

“Proxy Access on Steroids” — Sidley Sends Formal Comment Letter on the SEC’s Universal Proxy Proposal

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On June 7, 2021, the leaders of Sidley Austin LLP’s Shareholder Activism & Corporate Defense Group sent a formal comment letter regarding the recent proposal of the U.S. Securities and Exchange Commission (SEC) to adopt a universal proxy (File No. S7-24-16) under the Securities Exchange Act of 1934 (as amended, the Exchange Act) (the Proposed Rule). We summarize our comments in this article (our full 20-page comment letter, including citations, can be reviewed [here](#)).

Since proxy contests are the context in which universal proxy cards would be used, we believe that our experience affords us with relevant perspectives on legal, procedural, and practical considerations. We have been involved in over 85 proxy contests in the past five years, more than any other law firm representing companies. In 2020, Sidley was ranked as the No. 1 legal advisor to companies in proxy contests by number of representations in the league tables maintained by *Bloomberg*, *FactSet*, *Refinitiv* (formerly *Thomson Reuters*), and *Activist Insight*.

We believe the Proposed Rule, as drafted, is the equivalent of “proxy access on steroids.” Compared to Rule 14a-8 and the vacated “proxy access” Rule 14a-11, the Proposed Rule would confer substantially greater rights to shareholders. However, unlike Rules 14a-8 and 14a-11, the Proposed Rule does not contain any minimum ownership and holding requirements or related restrictions on the right of use. Therefore, we recommend that the SEC revise its proposal to require that a shareholder has continuously held at least 3% of the total voting power of a registrant’s securities for at least three years in order to request the use of a universal proxy card. We also recommend that the SEC add certain other limitations on the right to use universal proxies, as it has done with Rule 14a-8 and Rule 14a-11.

Our comment letter discusses (1) the aforementioned lack of minimum ownership requirements and related restrictions, (2) various other aspects of the SEC’s universal proxy card proposal, and (3) certain longstanding issues with the existing federal proxy rules.

1. Lack of Minimum Ownership Requirements and Related Restrictions

One could argue that the Proposed Rule is effectively “proxy access on steroids.” After all, compared to Rules 14a-8 and 14a-11, the Proposed Rule confers on shareholders substantially greater rights: The maximum effect of a shareholder proposal under Rule 14a-8 on corporate

control and policy is that shareholders would approve a nonbinding advisory proposal. The maximum effect of a proxy access nomination on corporate control and policy is that at any given annual meeting, a 3% or greater shareholder who has held the stock for three years or more can nominate a number of directors not exceeding 20% of the total number of authorized board seats. By contrast, under the Proposed Rule, a dissident shareholder faces almost no limitations in exercising a rule that would allow it to replace the *entire* board of directors. Even if the dissident were to fail drastically in one year, or for five years in a row (for example, by receiving less than 1% of the vote for its nominees each time), or use its universal proxy right for facially inappropriate reasons, the shareholder would face almost no limitations when seeking to do the same in future years. However, unlike Rules 14a-8 and 14a-11, the Proposed Rule does not contain any minimum ownership and holding requirements or related restrictions on the right of use.

In light of the foregoing, we recommend that the Proposed Rule require that a shareholder has continuously held at least 3% of the total voting power of a registrant's securities for at least three years in order to request the use of an universal proxy card. Imposing such minimum share ownership and holding requirements, as well as related restrictions on the right of use in a manner comparable to Rule 14a-11 and Rule 14a-8, would promote good faith use of the shareholder right afforded by the Proposed Rule and guard against undue imposition on registrants and shareholders of the costs and distractions associated with dissident director nominations.

The only credible counterargument against limitations on the universal proxy card might be that the Proposed Rule, unlike Rule 14a-8 and Rule 14a-11, requires a dissident shareholder to file and disseminate its own proxy statement. However, in practice, the effort and cost of preparing a proxy statement is not significant for a dissident. Rule 14a-5(c) allows dissidents to omit from their proxy statement any information contained in the proxy materials of the registrant. In practice, most dissidents rely on that rule, resulting in comparatively brief and straightforward dissident proxy statements. Also, the Proposed Rule would require a dissident to solicit only a majority (but not all) of the shares entitled to vote on the election of directors. Last, the Proposed Rule would permit dissidents to use the "notice and access" rule, which allows sending only a one-page notice of the online availability of proxy materials. As a result of the foregoing, the proxy statement requirement does not appear to justify the significantly different treatment of the Proposed Rule when compared to Rule 14a-8 and Rule 14a-11.

The below chart summarizes the inconsistencies between Rule 14a-8 and vacated Rule 14a-11 (and most proxy access bylaws), on the one hand, and the Proposed Rule on the other.

