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January 4, 2017

Re: Universal Proxy
Release No. 34-79164; IC-32339
File No. S7-24-16

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Dear Mr. Fields:

This letter responds to the Commission's request for comment on the above-referenced proposing release. We appreciate the opportunity to provide input on the Commission's universal proxy proposal and the important issues it raises.

Although we generally support efforts to improve the proxy process, we are concerned that the proposal likely exceeds the Commission's authority under Section 14(a) of the Securities Exchange Act of 1934. In addition, we believe the Commission lacks sufficient empirical data to ensure that the proposed changes to the proxy rules would not have an adverse impact on board effectiveness and long-term corporate performance, among other critical concerns. Without this assurance, we do not think it makes sense to introduce potentially far-reaching changes into a long-established process that in our experience already works reasonably well – for shareholders, dissidents and companies – in the vast majority of cases. We also think that without this assurance, the Commission may be unable to sustain its burden under the Administrative Procedure Act to justify departure from longstanding Commission policy. If however the Commission proceeds with the current rulemaking project, we believe that an optional approach, as discussed below, would be preferable to the mandatory approach outlined in the proposal. We also believe the rulemaking project should be limited to contested elections only.

I. The proposal, if adopted, would likely exceed the Commission's authority under the Exchange Act and would also be vulnerable to challenge under the Administrative Procedure Act.

A rule instituting universal proxies would likely exceed the Commission's existing powers under Section 14(a) of the Exchange Act. The proposing release states that "fair corporate suffrage," the key principle underlying Section 14(a),[1] is most appropriately served by "*replicating the vote that could be achieved at a shareholder meeting*," and that therefore "the proxy voting process should *mirror to the greatest extent possible* the vote that a shareholder could achieve by attending the shareholders' meeting and voting in person."[2] The proposing release does not cite direct Commission or other authority to justify this statement, which conflicts with the understanding of Section 14(a) that the Commission held at least through 1992, the last time it undertook amendments to the bona fide nominee rule, Rule 14a-4(d)(1) under the Exchange Act. At that time, the Commission implicitly recognized that requiring a universal proxy was beyond the scope of its mandate – even though it found the idea "appealing":

> "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."[3]

Had the Commission believed in 1992 that the purpose of the proxy process was to ensure that a "shareholder could make [the same] selection [as] if he or she attended the annual meeting in person," the Commission surely would have considered it a duty to require a universal proxy 25 years ago, when it pointed out that a universal proxy would accomplish that goal. Instead, the Commission took the more narrow path of preserving the bona fide nominee rule, a policy choice it first made in 1966, and adopting the short slate rule, the proviso to Rule 14a-4(d).

It is not hard to see why the Commission implicitly concluded in 1992 that it lacked statutory authority to prescribe universal proxies. The conclusion follows directly from the basic premise that Section 14(a) was designed to address abuses in the *proxy process* – in which management and sometimes dissident shareholders solicit proxies to vote for their own preferred slate of candidates. Corporate proxies are a convenience of state law, and no state has legislated that their use must be designed to give shareholders who do not attend a meeting the same experience as those who do attend. This is why in adopting the 1992 amendments to the bona fide nominee rule, the Commission explained its regulations under Section 14(a) not as being intended to replicate the shareholder meeting, but as having "been designed to make sure that management and others who solicit shareholder proxies provide . . . needed information to shareholders, allow them to instruct the specific use of their proxy and provide them access to other shareholders through mailing or by access to a shareholder list."[4] The proposing release

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[1] SEC, *Universal Proxy,* Rel. No. 34-79164 (Oct. 26, 2016) [81 FR 79122, n. 12 (Nov. 10, 2016)] (the "**proposing release**").

[2] *Id*. at 79124 (emphasis added).

[3] SEC, *Regulation of Communications Among Shareholders*, Rel. No. 34-31326 (Oct. 16, 1992) [57 FR 48276 at 48288 (October 22, 1992)] (emphasis added).

