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The SEC Speaks in 2016: Division of Corporation Finance Panel – Proxy Season

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By: Garrett A. DeVries, John Goodgame, Bruce S. Mendelsohn, Rosa A. Testani, Daniel G. Walsh

As explained by Michele Anderson, associate director in the Office of Disclosure Operations, universal proxy balloting contemplates a single proxy card in contested elections that includes both the company's slate of directors and an outside party's slate of directors. In January 2014, the Staff received a rulemaking proposal from the Council of Institutional Investors requesting that universal proxy balloting be mandatory in all contested elections. Before that, the Investor Advisory Committee recommended that the SEC provide the ability for parties to use universal proxy balloting at their option in certain short-slate director nominations. Last year, the SEC held a roundtable to discuss potential improvements to the proxy voting process, including universal proxy balloting. Per Anderson, a common theme in the discussions was that the proxy rules should allow shareholders to do by proxy what they can do by attending a shareholders meeting in person. Several panelists agreed that the current iteration of rules is not achieving this goal in contested elections.

Based on these discussions, as well as suggestions from outside commenters Chair White asked the Staff to develop rules related to universal proxy balloting for the SEC's consideration. Anderson stated that it is far too early to speculate on what actions the SEC may take on the Staff's proposals. However, she did offer several insights from the Staff's efforts, namely that:

- it was looking at the issue from the vantage point of a shareholder who wants to vote for a mix of directors that would best serve the company
- it does not favor the position of the company or outside party and that, in any event, it is not clear that universal proxy balloting would favor one or the other anyway

- it is cognizant of situations where control of the board of directors may be at stake.

Anderson then noted that the key issues being considered were:

- whether universal proxy balloting should be optional or mandatory, and under what circumstances
- when universal proxy balloting should be permitted or required (e.g., every election or only when minority control of the board is at stake)
- what a universal proxy card would look like (e.g., both sides being identical or each side tailored to the party's suiting).

Shareholder Proposal Season

Rule 14a-8 of the Securities Exchange Act of 1934 (the "Exchange Act") establishes a process for shareholders to submit proposals for inclusion in company proxy materials and provides certain bases under which companies may exclude such proposals. Per Rule 14a-8, a company must include a shareholder proposal in its proxy materials, unless it violates one of the rule's eligibility and procedural requirements or falls within one of the rule's 13 substantive bases for exclusion. During each proxy season, the Staff considers the arguments of companies seeking the exclusion of shareholder proposals and issues "no-action" relief to companies in instances where exclusion is appropriate. Frederickson, whose office oversees the Rule 14a-8 process, initiated his remarks by noting that the volume of no-action letters seeking exclusion of shareholder proposals was down significantly from recent years. Also, as compared to 2015, which saw significant developments with respect to the exclusions for "conflicting proposals" and "ordinary business decisions" that culminated in the issuance of Staff Legal Bulletin No. 14H in October 2015, Frederickson stated that the 2016 shareholder proposal season has been fairly quiet.

Frederickson did note, however, that the Staff recently granted no-action relief to 15 companies seeking to exclude proxy access shareholder proposals under Rule 14a-8(i)(10) on the basis that the companies already had "substantially implemented" the shareholder proposal. The companies' proxy access bylaws and the shareholder proposal proxy access bylaws each had three-year and three percent ownership standards, but the companies' access bylaws differed, for example, on aggregation limits and the maximum number of proxy access candidates. Frederickson explained that the Staff will grant relief even when the company's proxy access bylaw deviates from the shareholder proposal so long as differences are limited to less material aspects of the access bylaw. In light of the no-action letters and

Frederickson's remarks, it seems that the Staff will grant relief when the company's proxy access bylaw deviates from the shareholder proposal in one or both of the following respects:

- limiting the number of shareholders permitted to aggregate (e.g., no more than 20 shareholders), while the shareholder proposal expressly requires "unrestricted aggregation"
- limiting the maximum number of proxy access candidates to 20 percent or 25 percent of the board of directors (rounding down) without also setting a minimum number of access candidates that the company must include, while the shareholder proposal expressly requires that the company include access candidates representing the greater of a percentage of the board or a minimum number (e.g., the greater of 25 percent of the board or two).

Disclosure of Voting Standards and Elections

In recent years, companies have shifted their election of directors from a plurality standard to a plurality-plus standard or a majority voting standard. In a plurality-plus regime, director nominees agree in advance to resign if they receive a majority of "withhold" votes. At that point, the remaining directors have the discretion whether to accept or reject such director's resignation. In a majority voting regime, director nominees are elected only if a majority of the votes cast are in favor of the nominee.

Anderson noted that the Staff has been concerned with the disclosures regarding voting standards in director elections, specifically the lack of clarity or accuracy in some instances. She highlighted that the disclosure requirements for director election voting are found in Rule 14a-4 of the Exchange Act and Item 21 of Schedule 14A. Per Rule 14a-4, a form of proxy is to provide a means to "withhold authority to vote for each nominee." As a result, proxy cards under a plurality standard offer shareholders the ability to vote "for" a nominee or "withhold" his or her vote; there is no ability to vote "against" a nominee. However, Anderson stated, if applicable state law gives legal effect to votes cast against a nominee, such as under a majority voting standard, then companies should provide a means for a shareholder to vote "against" a nominee in lieu of, or in addition to, an ability to "withhold" a vote. Item 21 of Schedule 14A merely calls for disclosure of the method by which votes will be counted.

According to Anderson, last year, the SEC received two rulemaking petitions related to director election voting disclosures. Both petitioners highlighted what they believed were ambiguities or inaccuracies related to voting standard disclosures in a number of proxy statements. In light of these concerns, and with the help of the Division of Economic and Risk

Analysis, the Staff performed an assessment of the quality of voting standard disclosure among a broad, statistically significant sample size of companies. While some inaccuracies were identified, the bulk of the disclosure was not incorrect, but rather ambiguous or less than ideal. The areas of concern include:

- companies that mistakenly use the "against" option when directors are elected by plurality voting
- companies that do not provide an "against" option when directors are elected by majority voting
- companies that disclose that they have adopted majority voting when they actually have "plurality-plus" policies (by which directors offer to resign if they have a majority of withhold votes)
- companies that indicate that withhold votes count in director elections, but do not discuss the impact that withhold votes will have on the outcome of the election.

In closing, Anderson stated that the Staff will continue to monitor this area and consider whether additional action is needed. If action is needed, Anderson noted that it may coincide with the decision on what action, if any, to take with respect to universal proxy balloting. In the interim, she encouraged companies to review their proxy statement disclosures regarding the requisite voting standards and the voting choices on their proxy cards to determine whether changes or enhancements are warranted.

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