

Public Company Advisor

Practical Insights for Public Company Counsel

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King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.

New Life Breathed into SEC's Unbundling Rules

The SEC's "unbundling" requirements have largely been the stuff of SEC lore -- periodically referred to but rarely seen in corporate governance matters. However, thanks to the high profile dispute between David Einhorn's Greenlight Capital and Apple, the unbundling rules may finally be coming out of the shadows. As a result, companies should carefully consider their application when preparing their proxy materials, especially those that may come under attack by shareholder activists.

Background on the Unbundling Rules

The SEC's unbundling rules effectively require a distinct shareholder vote on each "separate matter" listed on a company's proxy card, regardless of the state law requirement that would be required to approve the matter. Although the rules technically apply to any matter submitted for a shareholder vote, in our experience they have most often been implicated in connection with merger transactions and have rarely arisen in the context of a corporate governance matter (as they did in the Greenlight/Apple dispute).

The SEC's unbundling rules were adopted in 1992 to ensure that shareholders would not be forced to approve or disapprove an entire package of items that could otherwise be separated into individual components on which shareholders may cast their vote. The rules are set forth in Rules 14a-4(a)(3) and 14a-4(b)(1) and require that:

1. The form of proxy identify clearly and impartially each separate matter intended to be acted upon, whether or not related to or conditioned on the approval of other matters.
2. Shareholders are given an opportunity to specify by boxes a choice between approval or disapproval of, or abstention with respect to, each separate matter referred to therein as intended to be acted upon.

Accordingly, each item included in the proxy statement that is a "separate matter" must be unbundled into a separate voting item. What constitutes a "separate matter" for purposes of the rules is ultimately a question of fact.

The unbundling rules have received little attention from the SEC, shareholders and the courts. Historically, the SEC staff has applied the rules narrowly, and the only significant guidance from the SEC staff has come in the form of a 2004 published staff interpretation regarding the bundling of votes in connection with mergers and amendments to a company's charter. In that

interpretation, the SEC staff noted that a proposal to approve a merger grouped with approval of a material change to a company's charter would generally violate the unbundling rules.

The Greenlight/Apple Dispute

In May 2012, Greenlight approached Apple with a proposal to use Apple's authority in its articles of incorporation to issue "blank check" preferred stock to return value to shareholders by issuing perpetual preferred shares to its shareholders. Apple rejected this proposal and instead moved forward with a plan to eliminate its authority to issue blank check preferred stock. Accordingly, Apple's proxy statement for its 2013 annual shareholders' meeting included a proposal to amend Apple's articles of incorporation to:

1. Eliminate language relating to directors' terms of office in order to facilitate the adoption of majority voting;
2. Eliminate blank check preferred stock;
3. Establish a par value for Apple's common stock; and
4. Make other conforming changes to the articles of incorporation.

The proposed amendment to the articles was presented to Apple's shareholders as a single proposal. Greenlight subsequently filed suit against Apple, alleging that this "up or down" vote on the amendment violated the SEC's unbundling rules. On February 22, 2013, the U.S. District Court for the Southern District of New York agreed and issued a preliminary injunction preventing a vote on the amendment on the grounds that the proposal likely violated the unbundling rules.

In its ruling, the court rejected Apple's arguments that the proposal complied with the unbundling rules. Among other matters, Apple claimed that the proposal did not constitute bundling, because shareholders "are only being asked one thing — whether to amend the [a]rticles." The court disagreed, noting that holding otherwise would preclude the application of the unbundling rules to all but the most egregious of circumstances.

Apple also argued that its presentation of the proposed amendment was consistent with current practices with respect to unbundling, as many other proxy statements combine changes to eliminate authority to issue blank check preferred stock together with other charter amendments. The court held that this was "of no moment as none of the proxy statements cited by Apple have been held to comply with SEC rules."

Finally, Apple argued that each of the proposed amendments was not a material matter. The court rejected this argument, and held that three of the proposed amendments were likely material to shareholders. The court noted that Apple's assessment of the "pro shareholder" nature of the amendments was irrelevant, as management's views of the benefits of the amendments should not supersede the right of shareholders to express their views on such matters.

Implications, Considerations and Advice

Companies should consider the following with respect to the preparation of their proxy materials, particularly those that may be controversial and subject to scrutiny by shareholder activists:

1. Consider the need to unbundle: If a company is planning on amending its charter or bylaws, it should consider whether these amendments raise any issues under the SEC's unbundling rules. Even though an amendment to a company's charter or bylaws may only require one shareholder vote under state law, the SEC unbundling rules, if applied consistently with the Apple decision, could require a separate vote on each material item that is being amended.
2. Condition separate matters upon each other as necessary: The unbundling rules specifically allow a company to condition approval of one matter on the approval of other matters presented to shareholders. Accordingly, with respect to amendments to charters or bylaws, companies should consider breaking out each non-administrative change for a separate vote, with each such vote conditioned on the approval of the others.
3. Do not expect additional SEC guidance: At the spring meeting of the ABA Business Law Section, SEC staff members noted that they did not anticipate the SEC issuing additional guidance or interpretations of its unbundling rules, and further suggested that companies should heed the application of the rule as set forth in the Apple decision.

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King & Spalding's Public Company Practice Group is a leader in advising public companies and their boards of directors in all aspects of corporate governance, securities offerings, mergers and acquisitions and regulatory compliance and disclosure.

About King & Spalding

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