Never Mind Equal Access: Just Let Shareholders “Split Their Ticket”

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Since the Securities and Exchange Commission (“SEC”) first proposed its “equal access” rule in 2003, there has been a great deal of focus in the governance community on whether shareholders should have the ability to include their candidates for director in a company’s proxy statement and proxy card, instead of preparing and distributing their own proxy materials. A version of federally-mandated equal access recently appeared in an early draft of the Troubled Asset Relief Act of 2008. While there is no doubt that the contentious debate over equal access will continue, it is beyond the scope of this article to address the merits of equal access, except to note that any equal access reform undoubtedly will be controversial. Moreover, given the upcoming change in the Chairmanship of the Commissioners at the SEC as a result of the recent presidential election, any equal access reform is not likely to be enacted in time for the 2009 proxy season.

However, there is a less controversial, alternative reform that the SEC could consider that would increase “shareholder democracy.” This reform could be accomplished by a relatively simple amendment to the proxy rules. The rule change would permit shareholders to “split their ticket” and vote for any combination of director candidates that they choose in the event that there is a bona fide “election contest” where more candidates are running for election than there are board seats. This change would enable shareholders in a contested election to vote via a proxy card the same way that shareholders can currently vote by attending a meeting and voting in person.

The Issue

Under current proxy rules, if there is an election contest and a shareholder desires to support only some (but not all) members of the dissident slate and some (but not all) members of the company slate, it is extremely difficult for the shareholder to do so and vote by proxy. However, by voting its shares in person at the shareholder meeting, a shareholder can “split its ticket” and vote for any combination of directors that it thinks best for the company. There is little reason that a shareholder’s ability to vote for a combination of candidates for the board of directors should depend on the method by which a shareholder chooses to exercise its franchise.

Proxies are governed by both state and federal law, and it is the interaction of state and federal law that creates the “split the ticket” problem. State laws almost universally provide that the latest-dated proxy revokes any previous proxy. This means that shareholders can only vote for nominees named on a single proxy card because voting on a second later-dated proxy card will automatically revoke the prior card. The last in time rule, however, would not create a problem for a shareholder who wanted to “split its ticket” if all the company’s and the dissident’s nominees for director were required to be listed on a single proxy card.

However, current SEC rules restrict the nominees that can be named on any single proxy card. Under the bona-fide nominee rule, a proxy cannot confer authority to vote for any person for an office unless that person has consented to being named on that proxy and to serve if elected. The bona-fide nominee rule means that any company nominee would have to agree to be named on a dissident’s proxy if that dissident wanted to name any of the company nominees along with its own nominees. Company nominees, not surprisingly, do not often give such consent.

Circumstances where a dissident wants to support some of the company’s nominees are fairly common when a dissident is running a non-control or so-called “short-slate” of directors for the company’s board. In order to allow dissidents running a short slate to afford shareholders the opportunity to vote for a full slate of directors (i.e., both the dissident’s
nominees and specified company nominees), the SEC amended the bona-fide nominee rule in 1992. The amendment is commonly referred to as the “short-slate rule.” The short-slate rule, while confusing in its implementation, allows shareholders who wish to support a dissident who is seeking to elect a short-slate (i.e. a minority or less than half) of directors to be able to exercise their full shareholder franchise and vote for a full slate of candidates.

The short-slate rule requires the dissident to identify by name on its proxy card the company’s nominees that it will not vote for; under the rule, the dissident is not permitted to identify by name the company nominees that will be voted for on its proxy card. Therefore, to determine which directors the dissident running the short slate is planning on supporting, a shareholder must consult both the dissident’s and the company’s proxy materials. The short-slate rule also requires that the dissident state in its proxy solicitation materials that there is “no assurance that the registrant’s nominees will serve if elected with any of the soliciting party’s nominees.” Finally, the short-slate rule requires that a shareholder voting on the dissident’s proxy card be able to withhold support for any of the nominees, including any of the company’s nominees for whom the dissident is soliciting support.

The short-slate rule, however, does not provide a mechanism by which a shareholder can support an alternative configuration of nominees if the shareholder does not support the exact company slate or dissident slate. Once a shareholder makes the decision to vote on either the company’s or the dissident’s proxy card, the only remaining decision for the shareholder is whether to withhold support for any nominee that the named proxies are supporting. If a shareholder withholds support for one of the nominees, there is no means by which a shareholder can write in the name of a nominee on the proxy card to round out its votes so that it can vote for a full slate of directors.

The only sure way for a shareholder to “split its ticket” (i.e., vote for a combination of director candidates who are not reflected on either side’s proxy card) is to vote in person at the shareholder meeting. However, there are costs to voting at the shareholder meeting, including obtaining a legal proxy (if shares are held in “street name”) as well as the time and expense associated with actually attending the meeting and voting in person.

