

## **Deciding to be Dissident: Proxy Contest Basics for Non-Registrants**

**By Cory White<sup>1</sup>**

The proxy solicitation process is one of the key components to effective shareholder franchise. In principal, it provides shareholders of companies with diversified ownership the ability to exercise their statutory right to vote in an informed and efficient manner, allowing votes to be cast for corporate proposals without the need to attend the annual meeting or special meeting, as the case may be. The solicitation of proxies, while always of consequence, takes on an even larger role in shareholder franchise during a contested solicitation in which a dissident shareholder or group of dissident shareholders are running proposals in opposition to the company's board of directors. In these instances, it is imperative that all applicable laws are followed in order to afford all shareholders their full and unencumbered voting rights. The laws in question are both state and federal. State law tends to speak in general terms about the power to confer a proxy, the revocability of a proxy, and general form of proxy ("proxy card"). Federal securities law, which is primarily the subject matter of this article, applies when dealing with proxies with respect to securities registered under Section 12 of the Securities Exchange Act of 1934 ("34 Act").<sup>2</sup> Such law regulates the process by which proxies are solicited and the various disclosures that must be made with the form of proxy. This article will provide a very basic guide to non-registrants, i.e. dissident shareholders, who wish to proceed in a proxy contest. In discussing the required components of a non-registrant contested solicitation, the vital steps in the process will be elaborated upon. Still, this is a very basic overview and an attorney representing a client during a proxy contest must tackle each issue in detail, carefully reviewing all relevant statutes, rules, regulations, cases, and SEC decisions.

### **Complying with Advance Notice Provisions**

A dissident shareholder soliciting proxies to vote for a particular proposal must first be able to present that proposal at the applicable shareholder meeting. In this regard, the right to submit a proposal must be perfected according to the company's governance documents (bylaws or articles of incorporation). Although each notice may differ depending on the corporate governance documents in play, the notice usually requires the following:

- (a) For Shareholder Director Nominees – all the information required for such persons according to Regulation 14A and the rules thereunder, in particular Rule 14a-101;<sup>3</sup> and
- (b) For All Other Proposals – reasons for bringing the proposal, a brief description of the proposal, and any interest that the dissident shareholder in question may have in proposal.

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<sup>1</sup> Cory White is a 2009 graduate of DePaul University College of Law. He is currently a managing member at the law firm Hafelein | White, LLC where he focuses his practice on securities compliance and entity structuring.

<sup>2</sup> 15 U.S.C. § 78n(a).

<sup>3</sup> See generally 17 C.F.R. § 240.14a-101.

In the unlikely event that a company does not contain an advance notice provision in its governance documents, it is recommended that, in the interest of complete disclosure, notice be given to the company containing the information specified above.

### **Procuring the Shareholder List**

All states require that companies provide their shareholders with access to their books and records upon proper notice and perfection of right, as required by the applicable state statute. The dissident shareholder seeking to launch a proxy contest cannot do so without a list of the company's shareholders. A request should be made for all records, up to the date of the meeting in question, which are in the possession of the company, relating to the identity of all record holders, non-objecting beneficial owners, and the participants in any share purchase or option plan. The proxy materials sent by the dissident shareholder should be directed to the individuals capable of executing a proxy, namely the record holders. Still, a record holder, such as a broker-dealer, holding shares for the benefit of another individual must first receive voting instructions from the beneficial owner prior to executing the proxy card in respect of all non-routine matters listed on the card.

### **Pre-Solicitation Considerations**

After adequate notice has been given to the company and the demand for the shareholder list(s) have been made, the next step will be to plan a solicitation strategy most conducive to getting the required votes to win the proposal(s) which the dissident shareholder seeks to present at the meeting. In doing so, several prominent issues will become apparent, namely: (a) the extent to which pre-solicitation communication is allowed; (b) whether or not it is appropriate to file an information statement under the cover of Schedule 13D; and (c) the logistical issues concerning the mailing out of solicitation materials to the record holders of the securities in question.

(a) Pre-solicitation Communications – Under Rule 14a-3 of the 34 Act, unless an exemption applies, it is inappropriate to solicit proxies or consents without first furnishing a proxy statement to shareholders.<sup>4</sup> A solicitation is defined as (i) any request for a proxy whether or not accompanied by or included in a form of proxy; (ii) any request to execute or not to execute, or to revoke a proxy; or (iii) the furnishing of a form of proxy or other communications to security holders under circumstance reasonable calculated to result in the procurement, withholding or revocation of a proxy.<sup>5</sup> In short, any communication that is designed to, at some point in the future, secure a proxy from another shareholder should be avoided, unless an exemption is found or the provisions of Rule 14a-3 are complied with.

In terms of exemptions from the requirements of Rule 14a-3, the dissident shareholder has one fairly powerful exemption that can create a strategic advantage. Rule 14a-2(b)(2) provides that a non-registrant person does not have to comply with the requirements of Rule

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<sup>4</sup> 17 C.F.R. § 240.14a-3.

