

SEC Proposes Universal Proxy Cards in Contested Director Elections

The Securities and Exchange Commission (“SEC”) recently proposed amendments to the federal proxy rules that would impose mandatory use of a universal proxy card in election contests.¹ The proposed amendments would require each proxy card to include the names of all nominees named in any proxy statement. Thus, the registrant proxy card would include its own nominees and the nominees of any dissident shareholder, and vice versa. The proposed amendments are intended to enable shareholders who vote by proxy to be able to express their preference nominee by nominee, among all nominees, to replicate the voting rights a shareholder would have if the shareholder voted in person by ballot at a shareholder meeting.

The proposed amendments would also add new procedural and disclosure requirements to effect the use of a universal proxy. Furthermore, they would require additional disclosure and clarity on proxy cards with respect to voting options.

I. Background

The Voting by Proxy Process

Regulating the proxy process remains a prime concern for the SEC, since today most shareholders of companies registered under the Exchange Act vote not in person but rather through the proxy system.² Over the years, various proposals, reports, and comments have devoted serious time and attention to shareholders’ ability to exercise their rights through the proxy process.³ Despite past efforts to make the proxy process align with in-person voting at shareholder meetings, the current proxy rules differ in important ways from in-person voting. For example, shareholders who vote at a shareholder’s meeting have the option of selecting from among all duly nominated candidates. In contrast, shareholders who vote by proxy are provided the opportunity to vote for the slate of candidates listed on the proxy card provided to them by the party soliciting their vote.

Rule 14a-4(d)(1), otherwise known as the “bona fide nominee rule,” imposes certain restrictions on the nominees who can be named on a proxy card.⁴ The SEC defines a bona fide nominee as a nominee who has “consented to being named in the proxy statement and to serve if elected.”⁵ In an election contest, a party is only permitted to include on its proxy card the nominees named in its own proxy statement. In order to include the other party’s nominees, the other party’s nominees would have to consent to be named.⁶ The SEC notes that this

¹ “SEC Proposes Amendments to Require Use of Universal Proxy Cards” Release No. 34-79164; File No. S7-24-16 (Oct. 26, 2016) (the “Release”), available at <https://www.sec.gov/rules/proposed/2016/34-79164.pdf>. The SEC is seeking comments to the proposed rules which must be received no later than 60 days after date of publication in the Federal Register.

² In a 2015 public statement, SEC Commissioner Luis A. Aguilar noted that “the days of shareholders coming together, sitting in a room and talking one-on-one with the directors and officers running their companies are long gone.” Because voting by proxy has become the primary method of shareholder voting, Aguilar noted that the proxy statement process should attempt to replicate in-person voting to the fullest extent possible. See Luis A. Aguilar, *Ensuring the Proxy Process Works for Shareholders*, SEC.GOV (Feb. 19, 2015), <https://www.sec.gov/news/statement/021915-psclaa.html>.

³ For example, in the 1990s, the SEC extensively examined the process of voting by proxy. This examination led to several amendments to the federal proxy rules that reduced regulations on shareholder communications and exercise of voting rights. See Release at 6-7.

⁴ 17 CFR 240.14a-4(d)(1).

⁵ 17 CFR 240.14a-4(d)(4).

⁶ The SEC has noted in the past that the bona fide nominee rule is problematic because under the rule, shareholders cannot

rarely, if ever, happens.⁷ Since state law provides that the most recently delivered valid proxy card controls, shareholders must attend meetings in person and vote by ballot if they desire to vote for a mix of both registrant and dissident nominees.⁸

The Short Slate Rule

In 1992, the SEC adopted Rule 14a-4(d)(4), referred to as the “short slate rule.” Since only one proxy card can control a shareholder vote, the rule was enacted to allow dissidents who put forth a partial slate of nominees to also solicit proxy authority to elect some of the registrant nominees in order to elect a complete slate using the dissident proxy card.⁹

While the short slate rule does enable shareholders to vote for all seats up for election in a contested election, the rule is limited in its scope. The rule applies only where a dissident is seeking election of a minority of the board. Furthermore, the dissident—not the shareholder—is authorized to select by proxy the specific registrant nominees to vote for under the short slate rule.

