

## SEC Proposes Universal Proxy Cards

October 28, 2016

On October 26, the Securities and Exchange Commission **proposed long-expected changes** to the proxy rules in order to mandate the use of universal proxy cards in contested elections at annual meetings. The proposal is designed to address the current inability of shareholders to vote for the combination of board nominees of their choice in an election involving a proxy contest. Under the proposal, each party in a contested election – management and one or more dissident shareholders – would continue to distribute its own proxy materials and use its own proxy card to solicit votes for its preferred slate of nominees. However, each party’s proxy card would be required to include the nominees of all parties, and thus enable the proxy voter to select its preferred combination of candidates.

The proposal would –

- mandate the use of universal proxy cards for most contested director elections,
- establish notice and filing requirements for both companies and dissidents,
- require dissidents to undertake a minimum solicitation effort, and
- prescribe form and presentation criteria for the proxy card.

What seems clear to us is that the universal proxy would ultimately move the balance of corporate power further from the board and closer to the shareholders. As the SEC observed in the proposing release, “[i]f the proposed amendments result in additional dissident representation, it is difficult to predict whether such additional dissident representation would enhance or detract from board effectiveness and shareholder value.” The SEC is seeking comment from all affected constituencies, including companies, on this critical question. The deadline for comments on the proposal is expected to fall in late December 2016, 60 days after publication of the proposal in the Federal Register. Given the timing of the proposal and comment period, there is little chance that a universal proxy card would be required for the 2017 proxy season.

### Why Is the SEC Acting?

Currently, a shareholder voting by proxy in a contested election is effectively required to choose between the slate of nominees put forward by management and the slate put forward by the dissident. By contrast, a shareholder who attends a meeting in person can pick and choose between directors nominated by management and directors nominated by dissidents. In the SEC’s view this creates a kink in the proxy plumbing, the overarching goal of which is to make proxy voting as close as possible to voting at a shareholder meeting, due to the interplay between two rules –

- **“Bona fide nominee” rule** – Under the SEC’s rules, one party’s director nominee may not be included on the opposing party’s proxy card unless the nominee gives his or her consent to the opposing party. Since this rarely happens, the bona fide nominee rule usually results in two separate proxy cards, forcing a shareholder voting by proxy to choose one slate or the other.
- **“Last in time” rule** – Delaware and other state corporate laws generally provide that the latest proxy revokes any earlier proxy executed by a shareholder. The last-in-time rule therefore effectively stymies a shareholder’s attempt to submit multiple proxy cards to vote for a combination of nominees from different slates, even if the aggregate number of nominees selected is the same as the number of seats up for election.

In 1992, the SEC introduced a modification to the bona-fide-nominee rule to permit a dissident to propose a “short slate” of nominees – that is, a slate where the dissident nominees would constitute a minority of the board – and then to “round out” the dissident proxy card by identifying management nominees that the dissident *would not* vote for, resulting in a proxy voter’s remaining votes being cast for the *unnamed* management nominees. While the short-slate rule allows proxy voters to vote for a combination of dissident and management nominees, albeit in a roundabout way, the shareholder is still unable to mix and match as it sees fit, since the combination of dissident and management nominees is dictated by the dissident.

## Key Features of the Proposal

**Mandatory use.** The proposal would require universal proxy cards for most contested director elections at annual meetings. Each soliciting party would continue to distribute its own proxy materials and its own version of the universal proxy card. The proposal would not require the cards to be identical; rather, each party would be permitted to design its own card so long as the content, format and presentation comply with the proposal’s criteria.

Mandatory use only applies to solicitations that involve a contested election where a dissident is proposing a competing slate of director candidates. However, with the amendment to the bona-fide-nominee rule, a dissident could name all of management’s nominees on a proxy card in order to solicit against their election, or to seek their removal, even without a universal proxy card. A dissident could also solicit for a proposal other than an election of directors but name all of management’s nominees in order to have a proxy card that could be used for all matters to be voted on at the meeting.

Mandatory use also would not apply to “exempt solicitations” under the proxy rules or to registered investment companies or business development companies.

**Revision of the bona-fide-nominee rule.** The proposal would define a “bona fide nominee” as a person who has consented to being named in *any* proxy statement relating to the company’s next meeting of shareholders for the election of directors. The proposal would retain the requirement that a nominee intend to serve, if elected. If a nominee intends to serve only if his or her nominating party’s slate is elected, the proxy statement would need to disclose that fact.

**Elimination of the short-slate rule.** The proposal would eliminate the short-slate rule because universal proxy cards obviate the need for dissidents to round out partial slates with management nominees. Dissidents would however retain the ability to recommend their preferred management nominees in their proxy materials.

