

Logistics Questions Loom As SEC Mulls Proxy Ballot Reforms

By Karlee Weinmann

Law360, New York (April 4, 2014, 4:51 PM ET) -- An official recently confirmed that the U.S. Securities and Exchange Commission was still reviewing the prospect of a universal proxy ballot that would include board nominees from both sides in a short-slate proxy fight, giving shareholders more freedom in electing directors. But while experts say the idea has more support than ever, there are still plenty of issues to untangle.

Last year, the Council of Institutional Investors, an association that includes pension funds and endowments, reignited the debate with a petition for the SEC to allow parties to mail ballots that list all prospective board members to effectively recreate a pivotal benefit afforded to the few investors able to vote in person at annual meetings, where they can freely select candidates from both sides of the table.

As it stands, most shareholders have to choose to vote on one party's card, shaping what critics call an undemocratic framework that keeps shareholders from selecting all the candidates they want. A company's card typically includes only its slate of nominees, while an activist's card includes its picks and, unless it is pushing for majority board control, its favorite incumbent directors. If an investor likes some candidates on each side and is forced to submit one card or the other, its ballot likely can't reflect its true wishes.

"If a shareholder attends an annual meeting in person, they can vote for a mix of nominees from the company or the activist that they prefer, but if they vote by proxy, they can't," said Marc Weingarten, co-head of the shareholder activism practice at Schulte Roth & Zabel LLP. "It makes no sense. It denies shareholders their rights."

Michele Anderson, the SEC's chief of mergers and acquisitions, confirmed the ongoing evaluation late last month at a conference. The commission's last major announcement came in July, when it adopted a recommendation from its investor advisory committee to explore relaxing its rules.

A universal ballot would list both sides' complete candidate lists, giving voters a more robust pool of prospective board members to choose from and, in a sense, leveling the playing field for the parties on either side of the proxy battle, especially in light of proxy advisers' growing flex in disputes.

The movement for ballot reforms has picked up steam as shareholders increasingly rely on the advisory firms, most notably Institutional Shareholders Services Inc., to steer votes. The advisers' endorsements can — and often do — include candidates from both sides, but the SEC's single-card restriction

frequently deprives one party to the proxy fight, even though it might have notched approval from ISS or another firm.

“Institutional investors really want it,” said Steve Wolosky of Frome Wolosky LLP, who represents investors in proxy fights. “They're saying, 'Why shouldn't I, because I'm a significant shareholder, be able to vote for the seven people I want to vote for that I think are the best candidates for the board?’”

In the half-decade since the universal ballot campaign has taken firm hold, companies have pushed back against the idea of including dissidents' nominees on their ballots, a potential roadblock to the SEC's implementation of a universal ballot down the line. But as shareholder activism ramps up and more institutional investors are cozying up to activist campaigns, corporate America is beginning to see the upside of the proposed switch, said Keith Gottfried, head of the shareholder activism defense practice at Alston & Bird LLP.

“A lack of a universal ballot, or the inability to have shareholder be able to combine nominees — particularly in short-slate contests — is very frustrating,” he said.

Where an activist makes a play for minority board representation, a universal ballot would free up the targeted company to recommend certain dissident nominees, giving the activist a leg up but also helping it shake off the candidates it doesn't want.

Target companies' proxy advisers and investment bankers are increasingly open to that approach, particularly as activists prove they can win short-slate contests.

“The likelihood is that the activist is going to get one or two of their nominees elected,” Weingarten said. “The company would like to be able to manipulate the votes of shareholders by having everyone's name on their proxy and telling shareholders to vote for this particular nominee or that particular nominee of the shareholder slate, or otherwise vote for the incumbents.”

Still, as support for a universal ballot mushrooms, the SEC has yet to answer pivotal questions about its implementation and implications.

So far, speculation has focused on SEC rule changes that would make it optional for companies and activists to include rival nominees on their materials in short-slate fights. Under that scheme, both sides could weigh the impact of the universal ballot and shape their strategy accordingly on a case-by-case basis. But that freedom could get messy without clear guidelines, attorneys say.

Companies generally circulate their proxy materials before dissidents, who sometimes don't decide whether to proceed with a contest until after mailings reach shareholders. That leaves targets to decide whether to introduce investors to a group of nominees that might not make it to the vote, or to incur what could be substantial mailing costs to send supplemental materials after an activist firms up its opposition and proceeds with the fight.

But even before that, the SEC has to decide exactly what the universal ballot would look like. While the ballots provided to shareholders at annual meetings could serve as a blueprint, the agency would have to take a closer look at every part of its design, starting with who will be responsible for preparing the ballot and how it will list nominees.

With many ways to arrange candidates names — alphabetically, split along company-dissident lines,

from right to left — regulators would have to devise a system widely seen as both clear and fair, particularly amid concerns that a sizable chunk of investors casts its votes without looking carefully at that ballot, generally from the top down.

It also remains unclear what disclosures the parties to a proxy fight would have to make about opposing candidates in their own proxy materials. Practitioners have questioned whether listing a board nominee's name and affiliation is enough, or if including some biographical information could help voters make a more informed choice.

Then there are worries that a universal ballot could help activists shoehorn untenable directors into the boardroom. Particularly if the SEC mandates a universal ballot, targeted companies could find themselves forced to include on their proxy card proposed directors that it sees as throwaway candidates.

“A lot of the activists I come across today are very credible and have very highly qualified nominees,” Gottfried said. “But there are times when an activist has less-than-credible nominees.”

Even after the process is fine-tuned — a prospect that is still a long way off — it will still hold an extra element of uncertainty for companies and dissidents that have likely shaped their slates and endorsements around directors they believe will work well together.

“You're going to have permutations and combinations that one side wouldn't exactly want or the other side wouldn't exactly want,” said Barry Genkin, the leader of Blank Rome LLP's shareholder activism practice. “One of the things that this may result in is this concept of strange bedfellows, having directors who are mixed and matched, and potentially the dynamics of the boardroom will get affected in ways that they wouldn't otherwise get affected.”

The SEC has not sketched out a timeline for its evaluation. Despite the questions that hang over the movement for change, waning opposition suggests a prevailing view that tipping the scale in shareholders' favor is a shift that is not only tough to argue but an inevitability for the commission's rule-making.

“Regardless of whether the activist or the company thinks it's to their advantage to use a universal proxy, it's much more an issue of fundamental shareholder rights,” Weingarten said. “If [shareholders] went to a meeting in person, they could vote on a universal ballot. They should be able to do so by proxy.”

--Editing by Elizabeth Bowen. and Chris Yates.