<sup>5</sup> 17 C.F.R. § 240.14a-1(l).

14a-3 if the total number of persons solicited is not more than ten.<sup>6</sup> Once the dissident shareholder acquires the list of shareholders, it would be beneficial to target several large beneficial owners to ask for preliminary support.

Finally, a shareholder may solicit proxies prior to the distribution of the proxy materials through the usage of Rule 14a-12, allowing the shareholders to distribute a solicitation communication to shareholders asking for support in the upcoming proxy contest. This communication must be filed with the commission prior to dissemination and it cannot be sent with a form of proxy. Generally, press releases and other public communications to shareholders referencing the proxy contest prior to the dissemination of the definitive proxy statement will be considered 14a-12 material. After the filing of this material, the dissident shareholder should always provide or give access to the materials when soliciting another shareholder.

(b) Schedule 13D – Generally, any person who beneficially owns 5% of the equity voting securities of a company, as such securities are registered under Section 12 of the 34 Act, must file an information statement with the SEC noting such holdings.<sup>7</sup> Like Regulation 14A, Regulation 13D controls the more intricate rules relating to the filing, noting who is required to file and what information is required for the filing.<sup>8</sup> For the purposes of such filing, a “person” can mean a group of individuals that collectively share voting or dispositive power over the securities in question, i.e. a shareholder voting group.<sup>9</sup> Additionally, all individual members of such group may be deemed to beneficially own, directly or indirectly, for the purposes of Section 13(d)(3), all of the securities collectively owed by the group.<sup>10</sup> As an example, if two individuals each own 3% of the voting securities of the registrant company and they choose to form a voting group, such group and each individual in the group must report under Section 13(d) and the rules thereunder. It may be advantageous to form such a group prior to disseminating the proxy materials to the rest of the shareholder body, as it could create a large voting block and serve to bring in more participants into the solicitation who could potentially defray the expenses and costs associated with the proxy contest.

(c) Logistical Issues – Finally, prior to the dissemination of the proxy materials it would be wise to come to terms with a mailing firm as to the costs and expenses associated with distribution of proxy materials and the recording of votes. The mailing firm is primarily responsible for printing the proxy materials, mailing/disseminating the materials, and collecting votes in relation to the executed proxies.

### **Proxy Statement and Proxy Card**

After the pre-solicitation phase the dissident shareholder and his or her attorney will begin the process of drafting the proxy statement and proxy card, which will ultimately be the

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<sup>6</sup> 17 C.F.R. § 240.14a-2(b)(2). See also *Crouch v. Prior Jr.*, 905 F. Supp. 248 (D.V.I. 1995) (noting that a single person having ultimate voting power for several blocks of the same securities can be considered one person).

<sup>7</sup> 15 U.S.C. § 78m(d)(1).

<sup>8</sup> 17 C.F.R. § 240.13d-101.

<sup>9</sup> 15 U.S.C. § 78m(d)(3); 17 C.F.R. § 240.13d-3(a).

<sup>10</sup> 15 U.S.C. § 78m(d)(3); 17 C.F.R. § 240.13d-3(a).

materials distributed to the other shareholders. The content of these two important documents are controlled by a set of intricate rules and regulations contained in Regulation 14A, principally in Rules 14a-4, 14a-5, and 14a-101. Once drafted, these proxy materials, like all solicitation materials, must be filed with the SEC prior to dissemination to the shareholders.<sup>11</sup> The following are a few things to keep in mind while drafting and filing the proxy materials:

(a) The Proxy Statement – The proxy statement serves as the primary disclosure document for the dissident shareholder. The content of the proxy statement is governed by Rule 14a-101. This content will vary depending on the proposals being submitted to the shareholder vote, but all proxy statements will contain disclosures about: the participants in the contest; the interests that such participants may have in the contest; the relevant components and the effect of all proposals submitted; and basic information about how the company in question calls for and counts votes for a particular proposal.<sup>12</sup> The term “participant” is a defined term under Item 4 of Rule 14a-101 and generally means anyone that is a nominee for director of the company, any group or individual that helps finance the proxy contest, and any group or individual that solicits proxies.<sup>13</sup> There are certain persons excluded from the term “participant,” including persons that are retained specifically to solicit proxies and persons who only transmit proxies or provide other ministerial duties, such as a proxy mailing firm. It should be stressed that Rule 14a-101 is incredibly detailed and should be consulted carefully while drafting the proxy statement.

