

## CLIENT MEMORANDUM

# SEC Proposes Universal Proxy Requirement for Contested Elections of Corporate Directors

November 10, 2016

## AUTHORS

**David Boston** | **Jeffrey Hochman** | **Manuel Miranda** | **Robert Rachofsky** | **Michael Schwartz** | **Steven Seidman**

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The Securities and Exchange Commission (the “SEC”) recently proposed amending its proxy rules to require the use of universal proxy cards in solicitations involving contested elections of directors for which proxy statements are required to be delivered.<sup>1</sup> This proposal provides a convenient way for shareholders to “split their votes” between competing slates of director nominees and has long been on the wish list of institutional investors.

### **The Problem with Today’s Proxy Cards**

In a contested election of directors between a management slate of nominees and a full slate presented by a “dissident” shareholder, each side will prepare its own proxy materials and name in its proxy card only its own nominees. Shareholders receive both management and dissident proxy cards, but only one of those cards will be given effect — even if both are signed — because a later-dated proxy card will revoke an earlier-dated one. As a result, shareholders that vote by proxy under today’s rules are forced to choose one slate of nominees or the other and generally cannot split their votes between the competing slates.

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<sup>1</sup> SEC Release No. 34-79164, *Universal Proxy*, <https://www.sec.gov/rules/proposed/2016/34-79164.pdf> (October 26, 2016).

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The inability of a shareholder voting by proxy to split its vote is effectively ordained by the SEC's "bona fide nominee" rule, which prohibits the inclusion of a nominee in a proxy card unless the nominee has consented to be named in the soliciting person's proxy statement and to serve as a director if elected.<sup>2</sup> As a practical matter, management nominees do not consent to be named in dissident proxy statements, and vice versa, because in any election one side or both sides are likely to perceive an advantage in forcing shareholders to choose between the slates rather than among individual nominees from both sides. Neither side is likely to include the other's nominees on its proxy card unless the other side reciprocates because neither would want the other's nominees to be included on both cards while its own nominees are included only on its own card.

The one exception to the bona fide nominee rule is known as the "short-slate" rule. Under the short-slate rule, a dissident shareholder that is not seeking to elect a majority of the board (a "short slate") is permitted to include management nominees on its card, in a back-handed way, in order to round out its slate and enable shareholders voting on the dissident card to vote for the full number of board seats up for election.<sup>3</sup> While this rule allows shareholders to vote by proxy and split their votes, it is the dissident shareholder, not the shareholder voting by proxy, that decides which management nominees the shareholder can vote for.

### The Universal Proxy Solution

If a shareholder wishes to split its vote between competing slates in an election contest, the only practical way to do so today is to obtain a "legal proxy," attend the meeting and vote in person.<sup>4</sup> This can be very inconvenient and, as a practical matter, is rarely done. However, by attending the meeting and voting in person, a shareholder can vote on a "universal ballot" containing the names of all nominees from both slates and can pick and choose among them. The guiding principle of the SEC's universal proxy proposal is to replicate a shareholder's ability to split votes as though the shareholder voting by proxy was attending a shareholders meeting in person and voting on a universal ballot.

### The SEC's Universal Proxy Proposal

The universal proxy rules proposed by the SEC (the "Proposed Rules") apply to all contested director elections for which the SEC's proxy rules require the delivery of a proxy statement, other than those involving solicitations at registered

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<sup>2</sup> Rule 14a-4(d)(1) under the Securities Exchange Act of 1934 (the "Exchange Act").

<sup>3</sup> Proviso to Exchange Act Rule 14a-4(d). Under the short-slate rule, a dissident shareholder is permitted to state that its proxy card will be voted for all management nominees other than those that the dissident shareholder specifies.

<sup>4</sup> Only "record holders" of shares and their authorized proxies can vote in person at a shareholders meeting. A shareholder that holds its shares in "street name" is not a record holder and needs to obtain a "legal proxy" from its bank, broker or other nominee in order to obtain authority to vote in person at a shareholders meeting.

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investment companies and business development companies.<sup>5</sup> Under the Proposed Rules, a shareholder is prohibited from conducting a non-exempt solicitation of proxies for director nominees other than those nominated by the company unless the shareholder triggers the rules by delivering to the company a notice that names each of the nominees for whom it intends to solicit proxies and states the shareholder's intention to solicit a majority of the eligible voting power in favor of those nominees.<sup>6</sup> Once the notice is delivered, both the shareholder and the company can solicit for the election of directors only with universal proxy cards.

**Notification Requirements.** Under the Proposed Rules, the shareholder's notice must be postmarked or transmitted electronically no later than 60 days prior to the first anniversary of the previous year's annual meeting or, if the company did not hold an annual meeting or has changed the meeting date by more than 30 days from the previous year's meeting date, by the later of 60 days prior to the meeting date and the tenth day following the day of the first public announcement of the meeting date. This notice is required in addition to any notice required under the company's governing documents, but is not required if the information has been included by the shareholder in a previously filed preliminary or definitive proxy statement.

Following receipt of a dissident shareholder's notice, the company is required to notify the shareholder of the names of the nominees for whom the company intends to solicit proxies. This notice must be sent no later than 50 days prior to the first anniversary of the previous year's annual meeting or, if the company did not hold an annual meeting or has changed the meeting date by more than 30 days from the previous year's meeting date, no later than 50 days prior to the meeting date.