[4] *Id*. at 48277.

reconceptualizes and extends the Commission's mandate under Section 14(a) in a way that would certainly effect a "substantial change in the Commission's proxy rules."[5] If the Commission intends to substantially reinvent the proxy process in addition to policing it for abuses, the Commission would need to obtain additional authority from Congress.

The "substantial change" in policy represented by the proposed amendments is also relevant to constraints imposed by the Administrative Procedure Act, given that this proposal to require universal proxies comes 50 years after the Commission adopted the bona fide nominee rule, establishing a clear policy preference against universal proxies. When a federal regulatory agency seeks to reinterpret its authority or reverse an established policy in the absence of legislative approval, the courts impose a high evidentiary bar. Before mandating use of universal proxies, the Commission would need to provide concrete evidence justifying its reversal of the longstanding agency policy reflected in the original bona fide nominee rule and the 1992 amendments, as the D.C. Circuit Court of Appeals noted in a similar case rejecting the Commission's reinterpretation of its authority under another statute:

> "[T]he Commission has failed adequately to justify departing from its own prior interpretation . . . . Absent such a justification, its choice appears completely arbitrary. See *Northpoint Technology, Ltd.* v. *FCC*, 412 F.3d 145, 156 (D.C. Cir. 2005) ('A statutory interpretation . . . that results from an unexplained departure from prior [agency] policy and practice is not a reasonable one.')."[6]

Basing the proposal on grounds that a universal proxy would more closely approximate participation in a shareholder meeting is not enough, because there is nothing new in this observation; it has been apparent for decades that the proxy rules do not accomplish this result, as the Commission acknowledged in 1992. From the "Discussion of Economic Effects" in the proposing release,[7] it appears that the Commission currently lacks evidence on whether required or authorized use of a universal proxy would be beneficial or detrimental for investors, efficiency, competition and capital formation – and is instead seeking to crowdsource this information during the proposal's 60-day notice-and-comment period. The proposing release is open about the fundamental unknowns raised by the proposal; for example:

- "Universal proxies may therefore result in either an increase or decrease in changes in control of a board, and in either dissidents or management winning more seats on the board, or a change in voting percentages without a change in the board composition."[8]

- "While we do not have specific data that suggests the proposed amendments would result in an increase in the reluctance of directors to serve, and it is unclear whether any such reluctance would be more likely to affect more qualified or less qualified candidates, any incremental increase in the reluctance of directors to serve may affect the ability of registrants to recruit individuals with the different skill sets needed to compose an effective board."[9]

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[5] *Id*. at 48288.

[6] *Goldstein* v. *SEC*, 451 F.3d 873, 883 (D.C. Cir. 2006).

[7] Proposing release, 81 FR at 79159.

[8] *Id*. at 79165.

[9] *Id*.

- "Overall, the proposed amendments may have some effect on the composition or control of boards. The effects of any such changes on board effectiveness or on registrant performance are difficult to predict. On the one hand, if more dissident nominees are elected or dissidents are more likely to gain control, it could result in greater efficiency and competitiveness to the extent dissident-nominated directors may be more effective monitors. On the other hand, if more registrant nominees retain their seats or are more likely to retain control, the board may be better able to focus on long-term value creation, because a lower risk of board turnover may reduce the risk that directors unduly focus on short-term metrics."[10]

Given the Commission's level of uncertainty over the impact of mandating universal proxies – on matters as central as corporate performance, board effectiveness and the ability to recruit and retain qualified directors – it is difficult to imagine that the public will be able to resolve these questions during the notice-and-comment period to provide the Commission with a satisfactory basis for concluding it makes sense to reverse decades of settled policy and practice. As a result, we doubt the Commission will be in a position to articulate an evidence-based rationale for reversing the policy decision it made in 1966 in originally proposing and later adopting the bona fide nominee rule and thereby precluding universal proxies in contested elections except by mutual consent. We therefore believe that any rule instituting a universal proxy in the current rulemaking project would be open to challenge under the Administrative Procedure Act.

