SEC Proposes to Require Universal Proxies; Adopts Final Rules to Facilitate Intrastate Offerings

On October 26, 2016, the Securities and Exchange Commission (SEC) proposed amendments to the proxy rules to require parties in contested elections to use universal proxy cards that would include the names of all board of director nominees, and adopted final rules to modernize how companies raise capital to fund their businesses through intrastate and small offerings.

Proposed Rules on Universal Proxy Cards

The SEC proposed amendments to the proxy rules that would require the use of universal proxy cards in all non-exempt contested director elections (other than those involving registered investment companies and business development companies). The proposed amendments also would amend the form of proxy and require additional proxy statement disclosure to clearly specify the applicable voting options and voting standards in all director elections subject to the proxy rules.

Under current proxy rules, shareholders voting by proxy in a contested election are generally not able to replicate the vote that would be available to them if they attended the shareholders' meeting and voted in person. In a contested proxy solicitation, management sends one proxy card with its slate of director nominees, while the dissident shareholder sends a separate proxy card with its full or partial slate of nominees. As a result, shareholders voting via proxy must choose to vote using either management's proxy card, or the dissident shareholder's proxy card, and are not able to vote for a combination of nominees from both proxy cards. In contrast, by attending a shareholders' meeting in person, a shareholder may select from among all of the director nominees by casting a written ballot, using a ballot that includes the names of all duly nominated director candidates, whether nominated by management or the dissident shareholder. Currently, Rule 14a-4(d) prohibits a party in a contested election from including the other party's nominees on its proxy card unless the other party's nominees consent to being named in the proxy statement, and this consent is generally not given for strategic reasons. Thus, shareholders voting by proxy are not able to select directors from among all possible director nominees based solely on their preferences for particular candidates.

The changes to the federal proxy rules proposed by the SEC would eliminate the difference between voting by proxy and voting in person by ballot, by requiring the use of a "universal proxy" that includes the names of all duly nominated director candidates. Use of a universal proxy would allow a shareholder who does not attend a shareholders' meeting to vote for candidates from both the management and dissident shareholder slates. "The proposed changes would allow shareholders to vote by proxy in a manner that more closely replicates how they can vote in person at a shareholder meeting," said SEC Chair Mary Jo White. "This change would allow shareholders through the proxy process to more fully exercise their vote for the director nominees they prefer."

The proposed amendments to implement a universal proxy would apply to all non-exempt solicitations in connection with contested elections where a person or group of persons is soliciting proxies in support of director nominees other than the registrant's nominees.

Proposed Amendments to Implement Universal Proxy Cards

Under the SEC's proposal:

- Rule 14a-4(d) would be amended to change the definition of "bona fide nominee" to be defined as a person who agrees to be named in any proxy statement relating to a company's next meeting of shareholders at which directors are to be elected. By referring to "a" proxy

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statement, rather than "the" proxy statement, the amendment would enable parties in a contested election to include all director nominees on their proxy cards. Rule 14a-4(d)(1)(i) would retain the requirement that a nominee must consent to serve if elected.

- The "short slate rule" in Rule 14a-4(d)(4) would be eliminated, because universal proxy cards would permit shareholders to vote for any combination of issuer and dissident nominees in order to cast a vote for a full slate of directors.
- Pursuant to new Rule 14a-19(e), proxy contestants in a contested election would be required to distribute to shareholders a universal proxy that includes the names of both management and dissident nominees for election to the board of directors, which would allow shareholders to vote by proxy for the combination of nominees of their choice. Universal proxies would be required in all non-exempt proxy solicitations in contested elections (for registrants other than investment companies and business development companies).
- Proxy contestants would be required to notify each other of their respective director candidates. A dissident would be required to notify the issuer of its intent to solicit proxies in support of director nominees, and the names of those nominees, not later than 60 calendar days prior to the anniversary of the previous year's annual meeting date. Similarly, the issuer would be required to provide the dissident with the names of its nominees not later than 50 calendar days prior to the anniversary of the previous year's annual meeting date. After the above-required notice is given, a dissident would be required to solicit shareholders representing at least a majority of the voting power of shares entitled to vote on the election of directors.
- Proxy contestants would be required to refer shareholders to the other party's proxy statement for information about that party's nominees and explain that shareholders can access the other party's proxy statement for free on the SEC's website. To ensure that shareholders who receive a universal proxy will have access to information about all nominees a sufficient amount of time before the meeting, dissidents would be required to file their definitive proxy statement with the SEC not later than 25 calendar days prior to the meeting date or five calendar days after the registrant files its definitive proxy statement.
- All universal proxy cards would be subject to presentation and formatting requirements with clear instructions to permit shareholders to effectively vote for the director nominees they prefer and help ensure that universal proxies are exercised in accordance with the choice specified by shareholders on the proxy card.
- The proposed amendments would not apply to exempt solicitations under Rule 14a-2(b).

Proposed Amendments Relating to Disclosure of Voting Standards and Voting Options in All Director Elections

To further facilitate shareholder voting in director elections, the SEC also proposed amendments to the proxy rules to ensure that proxy cards specify the applicable shareholder voting options in all director elections and to require that proxy statements disclose the effect of a shareholder's election to withhold its vote.

The SEC is proposing to amend Rule 14a-4(b) to: (1) mandate the inclusion of an "against" voting option in lieu of the "withhold authority to vote" option on the form of proxy where there is a legal effect to such a vote; and (2) provide shareholders the opportunity to "abstain" in a director election governed by a majority voting standard (rather than withhold authority to vote). The proposed amendment would eliminate the current ability to provide a withhold voting option when an against vote has legal effect. In addition, the proposed amendments would amend Item 21(b) of Schedule 14A to expressly require disclosure about the effect of a withhold vote in an election of directors.

