US Securities and Exchange Commission Clarifies its Position on "Unbundling" Proxy Proposals

When preparing proxy statements, public companies must not "bundle" separate matters together for the purposes for shareholder voting. In accordance with Rule 14a-4(a)(3) under the Securities Exchange Act of 1934, when distinct matters are submitted to shareholders for approval pursuant to the solicitation of proxy authority, they must be "unbundled" so that shareholders are given the opportunity to vote on each material item individually. Rule 14a-4(a)(3) requires that a proxy card must "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."

When the proposals being presented for approval at a shareholders meeting involve topics that are clearly different from each other, the division of the proposals into distinct voting items is relatively straightforward. However, when a proposal involves multiple components that bear relationships to each other, it can be more difficult to determine whether such proposal must be "unbundled" to give shareholders the option to vote on each separate part.

On January 24, 2014, the Division of Corporation Finance (the Division) of the Securities and Exchange Commission (the SEC) issued three compliance and disclosure interpretations (C&DIs) providing guidance on when unbundling is necessary.[1] This new guidance supplements the guidance on unbundling that the SEC provided in the context of mergers and acquisitions which appears in the SEC's September 2004 Interim Supplement to the Publicly Available Telephone Interpretations[2] and still remains in effect.

The first new C&DI involved a situation where management negotiated concessions from the holders of a series of a company's preferred stock to reduce the dividend rate on the preferred stock in exchange for an extension of the maturity date. The C&DI stated that this proposal did NOT need to be unbundled into a separate proposal relating to the reduction of the dividend rate and another relating to the extension of the maturity rate. According to the Division, "[m]ultiple matters that are so 'inextricably intertwined' as to effectively constitute a single matter need not be unbundled." In this case, each change related to a basic financial term of the same series of capital stock and was the sole consideration for the change to the other provision. The C&DI warned, however, that "the staff 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 because the matters represent terms of a contract that one or the other of the parties considers essential to the overall bargain."

The second C&DI involved an amended and restated charter being presented for shareholder approval that would:

- Change the common stock's par value,
- Eliminate provisions relating to a fully retired series of preferred stock and
- Declassify the board of directors (e.g., provide that all directors are elected annually)

The C&DI did not require this proposal to be unbundled because it viewed the change to par value and elimination of provisions for a defunct series of preferred stock to be immaterial. The C&DI noted that "[t]he staff would not ordinarily object to the bundling of any number of immaterial matters with a single material matter."

The C&DI observed that, while there "is no bright-line test for determining materiality in the context of Rule 14a-4(a)(3), registrants should consider whether a given matter substantively affects shareholder rights." Even if a component of an amended and restated charter does not substantively affect shareholder rights, it should be unbundled if management has reason to believe that the matter is one in which "shareholders could reasonably be expected to wish to express a view separate from their views on the other amendments." The C&DI makes clear that the unbundling analysis under the proxy rules is not affected by state law provisions which would permit voting on material aspects of a charter amendment to be bundled. For example, the C&DI specifies that a proposal to add a charter provision allowing shareholders to call a special meeting could not be bundled for proxy purposes with a charter amendment to declassify the board because both provisions are material.

The final C&DI addressed an omnibus amendment to an equity incentive plan that would:

- Increase the number of shares available for issuance under the plan,
- Increase the maximum amount of compensation payable to an employee as qualified performance-based compensation under Section 162(m) of the Internal Revenue Code,
- Add restricted stock as a type of award and
- Extend the term of the plan

The Division did not require these proposed changes to be unbundled. According to the C&DI, "the staff will not object to the presentation of multiple changes to an equity incentive plan in a single proposal.... This is the case even if the changes can be characterized as material in the context of the plan and the rules of a national securities exchange would require shareholder approval of each of the changes if presented on a standalone basis."

Practical Considerations

Public companies, especially public companies currently in the process of preparing their proxy statements, should analyze the agendas for their shareholder meetings if matters such as those described above are being voted on to confirm that the proxy card does not improperly bundle matters that must be voted on separately. This is a particularly important exercise when an amended and restated document is being voted on. A preliminary proxy filing is required when amended and restated charters or by-laws are submitted for shareholder approval. If upon review of the preliminary filing, the SEC examiner determines that components of such organizational document need to be unbundled, there may be a delay in finalizing the definitive proxy statement, which could potentially affect the schedule for the annual meeting and related solicitation period.

In addition to being separately identified on the proxy card, each material item requiring shareholder approval should be discussed distinctly in the proxy statement. Using the C&DI's example of a charter amendment allowing shareholders to call a special meeting and a charter amendment to declassify the Board, the proxy statement should specifically

disclose the details and ramifications of each such provision.

If a company so chooses, it may condition approval of a proposal that has been unbundled upon approval of the other component of the related matter. For instance, again using the example contained in the C&DI, the proxy statement could state that the special meeting charter amendment will only be adopted if shareholders also approve the amendment declassifying the board of directors.

If you have any questions about whether proxy proposals need to be unbundled into multiple voting proposals, please contact the author of this Legal Update, ***Laura D. Richman****, at* ***+1 312 701 7304****, or any of the lawyers listed below, or any other member of our Corporate & Securities practice.*

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Endnotes

[1] See http://www.sec.gov/divisions/corpfin/guidance/14a-interps.htm.

[2] See http://www.sec.gov/interps/telephone/phonesupplement5.htm.