II. Permitted Use of Universal Proxy Card

In an attempt to make the proxy process align more closely with in-person voting, the SEC has proposed revisions to Rules 14a-4(d)(1) and 14a-4(d)(4) to permit the use of a universal proxy card. Under the amended Rule 14a-4(d)(1), a bona fide nominee would be defined as “a person who has consented to being named in a proxy statement relating to the registrant’s next meeting of shareholders at which directors are to be elected” [emphasis added].¹⁰ In other words, the nominee must consent to being named in any proxy statement, rather than, as the rule currently provides, only the proxy statement of the soliciting party. This change would permit, but not require, a registrant or dissident to include the other nominees on its proxy card if it so desired, without specific consent from the other nominees.

In the proposing release, the SEC discusses several potential issues that have been raised regarding implementing this voluntary use of a universal proxy card. One major concern raised by registrants over use of a

“split their tickets” and vote for a combination of registrant nominees and dissident nominees. Shareholders who attempted to split their tickets were often disenfranchised, as their votes would be declared void. See Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots, SEC.GOV, 2 (July 25, 2013), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf>.

⁷ The SEC offers several explanations for this phenomenon, including the fact that nominees refuse to be included on the opposing party’s proxy card “because of a perceived advantage to forcing shareholders to choose between the competing slate of nominees.” See Release at 11.

⁸ The SEC notes that under the current proxy rules, “shareholders . . . are therefore effectively required to submit their votes on either the registrant’s or the dissident’s proxy card and cannot pick and choose from nominees on both cards.” As such, shareholders who vote by proxy do not have the opportunity to vote based on preference alone. See id.

⁹ A 2003 SEC Staff Report explained the rule as follows:

[I]f a shareholder wishes to nominate only two candidates to a seven person board, [the short slate rule] permits the shareholders to choose five of management’s nominees to fill out his or her ballot, provided that the shareholder does not name those management nominees on his or her proxy card, but instead names only those management candidates that the shareholder is opposing. See Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, SEC.GOV, 4 (July 15, 2003), <https://www.sec.gov/news/studies/proxyreport.pdf>.

¹⁰ See Release at 25. This seemingly small revision materially alters the definition of a “bona fide nominee.”

universal proxy card is that by naming the dissident's nominees on the registrant's proxy card, voters might be misled into thinking that the registrant supports these nominees.¹¹ The SEC noted, therefore, that the voluntary use of a universal proxy card is unlikely to benefit shareholders in most cases, because the registrant and dissident will unlikely cede to the other any advantage a universal proxy card might be perceived to have. In an attempt to remedy the concerns that have been raised over voluntary use of a universal proxy card and to ensure shareholders can benefit from a universal proxy card, the SEC is proposing a mandatory system for universal proxies in election contests.¹²

III. Proposed Rule 14a-19 – Mandatory Universal Proxy Card

The crux of the SEC's proposal is the adoption of proposed Rule 14a-19. Rule 14a-19 would provide that a soliciting party could not solicit proxies in favor of director nominees other than the registrant's nominees unless the party meets the rule's requirements. Specifically, the dissident must provide to the registrant, no later than 60 calendar days prior to the anniversary of the previous year's meeting, the names of all nominees for whom the dissident intends to solicit proxies. In turn, no later than 50 calendar days prior to the anniversary of the previous year's meeting, the registrant must provide the dissident with a list of names of all nominees for whom the registrant intends to solicit proxies. The proxy cards of the registrant and the dissident must list all of the nominees: the registrant must list all dissident nominees on its proxy card, and the dissident must list all registrant nominees in its proxy card. This would ensure that a shareholder voting by proxy can elect the nominees it desires among both slates, up to the maximum number of director seats being filled in that election, just as it would be able to do if the shareholder voted in person.