Cases Where the Current Rules Have Posed a Problem

In recent years, several situations have arisen where shareholders may have desired to “split their ticket” and support a combination of company and dissident nominees that was not reflected on either proxy card. In several cases, RiskMetrics (formerly known as Institutional Shareholder Services, or ISS) and other proxy advisory services—who are often highly influential in contested elections—have recommended that shareholders support some, but not all, of a dissident’s nominees. Absent attending the meeting and voting in person, any shareholder wishing to do so would find it difficult to vote by proxy for the ISS-recommended slate of directors or some other mix of directors that was not reflected on either proxy card. Two of the most prominent examples of this are the Blockbuster, Inc. and H.J. Heinz Co. proxy contests.

In 2005, activist investor Carl Icahn led a proxy challenge against the three Blockbuster directors who were standing for re-election that year (Blockbuster had a classified board). RiskMetrics recommended that shareholders vote in favor of two of Icahn’s nominees but withhold support for Icahn himself since RiskMetrics did not think that John Antioco, Blockbuster’s Chairman and CEO, should be removed from the board. Proxy rules prevented a shareholder from voting for the exact slate of directors recommended by RiskMetrics on any single proxy. In effect, a shareholder had to decide whether to vote the dissident card and withhold a vote for Icahn, to vote the company’s card and withhold support for the two company nominees other than Antioco or to go through the process of voting in person at the meeting where it could support any combination of candidates that it desired.

Prior to Blockbuster’s shareholder meeting, there was confusion among institutional shareholders about proxy voting rules and whether or not it was possible to vote for the exact slate of directors recommended by RiskMetrics. During Blockbuster’s first quarter earnings conference call, the following exchange occurred:
Analyst: “I’d like to ask you about the proxy process, because I’m confused as to whether it’s practical for investors to attempt to follow the ISS recommendation and split their vote. It appears to us, and I’m no expert in proxy law, that investors really have the option of voting for one proxy card or another—the other. They can’t vote both, and vote for you [John Antioco, Blockbuster CEO and Chairman of the Board] as a board member and vote for one or more of the Icahn nominees as board members.”

Antioco responded: “On the question of the, how do you implement the split ticket or the ISS suggestion, we’re as confused as you are, quite frankly. We don’t know how exactly you do it. So I’m afraid we can’t help you there…”

The analyst responded: “And, no, I understand. I know that any shareholder who wants to vote for the Blockbuster nominees can do that, but if a shareholder were to want to give you [John Antioco] a vote of confidence as a board member and vote for some other member other than on your ticket, my understanding is that the last received proxy card rules, and so I guess what I’m concerned about is if investors try to vote both cards and withhold a vote for one or more nominees on one of the cards, then I think that there may be some confusing outcome.”

This exchange makes it clear that even sophisticated investors can be confused about whether a shareholder can “split its ticket” and support a combination of nominees on both the company’s and the dissident’s slate.

The day before the election, Blockbuster issued a press release stating that shareholders could vote in accordance with RiskMetrics’ “split-ticket” recommendation by voting for the recommended company director on the company’s white card and the recommended dissident directors on Icahn’s gold card by voting both cards and including a statement on each of the cards saying: “This [White/Gold] proxy card dated May ____, 2005 does not revoke the [Gold/White] proxy card dated the same date, and authorizes the proxy committee to vote only as directed on this card.” Evidently, this written statement was designed to ensure that no proxies would be revoked by the last in time rule, since both would be dated as of the same date.

In the press release announcing this voting mechanism, Blockbuster stated that it had consulted with Delaware counsel and its counsel advised that such procedures were within the law. However, it is not entirely clear that a shareholder can simultaneously grant proxies to different proxy committees. Even if it would practically work for tabulating the director vote, if there had been any discretionary matter voted on at the shareholders’ meeting, it would have been unclear as to who would have had the authority to vote the proxies that had been given to two different proxy committees. Additionally, there is a concern that such split votes could be challenged in court, resulting in a loss of the shareholder franchise.

The 2006 proxy fight between the Trian Group and H.J. Heinz Co. is another situation in which shareholders might have benefited from a rule change allowing them to split their proxy votes among company and dissident nominees. RiskMetrics recommended voting for three of the five nominees that the Trian Group was running for Heinz’s twelve-person board. Glass Lewis & Co., another proxy advisory service, recommended that shareholders vote in favor of two of the five Trian nominees. Under the current paradigm, shareholders had no guaranteed way to follow either RiskMetrics’ or Glass Lewis’ recommendation without voting in person at the meeting—which, reportedly, some large shareholders did.

The Trian Group issued a press release about short-slate voting mechanics stating: “A number of Heinz shareholders have contacted us with questions about the mechanics of voting their shares at the August 16th [2006] Annual Meeting. Shareholders should be aware that attempting a ‘split vote’ by writing in the names of any of the Trian Group’s nominees on Heinz’ White proxy card could disenfranchise shareholders by those votes being deemed invalid. To our knowledge, Heinz has not established any mechanism to allow split voting on its White card nor indicated any intention of doing so.”
Heinz never attempted to create a means by which shareholders could vote for candidates on both the dissident and the company slate. As one commentator put it, “the Heinz fight also highlighted the lack of an effective mechanism for shareholders to split their votes, an issue that caused particular problems in light of the recommendations from the three largest advisory services that the shareholders vote for some but not all of Trian’s five nominees.”

