Proxy Access a' la Private Ordering? Not So Fast!

By Jim Moloney & Lauren Assaf of Gibson, Dunn & Crutcher LLP[1]

The American Bar Association's Proxy Statements and Business Combinations Subcommittee met on Friday, November 18, 2016, as part of the Business Law Section's Fall Meeting in Washington, D.C. Speakers at the Subcommittee meeting included Securities and Exchange Commission ("SEC") Associate Director (Legal) of the Division of Corporation Finance Michele Anderson, SEC's Office of Mergers & Acquisitions ("OM&A") Chief Ted Yu and Special Counsel Tiffany Posil, with Weil, Gotshal, & Manges LLP partner Jim Griffin and counsel Adé Heyliger serving as moderators.

Universal Ballot

Michele Anderson and Tiffany Posil opened the panel with a discussion of the SEC's recent universal proxy card rule proposals.[2] Both worked on drafting the proposed rules along with Christina Chalk, Senior Special Counsel in OM&A. Ms. Anderson and Ms. Posil explained that the Staff sought to create a management- and shareholder-neutral framework that would allow shareholders to use proxy voting systems in a way that mirrored the experience of voting in person at an annual shareholder meeting: in sum, the rules as proposed were designed to allow shareholders to vote by proxy for a mix of management and shareholder nominees all on one ballot (proxy card).

As proposed, the framework is mandatory in order to mitigate shareholder confusion and logistical issues, reduce the likelihood that parties could use universal proxies as tactical tools, and limit application of the rules to real election contests alone (*i.e.*, those solicitations where both sides seek to elect their own director nominees). The Staff also highlighted its keen interest in receiving comments on the proposed 60-day advance notice deadline for shareholders to submit the names of their nominees and related information to management,[3] and the requirement that shareholders solicit at least a majority of the voting power of shares outstanding and entitled to vote on the election of directors.[4]

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[1] © 2016 Gibson, Dunn & Crutcher LLP. James J. Moloney is Co-Chair of Gibson, Dunn & Crutcher LLP's Securities Regulation and Corporate Governance Practice Group and a Corporate Partner in the firm's Orange County Office. Lauren Assaf is a Corporate Associate in Gibson Dunn's Orange County Office.

[2] Universal Proxy, 81 Fed. Reg. 79,122 (proposed Nov. 10, 2016) (to be codified at 17 C.F.R. pt. 240). *See also SEC Proposes New Universal Proxy Card Rules for Contested Elections*, Gibson Dunn (Nov. 1, 2016), http://gibsondunn.com/publications/documents/SEC-Proposes-New-Universal-Proxy-Card-Rules-for-Contested-Elections.pdf.

[3] *See* Universal Proxy, 81 Fed. Reg. at 79,131, 79,135-37.

[4] *Id.* at 79,138-39.

"Affiliates" in Going Private Deals

Ted Yu then went on to address the Staff's longstanding interpretive position as to who is deemed an "affiliate" in connection with the application of Rule 13e-3 to "going private" transactions. Mr. Yu noted that the term "affiliate" is defined in Rule 12b-2 as "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified."

Citing to several recent going private transactions (without naming the parties involved), Mr. Yu explained that counsel for several companies recently argued their position to the Staff that a shareholder under the common control of the target and the acquirer should not be deemed an affiliate when certain procedural safeguards are imposed (*e.g.*, walling-off or ring-fencing the particular person, shareholder, or entity under common control from any transaction-related negotiations). Mr. Yu indicated that the Staff had recently rejected such arguments by counsel, recommending that a two-part analysis be conducted instead: first, a determination of whether a person is in fact an affiliate of the issuer, and second, whether the relevant party or parties are engaged in a transaction having a Rule 13e-3 "going private" effect.

Mr. Yu went on to caution the audience against raising certain categorical arguments; for example, that a party cannot be an affiliate if another holder has a significantly greater beneficial ownership position, or that a party with less than a majority (*i.e.*, 49% ownership stake) is not an affiliate. In both cases, Mr. Yu noted that such arguments, alone, are not generally persuasive to the Staff. Instead, Mr. Yu suggested that companies focus on the facts and circumstances of the underlying transaction and analyze whether the potential affiliate has the power to control the target's management or policies.

Proxy Access & Private Ordering

Lastly, Ms. Anderson and Mr. Yu discussed some interesting issues that have come up in connection with "private ordering" proxy access bylaws that were adopted in the wake of Rule 14a-11. The SEC's approach to proxy access, as embodied in Rule 14a-11,[5] sought to allow shareholders or groups of shareholders possessing an aggregate of at least 3% of the voting power of a company's securities for at least three years, to request inclusion of the shareholders' director nominees in the company's proxy materials disseminated to shareholders. The D.C. Circuit struck down the rule down in July 2011.[6]

Nonetheless, companies began to adopt their own "proxy access" bylaw provisions that essentially mirrored the requirements in Rule 14a-11 in what is commonly known today as "private ordering" proxy access. On November 10, 2016, GAMCO Investors, Inc. ("GAMCO") became the first shareholder to exercise its right to nominate directors under a private ordering proxy access bylaw provision at National Fuel Gas Company.[7]