For the foregoing reasons we believe the Commission's proposed revisions to the bona fide nominee rule would be vulnerable to challenge as exceeding the Commission's authority, as well as an arbitrary exercise of administrative discretion. We therefore believe the Commission should defer action on universal proxies until Congress has clarified its authority. Meanwhile, there are other avenues the Commission could explore to improve proxy voting and shareholder communications generally.[11]

II. If the Commission proceeds with rulemaking, the Commission should make the use of universal proxies optional and any party using one should be required to solicit all shareholders.

Although we believe the best course for the Commission is to defer action on the universal proxy proposal, if the Commission proceeds we believe the amendments as adopted should (1) allow each party – the dissident and management – the choice either to list *only* its own nominees on its proxy card or to use a universal proxy that lists the nominees of *all* parties (that is, an "all or nothing" model) and (2) require any party opting to use a universal proxy to solicit all shareholders.

We note that advocates for an optional approach are not solely companies and their advisors (like us); supporters also include the Commission's Investor Advisory Committee:

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[10] *Id*.

[11] *See, e.g.*, The Shareholder Communications Coalition, *Letter to the SEC re: SEC Proxy Voting Roundtable* (Apr. 1, 2015) (urging the Commission "to move forward with updating and modernizing SEC rules on shareholder communications and proxy voting" in lieu of "short-term fixes . . . symptomatic of the widespread frustrations with the proxy process" and asserting that reform proposals such as the universal proxy "raise significant issues that cannot be successfully addressed without attention to the mechanics of both the shareholder communications and proxy voting processes."), *available at* https://www.sec.gov/comments/4-681/4681-9.pdf.

> "The Commission should explore relaxing the "bona fide nominee" rule embodied in Rule 14a-4(d)(1) promulgated in 1966 under Section 14 of the [Exchange Act] to provide proxy contestants with the *option (but not the obligation)* to use Universal Ballots in connection with short slate director nominations."[12]

A. *An optional regime would allow the Commission to study the impact of universal proxies before mandating their use*.

As discussed in Part I above, the Commission lacks hard evidence about what would happen if it suddenly instituted mandatory universal proxies for all companies. The "known unknowns" inherent in the proposal strongly advise proceeding on a cautious and incremental basis until companies and shareholders have generated a track record with universal proxies and the Commission and the broader public are able to assess both the benefits and the drawbacks of this potentially significant change to a practice that is well understood by all interested parties.

In an optional regime, we expect that both companies and dissidents would on occasion consider it in their best interests to use a universal proxy, providing the Commission with data that it could use to determine whether a mandatory regime can be implemented without risking unintended adverse effects. We believe that a company could be prompted to distribute a universal proxy when faced with a dissident who is making an appealing argument to shareholders, leading the company to conclude there is a likelihood that shareholders will want to cast their votes for at least some names on the dissident slate. Rather than risk having shareholders use the dissident's proxy card for this purpose, potentially putting more management nominees in peril, the company may decide to give shareholders the option to vote for dissident nominees on the same card as the management nominees. We expect that dissidents could be incentivized to use a universal proxy especially when nominating less than a full slate, when a universal proxy would appeal to shareholders who otherwise may face the choice of having to "throw away" extra votes.

B. *An "all or nothing" approach would achieve the Commission's objective while minimizing investor confusion*.

Our proposed approach would condition relaxation of the bona fide nominee rule on the universal proxy's listing *all* nominees from *all* soliciting parties, including when there is more than one dissident slate – a scenario that is relatively rare today but that could become commonplace if the Commission permits universal proxies without limiting their use to shareholders who meet substantial ownership or other thresholds. We believe that this approach would be the least likely to cause investor confusion, while still addressing the Commission's objective of providing investors with a proxy card that replicates in-meeting voting.

We believe that an optional regime without an "all or nothing" requirement, in which the nominating party could choose how many and which opposing nominees to list, would be likely to result in confusion for investors, particularly retail investors who, experience suggests, are much less likely to read accompanying proxy materials.[13] We believe it would be significantly less confusing to investors if they know that a proxy card will either contain only the nominees of a

[12] *Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Explore Universal Proxy Ballots* (Jul. 25, 2013) (emphasis added), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/universal-proxy-recommendation-072613.pdf.