	Rule 14a-8	Vacated Rule 14a-11 (And Most Proxy Access Bylaws)	Proposed Rule
Access to registrant's proxy card	Yes	Yes	Yes
Shareholder right	Shareholder proposals (no director nominations)	Director nominations (no shareholder proposals)	Director nominations (no shareholder proposals)

Binding nature of shareholder vote	Nonbinding	Binding	Binding
Ownership requirements	Shares worth \$2,000 (for 3 years) \$15,000 (for 2 years) \$25,000 (for 1 year)	3%	1 share
Minimum holding requirements	1-3 years (see above)	3 years	None
Use restrictions	Various use restrictions	20% of total authorized board seats	None
Dissident proxy statement requirement	No	No	Yes

2. Comments on Other Aspects of the Proposed Rule

In our comment letter, we offer the following additional comments on certain other aspects of the Proposed Rule:

- The Proposed Rule would require a dissident shareholder to provide the registrant with the names of the nominees for whom it intends to solicit proxies no later than 60 calendar days prior to the anniversary of the previous year's annual meeting date. We recommend that the Proposed Rule, if adopted, instead establish a minimum deadline of the earlier of (i) 90 days prior to the meeting anniversary and (ii) the nomination deadline set forth in the registrant's bylaws or other organizational documents. The proposed 60-day deadline would provide companies with a significantly shorter window to review dissident director nominations than is provided by the bylaws of the vast majority of publicly traded companies in the U.S. that have adopted advance notice bylaws. Approximately 87% of such companies set a minimum deadline of 90 days or more for director nominations.
- The Proposed Rule would require a registrant to provide the dissident with the names of the nominees for whom the registrant intends to solicit proxies no later than 50 calendar days prior to the anniversary of the previous year's annual meeting date. We believe the Proposed Rule should be revised to eliminate this requirement as the existing proxy rules already facilitate sufficient notice to dissident shareholders and provide needed flexibility to registrants.
- The proposed form of universal proxy card under the Proposed Rule presents more opportunities for shareholder confusion than are recognized. The presentation and formatting requirements for the proposed form of proxy in the Proposed Rule are a step in the right direction but would not, alone, sufficiently mitigate the potential for shareholder confusion.

- We generally support a change to the definition of a bona fide nominee by the Proposed Rule, but the amended definition should apply only to proxy contests for director candidates and not to other types of campaigns.
- To promote good faith use of the shareholder right afforded by the Proposed Rule and guard against the undue imposition on registrants and shareholders of costs and distractions associated with threats of proxy contests, the SEC should consider including in the Proposed Rule legal consequences for dissidents who, after giving notice of a proxy contest, do not follow through with a proxy solicitation or do not comply with the Proposed Rule. We believe the Proposed Rule should provide that if a dissident fails to file and disseminate its definitive proxy statement by the date that is 25 days prior to the shareholder meeting (absent a legitimate reason such as a settlement), then the dissident should be prohibited from engaging in a proxy contest for a period of time (e.g., three years).
- The SEC should consider revising the Proposed Rule to provide that a registrant may opt out of the universal proxy system if it believes that using universal proxies in the manner of the Proposed Rule is not in the best interests of the registrant or its shareholders. Companies would opt out through a board decision and then publicly disclose the opt-out either in a Form 8-K or their annual proxy statements.

3. Other Issues With the Existing Federal Proxy Rules

Last, in our comment letter we encourage the SEC to address a few other issues with the existing federal proxy rules in connection with any adoption of a universal proxy card.

- Rule 14a-13 under the Exchange Act requires registrants to initiate a broker search at least 20 business days prior to the record date of an annual shareholder meeting. This rule dates to 1987 and no longer has a strong justification in the digital age. In practice, there is no problem with allowing significantly shorter time periods for a broker search. Notably, for *special* meetings, Rule 14a-13(a)(3)(i) allows a registrant to shorten this window to “as many days before the record date of such meeting as is practicable” where “such inquiry is impractical 20 business days prior to the record date.” In today’s world, broker searches in respect of special meetings for shareholder votes on mergers and similar transactions are initiated with as little as one business day’s notice. As such, we believe that the minimum time period for broker searches in respect of annual meetings should be shortened to one to three business days in connection with any adoption of the Proposed Rule.
- The SEC ought to consider an express and absolute prohibition on the disclosure of preliminary proxy tallies prior to a shareholder meeting. Such disclosures can spoil the fairness of the voting process by creating a “bandwagon effect,” whereby shareholders may decide to vote for the purported likely winner in the belief that the outcome has become a foregone conclusion. However, federal courts and the SEC’s staff (in comment letters) interpreted Rule 14a-9 *not* as an

absolute prohibition on disclosure of preliminary proxy voting tallies. As a result, we have observed numerous proxy contests in the recent past where participants disclosed preliminary proxy tallies—in press releases, one-on-one conversations with shareholders, and interviews with the media—without legal consequences. Therefore, we request that the SEC consider an express and absolute prohibition on the disclosure of preliminary proxy voting tallies by either side prior to a shareholder meeting.

For additional information on the topics covered in this update, see recent publications of Sidley Austin LLP on our practice pages for [Shareholder Activism](#).

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