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Potential Corporate Bylaw Amendments in Response to SEC Universal Proxy Rules

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On August 31, 2022, amendments to the federal proxy rules mandating the use of “universal” proxy cards in contested director elections, adopted by the Securities and Exchange Commission (the “SEC”) on November 17, 2021, went into effect. Under the new rules, which do not apply to investment companies or business development companies, proxy cards distributed by both public companies and dissidents in contested director elections must include both sides’ director nominees, allowing shareholders to “mix and match” nominees from the company’s and the dissident’s slates of nominees when voting by proxy.

OVERVIEW OF HOW THE NEW RULES WORK

The new rules revise the so-called “bona fide nominee” rule¹ and mandate the use of universal proxy cards by both public companies and dissidents when soliciting shareholders in contested director elections. That is, each proxy card must include the names of both the company’s and the dissident’s nominees, thereby permitting shareholders to vote for a combination of nominees from the separate slates submitted by the company and the dissident.

Among other requirements, the new rules require the dissident to notify the company of its intent to solicit proxies and provide the names of its nominees at least 60 calendar days before the anniversary of the previous year’s annual meeting; in turn, the company must provide the dissident with the names of its nominees at least 50 calendar days before that anniversary.² The dissident must file its definitive proxy statement with the SEC by the later of 25 calendar days before the shareholder meeting or five calendar days after the company files its definitive proxy statement.

In addition, the new rules require the dissident to solicit the holders of shares representing at least 67% of the voting power of the shares entitled to vote at the meeting. To satisfy this requirement, the dissident may mail the proxy materials to shareholders or use the less costly “notice and access” method.

POTENTIAL CORPORATE BYLAW AMENDMENTS

In adopting a mandatory universal proxy rule regime, the SEC made clear its aim to strike a balance between facilitating legitimate, potentially value-enhancing proxy contests (without imposing undue costs) and preventing dissidents from capitalizing on the new regime with frivolous director nomination campaigns, and accordingly adopted, among others, the guardrails and requirements described above.

In addition to these SEC requirements, companies should consider adopting amendments to their corporate bylaws to help ensure that the requirements of the

new rules are properly observed and to mitigate any abusive practices. Such amendments should also expressly provide for the company's redress in the event of shareholder non-compliance with the new rules—thereby alleviating any need to rely on SEC oversight and reducing uncertainty as to how such non-compliance would be viewed under state law.³ The particular bylaw amendments to be considered for adoption would necessarily need to be tailored to each company, including taking into account its existing constitutional documents, jurisdiction of incorporation and any related case law developments, but generally should include the following elements (plus any related conforming changes):

- A requirement that the dissident's director nomination notice (except when submitted pursuant to a company's proxy access provisions)⁴ include a representation from the dissident that it and any member of its group that intends to solicit proxies in support of non-company nominees (such persons, the "Dissident Solicitation Group") will:
 - solicit proxies from the holders of shares representing at least 67% of the voting power of the shares entitled to vote on the election of directors in compliance with SEC Regulation 14A;
 - include a statement to that effect in the dissident's proxy statement and/or form of proxy;
 - otherwise comply with the new rules (*i.e.*, Rule 14a-19 promulgated under the Securities Exchange Act of 1934, as amended); and
 - provide the company by a specified date prior to the meeting (or any adjournment, postponement or rescheduling thereof) with reasonable documentary evidence (as determined by the company or one of its representatives in good faith) that the Dissident Solicitation Group complied with such representations.
 - This requirement to provide evidence of compliance should be qualified by standards of reasonableness and good faith (as indicated above) to help ensure survival against any legal challenge.
- A provision requiring the dissident to notify the company within a specified period in the event it no longer intends to solicit proxies in accordance with its universal proxy rule representations.
- A provision:
 - expressly granting the chair of the meeting the power and obligation to determine whether any director nomination was made in accordance with the advance notice requirements set forth in the bylaws; and
 - providing that—in the event a dissident fails to comply with its representations given pursuant to such advance notice requirements—such dissident's nomination will be declared defective and disregarded, with no vote taken with respect to such nomination (notwithstanding any proxies with respect to such nomination having been received by the company).
- A provision providing that, in the event the company receives proxies for disqualified or withdrawn nominees, such votes will be treated as abstentions.
 - The treatment of such votes as abstentions, and not disregarded votes, may be preferable as such votes are then still counted for quorum purposes.
- A requirement that each dissident nominee submit a written consent to be named as a nominee in *any* proxy statement for the applicable meeting and any associated proxy card.

In order to best position itself against potential enforcement challenges, companies should adopt any such amendments on a "clear day" and not in response to a particular corporate threat or precipitating activism event, as board action in that context is more likely to receive judicial deference (assuming such action is taken with a legitimate corporate purpose and there is an absence of specific evidence of inequitable conduct).

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¹ Prior to recently effective amendments, this rule generally prohibited naming an individual who has not consented to appearing on a particular side's proxy card. As a result, shareholders voting by proxy could not "mix and match" their choices of directors, but instead were required to pick a slate—the company's or the dissident's.

² The 60-day requirement applicable to the dissident will not override any advance-notice provisions of the company's bylaws, which often require 90 calendar days' or more notice.

³ While non-compliance with the new rules would constitute an SEC disclosure violation, it is unclear (at best) whether the requirements of the new rules, without related bylaw changes, would have an effect under state corporate law.

⁴ This exception is for the scenario in which a shareholder avails itself of a company's proxy access bylaw provisions and does not engage in any solicitation of proxies. By its terms, the new universal proxy rules only apply to any person that solicits proxies in support of director nominees.