In order for a dissident to solicit proxies under proposed Rule 14a-19, the dissident shareholder must certify that it intends to solicit proxies from at least a majority of the shareholders entitled to vote. The SEC explained that "without a minimum solicitation requirement, mandatory universal proxy could enable dissidents to capitalize on the registrant's solicitation efforts and relieve dissidents of the time and expense necessary to solicit sufficient support for its nominees to win a seat on the board of directors."¹³

Furthermore, proposed Rule 14a-19 would require the dissident shareholder to file its proxy statement 25 days before the shareholder meeting or five days after the registrant files its proxy statement, whichever is later. The SEC has proposed this requirement to provide shareholders with sufficient time to access information about all nominees.

¹¹ Other concerns include forcing nominees to lend their name and reputation to the opponent's campaign and legitimizing the dissident nominees by placing them on a registrant's proxy card. See id. at 26.

¹² The mandatory use of a universal proxy card would not apply to exempt solicitations in a contested election where a shareholder is soliciting proxies in support of dissident nominees. See id. at 45. Exempt solicitations include solicitations involving investment companies registered under Section 8 of the Investment Company Act of 1940 and business development companies. See id. at 88.

¹³ See id. at 62. However, there are several issues that will likely arise with a mandatory universal proxy system. For example, under the proposed rule, a dissident is essentially barred from initiating an election contest that is less than 60 calendar days prior to the annual meeting. The SEC addresses this problem by noting that contests rarely arise during this time frame and that such contests are usually prohibited by advance notice requirements that the registrant sets forth in its organizational documents. Another issue with the proposed rule is that a dissident might provide the notice required under the rule but then choose to abandon its efforts to solicit proxies. The SEC has proposed that in this situation, a registrant could distribute an updated, non-universal proxy card that includes only the registrant nominees. See id. at 54-55.

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In addition to the procedural requirements discussed above, proposed Rule 14a-19 specifies certain technical requirements that soliciting parties must follow. For example, in order to avoid shareholder confusion, under the proposed Rule proxy cards must clearly identify the registrant nominees and the dissident nominees; they must list all of the nominees on the card in the same font type, style, and size; and they must list each group of nominees in alphabetical order by last name.¹⁴

IV. Short Slate Rule Eliminated

The proposing release would eliminate the short slate rule. Because a mandatory universal proxy card would be required under proposed Rule 14a-19, a dissident proposing a minority slate would no longer need proxy authority to vote for any of the registrant nominees to fill the other open seats. Shareholders would be able to do this directly on the face of the universal proxy card.

V. Other Voting Options Amendments

The SEC also proposed amendments to clarify voting options that would apply to all director elections. The overall purpose of these amendments is to enable shareholders to more clearly understand the consequences that “withhold” votes have on an election’s outcome.¹⁵ These proposals include:

- amending Rule 14a-4(b) (1) to require an “against” voting option rather than a “withhold authority to vote” option on the proxy card for director elections where there is a legal effect to votes cast against a director nominee and (2) to allow shareholders to “abstain” in a director election governed by a majority voting standard if such shareholders are neutral toward a director nominee; and
- amending Item 21(b) of Schedule 14A to mandate the disclosure of a “withhold” vote’s effects.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jonathan I. Mark at 212.701.3100 or jmark@cahill.com; or John J. Schuster at 212.701.3323 or jschuster@cahill.com.

¹⁴ The SEC notes that it considered providing more flexibility in terms of font type, style, and size and order of nominees. However, the SEC rejected this consideration. It believed that specific guidance was required for a universal proxy card because a more flexible approach had the potential to mislead or confuse shareholders. *See id.* at 78.

¹⁵ The SEC discussed that an assessment of the proxy statement voting standard disclosure of a wide range of companies was a factor in the SEC’s decision to propose these revisions. The assessment found that the absence and/or misuse of an “against” option created issues in voting. For example, “the failure to include an ‘against’ option on the form of proxy when a majority voting standard is used” and “the mistaken use of the ‘against’ option on a form of proxy when there was a plurality voting standard, where the only appropriate alternative for voting was ‘withhold’”, led to ambiguities or inaccuracies. *See id.* at 85.