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SEC Guidance On Proxy Presentation Of Certain Matters In The Merger And Acquisition Context

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In late October the SEC issued its first updated Staff Legal Bulletin on shareholder proposals in years – Staff Legal Bulletin No. 14H ("SLB 14H"). Please see my blog on SLB 14H HERE. On the same day the SEC published two new Compliance and Disclosure Interpretations ("C&DI") related to the unbundling of matters presented for a vote to shareholders in merger and acquisition transactions. The new C&DI has in essence granted voting rights to target company shareholders, on acquiring company organizational documents, where none existed before and has in essence pre-empted state law on the issue.

Unbundling under Rule 14a-4(a)(3) in the M&A Context

Exchange Act Rule 14a-4 relates to the requirements for a proxy card general. Rule 14a-4(a) provides:

(a) The form of proxy:

(1) Shall indicate in bold-face type whether or not the proxy is solicited on behalf of the registrant's board of directors or, if provided other than by a majority of the board of directors, shall indicate in bold-face type on whose behalf the solicitation is made;

(2) Shall provide a specifically designated blank space for dating the proxy card; and

(3) Shall 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, and whether proposed by the registrant or by security holders.

Part (b) continues with a requirement that the proxy shall provide a means "whereby the person solicited is afforded an opportunity to specify by boxes a choice between approval or disapproval of, or abstention with respect to each separate matter" other than director elections and votes on the frequency of votes on executive compensation (i.e., frequency of say-on-pay votes).

Exchange Act Rule 14a-4(a)(3) relates to the unbundling of separate matters that are submitted to a shareholder vote through proxy materials. The SEC previously issued C&DI guidance in January 2014. The new C&DI specifically addresses Rule 14a-4(a)(3) in the context of mergers, acquisitions and similar transactions. The SEC has historically been against bundling of proposals in a proxy and that trend continues with the new C&DI.

Following the January 2014 C&DI, the rules substantially provided that multiple matters that are inextricably intertwined need not be unbundled. However, separate matters do not rise to the level of "inextricably intertwined" just because they were negotiated as part of a single transaction with a third party. Moreover, matters that are immaterial may be bundled with other matters. Materiality is determined by considering whether a matter substantially affects shareholder rights or whether a shareholder would reasonably be expected to express or want to express a view on a matter.

The SEC has issued 2 new C&DI as follows:

Question: Rule 14a-4(a)(3) requires that the form of proxy "identify clearly and impartially each separate matter intended to be acted upon." Rule 14a-4(b)(1) further requires that the form of proxy provide a means for shareholders "to specify by boxes a choice… with respect to each separate matter referred to therein as intended to be acted upon." In a merger, acquisition, or similar transaction in which shareholders of the target are receiving equity securities of the acquirer, amendments to the organizational documents of the acquirer can often be required by the transaction agreement. Under these proxy rules, under what circumstances must a target seeking shareholder approval of such a transaction present separately on its form of proxy a proposal or proposals relating to the amendments to the organizational documents of the acquirer? In other words, when are these amendments which are embedded within the transaction agreement a "separate matter" for target shareholders?

Answer: As a preliminary matter, if a material amendment to the acquirer's organizational documents would require the approval of its shareholders under state law, the rules of a national securities exchange, or its organizational documents if presented on a standalone basis, the acquirer's form of proxy must present any such amendment separately from any other material proposal, including, if applicable, approval of the issuance of securities in a triangular merger or approval of the transaction agreement in a direct merger. See Question 101.02 relating to "Unbundling under Rule 14a-4(a)(3) Generally." As a general principle, however, only material matters must be unbundled, and acquirers should consider whether the provisions in question substantively affect shareholder rights. Examples of provisions meeting this standard that may be adopted in connection with a transaction include governance and control-related provisions, such as classified or staggered boards, limitations on the removal of directors, supermajority voting provisions, delaying the annual meeting for more than a year, eliminating the ability to act by written consent, or changes in minimum quorum requirements. In contrast, provisions such as name changes, restatements of charters, or technical changes, such as those resulting from anti-dilution provisions, would likely be immaterial.

If, consistent with the guidance in Question 101.02, the acquirer is required under Rule 14a-4(a)(3) to present an amendment or multiple amendments separately on its form of proxy, or would be so required if it were conducting a solicitation subject to Regulation 14A, then a target subject to Regulation 14A also must present any such amendment separately on its form of proxy. This is because the amendment, which is a term of the transaction agreement that target shareholders are being asked to approve, would effect a material change to the equity security that target shareholders are receiving in the transaction. Target shareholders should have an opportunity to express their views separately on these material provisions that will establish their substantive rights as shareholders, even if as a matter of state law these provisions might not require a separate vote. Similarly, if the acquirer presents a material amendment on its form of proxy as the only matter to be approved by acquirer's shareholders, then the target must present the amendment separately on its form of proxy. The target need not present as a separate matter on its form of proxy an amendment to increase the number of authorized shares of the acquirer's equity securities, provided that the increase is limited to the number of shares reasonably expected to be issued in the transaction.