**Minimum Solicitation Efforts.** In the solicitation, the dissident shareholder must solicit proxies from shareholders representing a majority of the voting power entitled to vote on the election of directors. This requirement is designed to avoid a dissident shareholder's "free riding" on the registrant's proxy materials, which under the Proposed Rules must include the dissident nominees. The dissident shareholder is required to file its definitive proxy statement by the later of 25 calendar days before the meeting date or five calendar days after the registrant files its definitive proxy statement in order to ensure that shareholders have the opportunity to obtain timely information about all nominees standing for election.

**Clear Presentation.** The Proposed Rules also contain requirements designed to ensure that universal proxy cards present all candidates in a clear and impartial manner, using the same font, size and style for all nominees. The rules require universal proxy cards to distinguish clearly between the competing slates of nominees and, within each slate, to list the nominees alphabetically by last name. If a soliciting person chooses to provide a means by which shareholders can vote for all of the nominees it is supporting, the same means must be provided for any competing slates.

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<sup>5</sup> Certain activities that constitute "solicitations" under the SEC's proxy rules, such as solicitations where proxy authority is not sought or where proxies are sought from 10 or fewer shareholders, may be exempt from the requirement to deliver a proxy statement and would not be subject to the Proposed Rules.

<sup>6</sup> Proposed Exchange Act Rule 14a-19.

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**Modification of Bona Fide Nominee Rule; Elimination of Short-Slate Rule.** In order to permit the use of universal proxy cards, the Proposed Rules would amend the bona fide nominee rule, which allows a nominee to be included on a proxy card only if the nominee has consented to be named in *the soliciting person's* proxy statement. As amended, the bona fide nominee rule would provide that a nominee can be included on a proxy card if the nominee has consented to be named in *any* proxy statement relating to the election. The Proposed Rules would not amend the bona fide nominee rule for solicitations relating to registered investment companies and business development companies since those registrants are excluded from the universal proxy mandate. With this change to the bona fide nominee rule, the short-slate rule would be eliminated by the Proposed Rules as no longer necessary (except for registered investment companies and business development companies) — dissidents would not need to round out their slates with company nominees because their proxy cards would be required to include all company nominees.

**Voting Options.** Alongside its universal proxy proposal, the SEC has proposed several changes to proxy cards that apply to all elections of directors, whether or not contested. Where state law gives effect to a vote “against” a director nominee, the SEC proposes to require an “against” voting option in lieu of a “withhold authority to vote” option. For example, if a company’s directors are elected only if they receive a majority of the shares voted, thus giving legal effect to a vote against a nominee, proxy cards would be required to include a means to vote “against” the nominee and a means to abstain from voting and would not be permitted to include a “withhold” option. If “against” votes are not given legal effect, such as where a company’s directors are elected by a plurality vote, the “withhold authority to vote” option would continue to be required. In conjunction with this change, the SEC is proposing to expand the currently required proxy statement disclosure as to the treatment and effect of abstentions and broker non-votes by requiring disclosure, where applicable, of the treatment and effect of the “withhold authority to vote” option.

### Looking Forward

If the Proposed Rules are adopted substantially as proposed, shareholders will be free to pick and choose among all nominees for election to the board, without regard to which side has nominated them. This freedom may make it more likely that shareholders will elect directors from both (or multiple) competing slates in contested board elections.

Beyond that, the Proposed Rules raise many tactical considerations for contested board elections. For example, unlike in short-slate contests today, it may become harder for dissident shareholders to target specific management nominees. Under the existing short-slate rule, which would be eliminated by the Proposed Rules, if three directors are to be elected and a dissident shareholder nominates a single nominee and rounds out its slate with two management nominees, the dissident has effectively targeted the management nominee that it does not include on its proxy card. In the same scenario under the Proposed Rules, targeting cannot take place in the same manner because all nominees from each slate must appear on the proxy card.

In addition, in cases where the full board is up for election, dissident shareholders may be more inclined under the Proposed Rules to nominate candidates for all or a majority of the board. Currently, dissident shareholders may resist

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running nominees for a majority or all of the board because the bar is much higher for obtaining shareholder support for a majority board change as compared to electing a single director or minority contingent from the dissident's slate. If a dissident shareholder nominates a majority of the board, shareholders that oppose a majority board change would likely vote on management's proxy card, which does not include dissident nominees. Under the Proposed Rules, there would be no such disincentive for nominating a majority of the directors up for election since all nominees would be included on all proxy cards.

The SEC is soliciting comment on all aspects of the Proposed Rules, specifically identifying 75 different topics on which it seeks the public's views. Comments are due by January 9, 2017, 60 days following publication of the proposal in the Federal Register. Given this timing, it is likely that the Proposed Rules, if adopted, will not be effective for the 2017 proxy season.

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If you have any questions regarding this memorandum or would like to submit comments on the Proposed Rules, please contact David Boston (212-728-8625, [dboston@willkie.com](mailto:dboston@willkie.com)), Jeffrey Hochman (212-728-8592, [jhochman@willkie.com](mailto:jhochman@willkie.com)), Manuel Miranda (212-728-8747, [mmiranda@willkie.com](mailto:mmiranda@willkie.com)), Robert Rachofsky (212-728-8088, [rrachofsky@willkie.com](mailto:rrachofsky@willkie.com)), Michael Schwartz (212-728-8267, [mschwartz@willkie.com](mailto:mschwartz@willkie.com)), Steven Seidman (212-728-8763, [sseidman@willkie.com](mailto:sseidman@willkie.com)) or the Willkie attorney with whom you regularly work.

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November 10, 2016

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