(b) The Proxy Card (Form of Proxy) – The proxy card must comply with both state corporate law and federal securities law in order to properly confer the power the vote. Statutory state law generally only requires that the proxy be in a form sufficient enough to confer the power to vote, not specifying the exact nature of the form required.<sup>14</sup> State law also speaks to the revocability of proxies once conferred. As a general principle, under Rule 14a-4 of the 34 Act, it is inappropriate for a proxy to confer blanket authority to vote on any matter that may come before the annual meeting.<sup>15</sup> Unless discretionary authority is granted under the Rule, a proxy must list each separate matter to be decided on at the annual meeting and give the shareholder the ability to vote for, against, or abstain from voting. For the election of directors, the shareholder must be given the ability to vote for or withhold votes for each nominee listed on the proxy card. A proxy must be voted in the way instructed.<sup>16</sup> Rule 14a-4 should always be consulted when drafting the proxy card.

(c) Filing Timelines – For the dissident shareholder the filing of the proxy statement and card will occur in two steps, the preliminary filing and the definitive filing, which are separated by a 10 day waiting/comment period.<sup>17</sup> This period usually involves a discourse with the SEC concerning the sufficiency of the disclosures made. During the comment period, the SEC, in its

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<sup>11</sup> See Generally 17 C.F.R. § 240.14a-6(a)-(b). Materials must also be sent to any registered national exchange on which the securities in question trade.

<sup>12</sup> See Generally 17 C.F.R. § 240.14a-101.

<sup>13</sup> 17 C.F.R. § 240.14a-101 item 4.

<sup>14</sup> See generally NY BCS Law §Article 6, § 609.

<sup>15</sup> 17 C.F.R. § 240.14a-4(a)-(b).

<sup>16</sup> 17 C.F.R. § 240.14a-4(a)-(b).

<sup>17</sup> 17 C.F.R. § 240.14a-6(a), (b).

discretion, has the ability to accelerate the 10 day period, giving earlier leave to file the definitive materials, which are then disseminated to the shareholders.

### **Special Considerations**

Prior to and during the solicitation process there are several special considerations that the dissident shareholder should keep in mind.

(a) Rule 14a-8 – This article discusses the steps and procedures necessary for a dissident shareholder to engage in a proxy solicitation outside of the scope of Rule 14a-8. Rule 14a-8 allows shareholders, if certain requirements are met, to submit proposals for inclusion with the company’s own proxy materials.<sup>18</sup> This allows shareholders to collect votes for their proposal without the need to engage in a separate proxy solicitation. Although the Rule has recently been amended in 2011 to allow for shareholder access proposals,<sup>19</sup> a shareholder cannot use rule 14a-8 to have his or her nominees listed on the company’s proxy materials.<sup>20</sup> Still, 14a-8 is a method by which a shareholder can effect corporate change without the need for a proxy contest.

(b) Rule 14a-16 – This rule allows for the dissemination of proxy materials via the internet. If certain requirements are met, the dissident shareholder will only need to send a brief notice to the shareholders, noting where the proxy materials can be found online and how the proxy card may be executed.<sup>21</sup> In this regard the dissident shareholder would be providing “notice and access” to the shareholder body. The contents of the notice will be governed by Rule 14a-16. The ability to use this notice is subject to timeframes dependent on the date of the annual meeting or the date that the company files its definitive proxy statement.

### **Settlement**

Proxy contests can become contentious affairs. The dissident shareholder will be running against the company’s board and seeking support for directors or proposals that are not supported by that board. The stakes can be high and the consequences of losing even higher. In order to mitigate the risk of losing, both sides may want to consider a settlement agreement. In this instance, the dissident shareholder would withdraw his or her proxy statement, in accordance with SEC rules, and be given several concessions from the board of directors for doing so. For example, where the shareholder was seeking to replace 3 out of 4 directors, he or she may be willing to settle for two, with his candidates getting the full support of the current board. These agreements generally provide for, among other things, waivers as to future litigation, standstill agreements that limit the shareholder’s ability to engage in future contests, voting agreements concerning future proposals, and the reimbursement of all of the dissident shareholder’s expenses associated with the proxy contest. As with the settlement of any legal matter, the likelihood of success must be weighed against the risk of failure.

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<sup>18</sup> See Generally 17 C.F.R. § 240.14a-8.

<sup>19</sup> These proposals seek to amend corporate bylaws to allow for, through private ordering, the placing of shareholder nominees on a company’s proxy card and having the company solicit proxies for those nominees.

<sup>20</sup> 17 C.F.R. § 240.14a-8(i)(8).

<sup>21</sup> See Generally 17 C.F.R. § 240.14a-16.

## **Final Considerations**

The preceding article only provides a brief overview of the proxy process in reference to a proxy solicitation conducted by a non-registrant, dissident shareholder. The complexities of the process, of which there are many, must be properly understood by the attorney seeking to adequately represent his or her client. Additionally, there are some key differences, in terms of disclosure, when a proxy solicitation is conducted by the registrant company. As always, it is recommended that all relevant rules, statutes, and judicial and administrative decisions be consulted. A firm understanding of the aforementioned bodies of law will generally lead to good results.