**Notice and filing.** The proposal would require a dissident shareholder to provide the company with notice of its intent to solicit proxies and the names of its nominees at least 60 days before the anniversary of the previous year’s annual meeting, or about two to four weeks prior to the time the company would typically mail its proxy statement. The company would then be required to provide the dissident with the names of management’s nominees at least 50 days before that anniversary. The dissident would need to file its proxy statement by the later of 25 days before the meeting date or five days after management files its proxy statement.

**Minimum solicitation effort.** Dissidents would be obligated to solicit holders of shares representing at least a majority of the company’s voting power, which would mean a dissident must expend its own resources in order to trigger use of the mandatory universal proxy card. However, because dissidents would not be required to solicit all shareholders, many shareholders (such as retail investors) may not receive proxy statements containing information about the dissident nominees – thereby decreasing the financial burden on the dissident. The SEC is seeking comment on whether dissidents should be required to solicit all shareholders.

**Presentation and formatting.** The proposal prescribes formatting and presentation criteria intended to ensure that information is presented clearly and fairly.

A universal proxy card would be required to –

- clearly distinguish between management nominees, dissident nominees, and any proxy access nominees,
- within each group of nominees, list the nominees in alphabetical order,
- use the same font type, style and size to present all nominees,
- disclose the maximum number of nominees for which authority to vote can be granted, and
- disclose the treatment 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.

A universal proxy card would be permitted to offer the ability to vote for all management nominees as a group or all dissident nominees as a group, but only if both parties have proposed a full slate of nominees and there are no proxy access candidates.

## Voting Standards Disclosure and Voting Options

The SEC has proposed additional rules governing all meetings, not just contested situations, for the election of directors. Due to concerns that some company proxy statements have ambiguous or inaccurate disclosures about voting standards in director elections, the proposal would mandate changes to proxy cards and the disclosure of those voting standards in the proxy statement.

If a company uses a majority vote standard for the election of directors and a vote cast against a nominee would have legal effect under state law, the proxy card would be required to include the options to vote “against” the nominee and to “abstain” from voting. The company would not be permitted to offer an option to “withhold” against a director.

A company that applies plurality voting standards for director elections, including a plurality voting standard with a director resignation policy (often known as “plurality plus”), would need to disclose in its proxy statement the treatment and effect of a “withhold” vote in the election – namely, that “withholds” have no legal effect.

## How Is This Different From Proxy Access?

Over the past two years, many companies have adopted “proxy access” bylaws that permit shareholders, typically those who have held at least 3% of the company’s shares for at least three years, to nominate candidates for inclusion in the proxy materials distributed by the company.

The SEC acknowledged that some are concerned that a universal proxy card could be viewed as a substitute for proxy access. However, the SEC indicated that significant differences exist. Unlike proxy access, using a universal proxy card would not require a company to include in its proxy materials the names of the nominating shareholder’s nominees, disclosure about the nominating shareholder and its nominees and a supporting statement from the nominating shareholder. Shareholders making nominations under proxy access can rely on the company’s proxy materials and are not required to prepare and file their own proxy materials, disseminate those materials and use them to solicit shareholders.

With universal proxy cards, by contrast, dissidents would need to spend the time and effort and incur the costs to develop their own proxy statements and solicit shareholders. A company need only include dissident nominees on the universal proxy card it uses, and can choose to provide no other information in the company’s proxy materials about the dissident’s nominees.

## What's Next?

The SEC nodded to concerns that have been raised over allowing universal proxy cards, including the potential for investor confusion and the implication that the soliciting party endorses the other party's nominees. Though it believes its proposal addresses these issues, the SEC acknowledged that other unknowns remain, including whether universal proxy cards would have an impact on the number of dissident nominees elected, whether they would increase the frequency of contested elections, and what the impact of these developments would be on board effectiveness and, ultimately, shareholder value. The SEC is seeking comment on all of these questions, and the responses it receives could shape any final rules in ways that differ materially from the proposal.

We expect the proposal to generate a lively debate among companies, institutional investors and shareholder advocates. The timing of the proposal, coming in the final days of the Obama Administration, suggests that any definitive action on universal proxy cards may be left to an SEC composed largely of newly appointed members, who may have priorities and concerns that differ from the current commissioners.

Whether or not the SEC adopts its proposal, it would make sense for companies to review their disclosure about voting standards and voting options on their proxy cards for the upcoming proxy season. The SEC staff has expressed concerns that some proxy statements contain ambiguities or inaccuracies under existing law and the Division of Corporation Finance may issue comments in advance of the final rules when it thinks companies may be making inaccurate disclosures.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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