[13] *See* proposing release, 81 FR at 79149 ("In particular, there are, on average, large differences in involvement by institutional investors compared to retail investors.").

particular party, or all nominees of all parties. Additionally, we note that allowing proponents to pick and choose would not achieve the Commission's preference for a proxy card that replicates voting in person at a meeting, but would introduce new vectors for gamesmanship in proxy contests.

C. *There should be a level playing field for all parties.*

In our era of highly sophisticated, well-funded and media-savvy activist investors, we do not believe there is any justification for providing dissidents with regulatory advantages over companies. The playing field should be level for all parties.[14] A disparity between solicitation requirements imposed on companies and dissidents would inappropriately favor the party with the lower solicitation burden. Therefore, if a party chooses to use a universal proxy, that party should be required to solicit – and bear the cost of soliciting – all shareholders, not just the majority envisioned by the proposal. This is especially the case given the lack of ownership, duration or other thresholds in the Commission's proposal, as compared to the three-percent/three-year thresholds that are increasingly common in proxy access bylaws.[15]

We also believe that obligating dissidents to solicit only a majority of shareholders would disadvantage retail investors.[16] Commissioner Piwowar explained the detrimental impact of a less-than-universal solicitation requirement at the Commission's meeting announcing the universal proxy proposal:

> "[T]oday's universal proxy proposal will be to the detriment of retail investors. Under the proposed rules, a dissident would only be required to solicit holders of shares representing a majority of the voting power of shares entitled to vote on the election of directors. Because dissidents would not be required to solicit all shareholders, many shareholders will not receive the dissident's proxy card, nor will they receive the dissident's proxy statement. And as the data indicates, the vast majority of these neglected shareholders are likely to be retail investors. More importantly, these

[14] Members of the Commission and its staff frequently advocate for a level playing field among market participants. *See e.g.*, Hon. Kara M. Stein, *Remarks before the Securities Traders Association's 82nd Annual Market Structure Conference* (Sep. 30, 2015) (explaining that "[a]lthough transparency can't solve every problem, it goes a long way towards leveling the playing field and empowering investors. It is clear that opacity does the opposite, and actually favors the interests of certain market participants over others."), *available at* https://www.sec.gov/news/speech/stein-market-structure.html; *See also* Mary B. Tokar, *Speech by SEC Staff: A Regulator's Perspective on the Needs of the Capital Markets*, Int'l Fed. of Accountants, IFAC 2000 (May 22, 2000) ("[markets] need regulators to keep a level playing field, with all participants held to the same standards"), *available at* https://www.sec.gov/news/speech/spch385.htm.

[15] *See* Geldzahler, Janet T., *Proxy Access Bylaw Developments and Trends*, Harvard Law School Forum on Corporate Governance and Financial Regulation, September 4, 2015, *available at* https://corpgov.law.harvard.edu/2015/09/04/proxy-access-bylaw-developments-and-trends/.

[16] *See* proposing release, 81 FR at 79160 ("In particular, smaller shareholders, such as those holding fewer than 1,000 shares in the registrant, are less likely to be solicited by dissidents."); *See also Id*. at n. 292 ("Based on industry data provided by a proxy services provider for a sample of proxy contests from June 30, 2015 through April 15, 2016, in contests in which fewer than all shareholders were solicited, the shareholders to be solicited were chosen based on the size of their shareholdings. Specifically, only those accounts holding a number of shares of the registrant equal to or exceeding a minimum threshold were subject to solicitation by the dissident.").