In all cases, the parties are free to condition completion of a transaction on shareholder approval of any separate proposals. Any such conditions should be clearly disclosed and indicated on the form of proxy.

Question 201.02

Question: Does the answer to Question 201.01 change if the parties form a new entity to act as an acquisition vehicle that will issue equity securities in the transaction?

Answer: No. In that case, the party whose shareholders are expected to own the largest percentage of equity securities of the new entity following consummation of the transaction would be considered the acquirer for purposes of this analysis. As in Question 201.01, the acquirer must present separately on its form of proxy any material provision or provisions of the new entity's organizational documents that are a term of the transaction agreement, if the provision or provisions represent a material change from the acquirer's organizational documents, and the change would require the approval of the acquirer's shareholders under state law, the rules of a national securities exchange, or its organizational documents if proposed to be made directly to its own organizational documents. Provisions that are required by law in the jurisdiction of incorporation of the new entity need not be presented separately on the form of proxy. As in Question 201.01,

if the acquirer is or would be required under Rule 14a-4(a)(3) to present separately on its form of proxy any provision of the new entity's organizational documents that is a term of the transaction agreement, then a target subject to Regulation 14A must also present the same provision separately on its form of proxy.

Question 101.02 referred to in Question 201.01 provides:

Question: Management of a registrant intends to present an amended and restated charter to shareholders for approval at an annual meeting. The proposed amendments would change the par value of the common stock, eliminate provisions relating to a series of preferred stock that is no longer outstanding and is not subject to further issuance, and declassify the board of directors. Under Rule 14a-4(a)(3), must the individual amendments that are part of the restatement be unbundled into separate proposals?

Answer: No. The staff would not ordinarily object to the bundling of any number of immaterial matters with a single material matter. 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. 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. However, if management knows or has reason to believe that a particular amendment that does not substantively affect shareholder rights nevertheless is one on which shareholders could reasonably be expected to wish to express a view separate from their views on the other amendments that are part of the restatement, the amendment should be unbundled.

The staff notes that the analysis under Rule 14a-4(a)(3) is not governed by the fact that, for state law purposes, these amendments could be presented to shareholders as a single restatement proposal. If, for example, the restatement proposal also included an amendment to the charter to add a provision allowing shareholders representing 40% of the outstanding shares to call a special meeting, the staff would view the special meeting amendment as material and therefore required to be presented to shareholders separately from the similarly material declassification amendment.

In an M&A context the new guidance is a significant change. The SEC is in essence requiring that target company shareholders be afforded an opportunity to vote on changes to the acquiring company's organizational documents, separate and apart from voting on the merger itself. The SEC reasons that since the target company shareholders will become acquiring company shareholders, they have an interest in the organizational documents. Although I understand that argument, I would think that the target company shareholders could consider the acquiring company's organizational documents, or changes thereto, in deciding whether to vote on the merger or not. I fail to see the benefit of a separate vote, nor the practical result if, for instance, the target company shareholders approve a merger but not the organizational document changes (other than giving plaintiff's attorneys another matter to litigate!)

From a company's point of view, it can make more sense to present an integrated proposal for a full merger plan. By unbundling the various items to the plan, including corporate governance and structure changes, the company could have a shareholder approval of the corporate changes but not the merger itself or vice versa. Moreover and worse yet, the reconfigured pieces of the transaction, following a shareholder vote on the parts as opposed to the whole, may have an unintended result. The SEC suggests that one can be conditioned on the other, but if that is the case, why require the unbundling in the first place?

The new C&DI continues the trend that I have written of several times, of the federal government imposing on state corporate law regulations. I am a vocal advocate of federal pre-emption of state securities laws, but am also an advocate of leaving corporate law matters to the states. In this case the SEC clearly spreads its reach into state law with the statement "[T]arget shareholders should have an opportunity to express their views separately on these material provisions that will establish their substantive rights as shareholders, even if as a matter of state law these provisions might not require a separate vote." In this instance, the target shareholders do not have the right to vote on the acquirer's organizational documents under state law, but apparently do have such right if the acquirer is subject to the SEC proxy rules.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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