’s proxy materials would not be required to name the dissident nominees, nor include any substantive information about the dissident. Nor would the company be required to include any statements by the dissident in support of its nominees. The Company would only be required to include a statement in its proxy statement directing shareholders to refer to the dissident’s proxy statement for information required by Schedule 14A about the dissident nominees.

What Happens Now?

The SEC is currently seeking comments on the proposed rules.⁸ The deadline for comments is January 9, 2017. Based on the timing of the SEC's proposal and request for comments, it is unlikely that any universal proxy card rule or related changes would be in effect for the Spring 2017 proxy season.

There is also a chance that the SEC's rulemaking effort may be impeded by future legislation. For example, in July 2016, the House of Representatives added language to a spending bill that would have barred the SEC from proposing and finalizing universal proxy rules.⁹ At that time, some Republican members of the House raised the concern that special interests may be able to more easily nominate their preferred candidates to companies' boards.¹⁰ Further, given the results of the 2016 presidential election and upcoming changes at the SEC, the SEC may not adopt final universal proxy card rules in the form proposed or at all.¹¹

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Capital Markets and Securities practice:

Keir Gumbs	+1 202 662 5500	kgumbs@cov.com
David Engvall	+1 202 662 5307	dengvall@cov.com
Ciarra Chavarria	+1 212 841 1112	cchavarria@cov.com
Reid Hooper	+1 202 662 5984	rhooper@cov.com
Frank Wu	+1 212 841 1117	fwu@cov.com

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.

⁸ The SEC has requested comments on over 100 separate questions, many of which relate to whether the mechanics of the proposed rules would effectively meet the SEC's regulatory objectives and whether the proposed rules would create confusion or ambiguity for shareholders.

⁹ See Financial Services and General Government Appropriations Act of 2017, H.R. 5485, 114th Cong. (2015-2016). As of the date of this client alert, H.R.5485 has not passed in the Senate.

¹⁰ The SEC's proposing release expresses similar concerns in that dissident representation on a board could lead to a less effective board of directors. As a result, the SEC is requesting comments on whether the proposed amendments would affect the number of dissident nominees elected to the board and whether such additional dissident representation would enhance or detract from board effectiveness and shareholder value.

¹¹ At present, there are two vacant SEC Commissioner posts, with a third vacancy on its way given the SEC's recent announcement that SEC Chair White is expected to step down at the end of President Obama's term in January 2017. The expected interim SEC Chair, Republican Commissioner Michael Piowar, voted against the universal proxy card rule proposal and has argued in the past that the universal proxy initiative would hurt retail investors and likely increase proxy fights at public companies.