> shareholders will not receive the important disclosures about the dissident's nominees contained in the dissident's proxy statement."[17]

III. If the Commission proceeds with rulemaking, it should address contested elections only.

The proposal includes features that would extend beyond contested elections. The proposed redefinition of "bona fide nominee" as a person who has consented to being named in any proxy statement would, as drafted, permit a dissident to include the names of one or more company nominees on its own proxy card even without nominating a competing slate, such as in a "vote no" campaign or when a proponent is putting forward a corporate governance proposal. The proposing release explains that this would address the possibility that a proponent "might want to include [company] nominees on its proxy card so that shareholders supporting its proposal would be able to use the proponent's proxy card also to vote in the election of directors."[18] This goes well beyond the Commission's statement that "the impetus for proposing amendments to Rule 14a-4(d) . . . is to address situations in which there are *competing slates* for the board of directors,"[19] and seems to have little or no nexus to the objective of aligning proxy voting to voting in person at a meeting.

Influential proponents of a universal proxy have defined the problem they want solved as arising in the context of contested elections. For example, in petitioning the Commission to adopt universal proxy rules, the Council of Institutional Investors explained that its request related "solely to proxy contests, which carry crucial significance for the companies and shareholders involved" and requested that the Commission "amend the proxy rules under Section 14 of the [Exchange Act] to facilitate the use of universal proxy cards featuring a complete list of board candidates in cases of a *contested election* of directors."[20] The Council noted that:

> "The problem that universal proxies would resolve is a problem that was clearly articulated by the SEC's own Investor Advisory Committee more than a year ago: Namely, investors are currently disenfranchised in a *proxy contest* because they have no practical ability to 'split their ticket' and vote for the combination of shareowner nominees and management nominees that they believe best serve their economic interests."[21]

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[17] Hon. Michael S. Piwowar, *Dissenting Statement at Open Meeting on Universal Proxy* (Oct. 26, 2016), *available at* https://www.sec.gov/news/statement/statement-piwowar-universal-proxy-10-26-2015.html.

[18] Proposing release, 81 FR at 79130.

[19] *Id*. (emphasis added). Furthermore, when Congress sought to grant the Commission limited authority to effectuate a proxy access regime by amending Section 14(a) of the Exchange Act under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the scope of the amendment was limited to situations in which a shareholder is submitting a nominee to the board. *See* PL 111-203 [HR 4173], 124 Stat. 1376, 1915 (2010) (explaining in a note that "[t]he Commission may issue rules permitting the use by a shareholder of proxy solicitation materials supplied by an issuer of securities for the purpose of nominating individuals to membership on the board of directors of the issuer, under such terms and conditions as the Commission determines are in the interests of shareholders and for the protection of investors.").

[20] Council of Institutional Investors, *Petition for Rulemaking to Amend Section 14 of the Securities Exchange Act of 1934 to Facilitate the Use of Universal Proxy Cards in Contested Elections* (Jan. 8, 2014) (emphasis added), *available at* https://www.sec.gov/rules/petitions/2014/petn4-672.pdf.

[21] Council of Institutional Investors, *Letter to the SEC re: Proxy Voting Roundtable* (Mar. 5, 2015) (emphasis added), *available at* https://www.sec.gov/comments/4-681/4681-7.pdf.

Given the Commission's lack of information on the likely effects of its proposal, we see no reason for the Commission to introduce changes to the proxy process that lack strong support even from outspoken investor advocates.

For shareholder proposal proponents, this aspect of the proposal is unnecessary because Rule 14a-8 under the Exchange Act already provides a time-tested avenue for a shareholder to require a company to include its proposal on the company's proxy card; Rule 14a-8 reflects a balancing of the interests of shareholders and companies that the proposal would ignore. The proposing release asks whether inclusion of company nominees on a proponent's proxy card when the proponent is not nominating its own candidate would imply that the company nominees support the proponent's proposal.[22] We believe it would, because it is foreseeable that a shareholder looking at a proxy card recommending all company nominees listed would assume that they supported the proposal also being recommended on the card.

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We appreciate the Commission and its staff's consideration of our comments. Please contact John A. Bick, Arthur F. Golden, Joseph A. Hall, Phillip R. Mills, William L. Taylor, Ning Chiu, Lillian deSouza Burr, Rebecca E. Crosby or Melissa Glass at 212-450-4000 to discuss any of the foregoing in more detail.

Very truly yours,

Davis Polk & Wardwell LLP

[22] Proposing release, 81 FR at 79130.