Now that a private ordering proxy access bylaw has been exercised, Mr. Yu observed several interesting practical issues in this case of first impression. Notably, the exemptions from Section 13(d) reporting and the proxy solicitation rules that were adopted as part of Rule 14a-11 went away when the rule was vacated. As such, some fundamental questions have arisen, including: how can shareholders seeking to rely on a proxy access bylaw be comfortable they are not engaged in a proxy solicitation in violation of the proxy rules should they do more than simply disclose the bare bones information permitted in the company's proxy statement and that required in the shareholder's Schedule 14N? And what, if any, proxy

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[5] Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668 (Sept. 16, 2010) (to be codified at 17 C.F.R. (to be codified at 17 C.F.R. pts. 200, 232, 240, 249).

[6] Bus. Roundtable v. SEC (*Business Roundtable II*), 647 F.3d 1144 (D.C. Cir. 2011).

[7] Nat'l Fuel Gas Co., Notice of Submission of a Nominee or Nominees in Accordance with Procedures Set Forth Under Applicable State or Foreign Law, or the Registrant's Governing Documents (Schedule 14N) (Nov. 10, 2016) (filed by GAMCO Asset Mgmt. Inc. and Gabelli Funds, LLC); *see generally* James McRitchie, *GAMCO Invokes Proxy Access at National Fuel Gas*, Corp. Governance (Nov. 10, 2016), http://www.corpgov.net/2016/11/gamco-invokes-proxy-access-national-fuel-gas/; N. Peter Rasmussen, *First Investor Takes Proxy Access Out For A Spin; Tea Leaves Muddled on "Fix It" Proposals*, Bloomberg BNA (Nov. 14, 2016), http://www.bna.com/first-investor-takes-b57982082713/. National Fuel Gas Company subsequently rejected GAMCO's proposed nomination on the grounds that GAMCO's nomination did not satisfy the company's bylaw provision. Specifically, the company said GAMCO was seeking to change or influence control of the issuer, citing the shareholder's beneficial ownership reporting on Schedule13D, and the prior submission of proposals seeking a spin-off transaction. Several days after the company's rejection, GAMCO withdrew its proposed nomination(s). *See* Kristyn Hyland, *First Proxy Access Nominee? Not So Fast Says National Fuel Gas Co.*, Bloomberg BNA (Nov. 28, 2016), https://www.bna.com/first-proxy-access-b73014447718/; Samantha Mergenthaler, *Bakrow Withdraws His NFG Board Nomination*, Intelligize (Nov. 30, 2016), http://www.intelligize.com/blog/bakrow-withdraws-nfg-board-nomination/.

solicitation exemptions may be available to such persons seeking to go one step further in articulating the reasons that shareholders should vote for their nominees, as opposed to management's nominees?

Ms. Anderson and Mr. Yu briefly reviewed some options including reliance on the "10-person-or-less" exemption in Rule 14a-2(b)(2) and the so-called "soapbox" exemption found in Rule 14a-1(1)(2)(iv) where a shareholder can state how it intends to vote (and the reasons therefor) by means of speeches in public forums, press releases, broadcast media, newspapers, magazines, or other similar publications that are disseminated on a regular basis. The Staff went on to note that the exemption in Rule 14a-12 is conditioned on the eventual filing of a definitive proxy statement. As such, Rule 14a-12 would not be available for the more extensive soliciting activities that one might want to engage in as part of a proxy access campaign.

The Staff also discussed the absence of any clear exemption from Section 13(d) beneficial ownership reporting obligations, noting that the relevant exemptions from 13(d) were similarly lost when Rule 14a-11 was vacated. Thus, if two or more shareholders come together in order to nominate directors under a private ordering proxy access bylaw, a Section 13(d) group may be formed as a result. Moreover, when shareholders with 5% or more (in the aggregate) seek to nominate directors under a proxy access bylaw, they would no longer be eligible to report their beneficial ownership on Schedule 13G (as previously permitted by Rule 14a-11), but instead would need to disclose their ownership on the more onerous Schedule 13D.

In the wake of GAMCO's initial lead in this area, we will likely see other shareholders attempt to nominate and elect their own director nominees in the upcoming 2017 proxy season using proxy access bylaws. In doing so, the issues highlighted by the Staff, notably the lack of any express exemptions from Section 13(d) and the proxy rules, will only become more prominent going forward. These issues will of course need to be resolved, either through advanced legal planning—which may include seeking guidance from the Staff (through no-action or exemptive relief)—or perhaps, given the current political climate, in *after-the-fact* litigation.

Either way, the discussion at the recent ABA subcommittee meeting highlights the Staff's concerns and the need for careful analysis when shareholders seek to utilize proxy access bylaws to nominate and elect their director nominees to a public board. Mr. Yu invited shareholders and issuers alike to call OM&A when faced with these and other issues, so that they may discuss with the Staff in advance their plans and approach to soliciting activities pursuant to a proxy access bylaw.