In the wake of the Heinz contest, in which two of the five dissident nominees were elected to the board, it was noted that “the lack of a mechanism for splitting votes is likely to continue to create problems in contested elections where shareholders want to elect only some of the dissidents’ slate, and may be an area for future revision to the proxy rules.”

### A Possible Solution

The SEC can remedy the “split ticket” problem by amending Rule 14a-4 to require that once there is a bona fide election contest (i.e., a dissident group has disseminated a definitive proxy statement to shareholders and there are more nominees than board seats), both sides would be required to put each other’s nominees on their own proxy card, thereby allowing shareholders to select the director candidates of their choosing.

In the SEC release accompanying the adoption of the short-slate rule, the SEC wrote: “Proposals to require the company to include shareholder nominees in the company’s proxy statement would represent a substantial change in the Commission’s proxy rules. This would essentially mandate a universal ballot including both management nominees and independent candidates for board seats. However, any such universal ballot is appealing since the shareholder could make such a selection if he or she attended the annual meeting in person.” Unlike an “equal access” rule, this possible rule change would not provide shareholders with access to a company’s proxy materials, or eliminate the need for a dissident to prepare and disseminate its own proxy materials which would include all the required disclosures. Rather, it would simply standardize the rules by which shareholders can vote by proxy with the way shareholders can vote in person at a meeting.

Requiring that both sides put all nominees on their proxy cards would enable each shareholder to vote for the mix of directors that it wants to be on the board rather than the slate selected by the company or the dissident shareholder. Unlike any equal access proposal, this rule change would not require a wholesale modification to the way election contests currently occur, but would merely provide shareholders with greater flexibility and choice when exercising their franchise. Under any such new rule, each side would presumably be required to refer shareholders to the other side’s proxy materials for information about an opposing party’s nominee(s).

Amending Rule 14a-4 to permit “ticket splitting” would also abolish much of the confusion surrounding the short-slate rule and voting practices in general. As evidenced by the Blockbuster contest, even sophisticated investors have been confused by this rule. Modifying the bona fide nominee rule to permit such voting would eliminate the need for the ad hoc fixes that have taken place in previous election contests. A change in SEC rules would allow a shareholder to vote by proxy for any combination of nominees on both cards without risking the invalidity of its proxy card under state law, since each shareholder would only need to send in one proxy card. One possible unintended consequence of such a rule change is that the shareholder advisory firms might be more prone to recommend that shareholders “split their ticket.” However, as evidenced by their position in the high profile cases discussed above, the advisory firms have not been reluctant to do so notwithstanding the practical difficulty that shareholders have in following their recommendations.

This possible rule would also promote “shareholder democracy” by not disenfranchising shareholders who wish to vote a “split ticket” on a proxy card. This possible rule change is not nearly as controversial or as difficult to implement as any equal access reform and could be accomplished quickly by the SEC though a relatively simple change to the proxy rules.

### NOTES

3. Section 9(c)(1) of the Troubled Asset Relief Act of 2008, discussion draft (September 22, 2008).

4. A shareholder who is the holder of record can vote by proxy or in person at the meeting. A shareholder who owns shares in “street” name must generally obtain a legal proxy in order to vote its shares at the meeting. For a discussion and comparison of legal and beneficial ownership of stocks, see Amy L. Goodman & John F. Olson, A Practical Guide to SEC Proxy and Compensation Rules, §§ 10.01-10.03, (2007).


10. 17 CFR 240.14a-4(d)(ii) (2008). The SEC chose this structure because of concerns expressed by corporate commentators during the comment process for the short-slate rule. Commentators suggested that including the names of the company’s nominees on the dissident’s card would imply that the company’s nominees supported the dissident’s position and confuse shareholders. Exchange Act Release 34-31326.


13. Marc Weingarten notes the same shortcoming of the short-slate rule but does not propose a rule modification along the lines of this article, Short Slates, Majority Slates and Full Slates: Strategic and Voting Considerations, Schulte Roth & Zabel LLP Release (Spring 2008).


18. Patricia Sabatini, As Nasty Heinz Fight Nears End, Observers Weigh In, Pittsburgh Post-Gazette (August 10, 2006).


22. Id.


24. Although the specifics of any rule would have to be worked out, companies, who typically mail before dissidents, could be required to include dissident nominees on the company’s proxy card if the dissident has filed a preliminary proxy statement with the SEC. If a dissident surfaces after a company mails, the company could be required to supplement its proxy materials to include the dissident’s nominees on a revised company card.


26. Rule 14a-5(c), CFR 240.14a-5(c) (2008), allows for information that has been furnished to shareholders in one set of proxy materials to be omitted from other materials as long as clear reference is made to the document containing the information.

New Russian Regime for Strategic Investments

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In his 2005 annual address to the Russian Federal Parliament, then-President Putin stressed the need for more active regulation of foreign investments in areas of strategic importance to Russia. On May 7, 2008, a new Federal law “On the Procedure for Making Foreign Investments in Business Enterprises Having Strategic Importance to Secure Defence and Security of the State” (the “SIL”) came into force.