The public comment period on the proposed rules will remain open for 60 days following publication of the proposing release in the Federal Register.

Final Rules to Facilitate Intrastate and Regional Securities Offerings

On October 26, 2016, the SEC also adopted final rules designed to modernize how companies raise money through intrastate and small offerings. According to SEC Chair White, "These final rules, while continuing to provide investor protections, update and expand the capital raising avenues for smaller companies, allowing them to take advantage of changes in technology and business practices more fully."

The final rules amend existing Rule 147 and adopt new Rule 147A under the Securities Act of 1933, as amended (the Securities Act) to modernize the safe harbor provided by Section 3(a)(11) of the Securities Act, so issuers may continue to rely on state law securities offering exemptions that are conditioned upon compliance with both Section 3(a)(11) and Rule 147. New Rule 147A also establishes a new intrastate offering exemption identical to existing Rule 147, but which also permits offers to be made to out-of-state residents and allows companies that are organized out-of-state to conduct offerings under Section 3(a)(11) if their principal business operations are located in that state.

New Rule 147A and Amendment s to Rule 147

Rule 147 was adopted in 1974 as a safe harbor under the statutory intrastate offering exemption provided by Section 3(a)(11) of the Securities Act, to facilitate local capital formation by companies within the company's state or territory. However, the statutory limitation in Section 3(a)(11) restricts offers to persons residing in the same state or territory as the issuer. This provision, combined with the prescriptive issuer eligibility requirements of Rule 147, effectively limited the availability of the exemption, and developments in business practices and communications technology have made Rule 147 outdated.

New Rule 147A and the amendments to existing Rule 147 under the Securities Act are designed to update and modernize the existing intrastate offering framework and permit a company to raise money from investors within its state without concurrently registering the offers and sales at the federal level. As amended, Rule 147 will remain a safe harbor available to issuers under Section 3(a)(11) of the Securities Act, so that issuers may continue to use the rule for securities offerings relying on current state law exemptions. New Rule 147A will be substantially identical to existing Rule 147, except that it will allow multi-state offers (for example, by issuers using unrestricted publicly available internet websites to locate potential in-state investors), and will permit companies to be incorporated or organized outside of the state in which they conduct the offering, provided that the jurisdiction is where they have their principal place of business.

Both new Rule 147A and amended Rule 147 include the following provisions:

- A requirement that the issuer has its "principal place of business" or jurisdiction of organization in the state in which the purchasers in the offering are resident, and satisfies at least one "doing business" requirement to demonstrate the in-state nature of the issuer's business;
- A requirement that issuers limit sales to in-state residents, and adoption of a new "reasonable belief" standard for issuers to rely on in determining the residence of the purchaser at the time of the sale of securities;
- A requirement that issuers obtain a written representation from each purchaser as to residency;
- A limit on resales to persons residing within the state or territory of the offering for a period of six months from the date of the sale by the issuer to the purchaser of a security sold pursuant to the exemption, so that the securities sold in an intrastate offering have "come to rest" in the state;
- An integration safe harbor that will include prior offers or sales of securities by the issuer made under another provision, and certain subsequent offers or sales of securities by the issuer within six months after the completion of the offering exempt pursuant to Rule 147 or Rule 147A; and
- Disclosure requirements, including a legend, to offerees and purchasers about the limitations on resale.

Amendments to Rule 504 and Repeal of Rule 505

The SEC has also amended existing Rule 504 of Regulation D under the Securities Act to increase the aggregate amount of securities that may be offered and sold in any 12-month period to $5 million from $1 million, to facilitate capital formation by smaller companies. Rule 504 is also being amended to apply the bad actor disqualifications in Regulation D to Rule 504 offerings to provide additional investor protection and to make Rule 504 offerings consistent with other offering exemptions under Regulation D. In light of the increased offering size provided by amended Rule 504, the final rules adopted by the SEC also repeal Rule 505 of Regulation D.

Existing Rule 504 of Regulation D offers an exemption from the registration requirements of the Securities Act for offers and sales of up to $1 million of securities in a 12-month period, provided that the issuer is not an Exchange Act reporting company, investment company, or development stage or blank check company. The rule also imposes certain conditions on the offers and sales, with limited exceptions made for offers and sales made in accordance with specified types of state registration provisions and exemptions. The amendments to Rule 504 retain the existing framework of the rule, but increase the aggregate amount of securities that may be offered and sold under Rule 504 in any 12-month period to $5 million, and disqualify certain bad actors from participation in Rule 504 offerings. The final rules also repeal Rule 505 of Regulation D, which permits offerings of up to $5 million annually. Rule 505 is no longer necessary in light of the amendments increasing the size of permissible offerings under Rule 504, and the availability of Rule 506 under Regulation D, which does not contain any aggregate offering amount limitation.

Amended Rule 147 and new Rule 147A will be effective 150 days after publication of the adopting release in the Federal Register. Amended Rule 504 will be effective 60 days after publication in the Federal Register, and the repeal of Rule 505 will be effective 180 days after publication in the Federal Register.

To discuss any questions you may have regarding the issues discussed in this Alert, or how they may apply to your particular circumstances, please contact Christopher J. Bellini at (612) 260-9029 or cbellini@cozen.com or Ellen Canan Grady at (215) 665-5583 or egrady@cozen.com.