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February 25, 2014

Just in Time for Proxy Season, SEC Provides New Guidance on Shareholder Proposal “Unbundling”

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The U.S. Securities and Exchange Commission (SEC) staff recently issued several Compliance and Disclosure Interpretations (C&DIs) providing guidance as to when it is permissible under Rule 14a-4(a)(3) (and its companion rule, Rule 14a-4(b)(1)) under the Securities Exchange Act of 1934 (the “Exchange Act”) to group multiple matters in a single proposal to be voted on by shareholders. These C&DIs provide an opportunity to review the Exchange Act rules regarding “bundling” of matters, and to discuss the practical implications of Rule 14a-4(a)(3) for companies and shareholders crafting proposals for shareholder votes to be included in proxy materials for the upcoming proxy season.

THE EXCHANGE ACT’S “UNBUNDLING” RULES

Exchange Act Rule 14a-4(a)(3) requires that 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.” Rule 14a-4(b)(1) further requires that the form of proxy provide separate boxes for shareholders to choose between approval, disapproval or abstention “with respect to each separate matter referred to therein as intended to be acted upon.” These rules are intended to provide a means for shareholders to communicate their views to the board of directors on each matter to be acted upon.

The rule does not define “matter.” However, in the release adopting the current form of Rule 14a-4(a)(3), the SEC expressed that the purpose of this rule is “to permit shareholders to communicate to the board of directors their views on each of the matters put to a vote, and not be forced to approve or disapprove a package of items and thus approve matters they might not [approve] if presented independently.”¹ Courts and commentators have determined that “what constitutes a ‘separate matter’ for purposes of [Rule 14a-4(a)(3)] ... is ultimately a question of fact to be determined in light of the corporate documents [of the registrant] and in consideration of the SEC’s apparent preference for more voting items rather than fewer.”²

THE JANUARY 2014 C&DIS – PERMISSIBLE BUNDLING

As noted above, on January 24, 2014, the staff of the Division of Corporation Finance of the SEC (the “Staff”) issued three C&DIs regarding Exchange Act Rule 14a-4(a)(3), providing examples of instances in which the Staff believes it is permissible for a registrant to combine multiple matters into a single proposal³. Two of these C&DIs are described below.⁴

¹ SEC Release No. 34-30849 (Jun. 23, 1992).

² *Koppel v. 4987 Corp.*, 167 F.3d 125, 138 (2d Cir. 1999).

³ See <http://www.sec.gov/divisions/corpfina/guidance/14a-interps.htm>.

⁴ In a third C&DI, the Staff reiterated previously published guidance that the Staff will not object to the presentation of multiple changes to an equity incentive plan in a single proposal. See *id.*

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C&DI ONE – BUNDLING OF “INEXTRICABLY INTERTWINED” MATTERS

In Exchange Act Rule 14a-4(a)(3) C&DI Question 101.01, the Staff addressed a situation where management of the registrant negotiated concessions from the holders of a series of its preferred stock to reduce the dividend rate on the preferred stock in exchange for an extension of the maturity date. The Staff considered whether a single proposal to approve a charter amendment containing these modifications must be unbundled into two separate proposals: one relating to the reduction of the dividend rate and another relating to the extension of the maturity date.

The Staff indicated that a single proposal submitted by management to holders of the issuer’s common stock to approve a charter amendment containing these modifications need not be unbundled into separate proposals under Rule 14a-4(a)(3). In this regard, the Staff notes that multiple matters that are so “inextricably intertwined” as to effectively constitute a single matter need not be unbundled. The Staff would view the matters relating to the terms of the preferred stock as being inextricably intertwined, “because each of the proposed provisions relates to a basic financial term of the same series of capital stock and was the sole consideration for the countervailing provision... .”⁵

C&DI TWO – BUNDLING OF IMMATERIAL MATTERS

In the second C&DI, the Staff considered a situation where management of a registrant sought to present an amended and restated charter to shareholders for approval at its annual meeting. The proposed amendments to the charter would: (a) change the par value of the common stock of the registrant; (b) eliminate provisions relating to a series of preferred stock of the registrant that was no longer outstanding and not subject to further issuance; and (c) declassify the board of directors of the registrant.

The Staff indicated that under Rule 14a-4(a)(3), these individual amendments that are part of the restatement would not need to be unbundled into separate proposals. In this regard, the Staff noted that it would not ordinarily object to the bundling of any number of immaterial matters with a single material matter. The Staff pointed out that there is no “bright-line” test for materiality, but advised that “registrants should consider whether a given matter substantively affects shareholder rights.” The Staff further observed that “while the declassification amendment would be material under this analysis, the amendments relating to par value and preferred stock do not substantively affect shareholder rights, and therefore both of these amendments ordinarily could be included in a single restatement proposal together with the declassification amendment.”

In addition, the Division noted that a registrant should unbundle an amendment if management knows or has reason to believe that shareholders “could be reasonably expected to wish to express a view ... separate from their views on other amendments,” even if such amendment does not affect substantive shareholder rights.

⁵ At the same time, the Staff noted that it would not view two arguably separate matters as being inextricably intertwined merely because the matters were negotiated as part of a transaction with a third party. Nor would the Staff view two separate matters as being inextricably intertwined because the matters represented terms of a contract that one of the parties considered essential to the overall bargain. *See id.*

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PRACTICAL IMPLICATIONS OF C&DIS FOR COMPANIES PREPARING PROXY MATERIALS

In light of the C&DIs discussed above, companies and shareholders preparing proxy materials should keep the following considerations in mind when drafting proposals for shareholder consideration:⁶

- Separate into different proposals matters that are “material” and, in particular, matters that arguably affect the substantive rights of shareholders. These matters include those relating to the election of directors, such as the use of majority voting or classification of directors. They also include matters relating to classes of shares that are still issued and outstanding or subject to issuance, such as economic or control rights granted to shareholders.
- Separate into different proposals matters on which shareholders have expressed an interest in voting separately. The Staff indicated that such matters should be unbundled even if substantive shareholder rights are not implicated by these matters. Further, as a practical matter, proposals containing such items are most likely to be subject to attack by a shareholder for violating Rule 14a-4(a)(3).
- If the company or shareholder groups multiple matters into the same proposal, ensure that matters listed in a proposal are as closely related as possible. To the extent the matters grouped in the proposal are related to one another, the proponent may be able to argue that the matters are “inextricably intertwined” and may be viewed as a single matter.
- Consider conditioning the passage of one proposal on the passage of one or more other proposals. SEC releases have indicated that companies may condition the approval of a proposal voted upon by the shareholders upon the approval or rejection of other proposals voted on contemporaneously by shareholders.⁷ In instances where the related material matters must be listed as separate proposals to comply with Rule 14a-4(a)(3), companies or proposing shareholders should consider whether it would be appropriate to condition the approval of one proposal on the approval of another proposal to increase the likelihood that such proposals are considered together.

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⁶ The Staff has also issued guidance regarding the application of Rule 14a-4(a)(3) to proposals presented to shareholders of a company involved in a merger, acquisition or similar transaction. This guidance was issued in 2004 and may be found at <http://www.sec.gov/interps/telephone/phonesupplement5.htm>.

⁷ See SEC Release No. 34-31326 (Oct. 16, 2002).