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SEC / CORPORATE

SEC Proposes Amendments To Require Universal Proxy Cards in Contested Elections

On October 26, the Securities and Exchange Commission voted to propose amendments to the proxy rules that would require the use of universal proxy cards in contested elections (i.e., in a contested election, shareholders would be provided with a proxy card that contains the names of both the management nominees and one or more dissident shareholder nominees for the board of directors).

Background. Currently, in a contested election, shareholders voting by proxy typically receive one proxy card with management's slate of nominees and a separate proxy card with the dissident's full or partial slate, and they must submit their votes on either the company's or the dissident's proxy card, but not both. Accordingly, a shareholder cannot pick and choose among the candidates on the two slates and, if dissidents have not proposed a full slate, will not be able to vote for all of the open slots if the shareholder wishes to vote for the dissident candidate(s). By contrast, shareholders who attend a meeting in person generally are able to cast a written ballot at the meeting that includes all duly nominated candidates for the board of directors (i.e., both management and dissident director nominees).

Proposed Amendments. The proposed amendments attempt to replicate the process by which shareholders can vote at in-person meetings for shareholders voting by proxy in a contested election. The proposed amendments would:

- Require proxy contestants (i.e., both management and dissidents) to provide shareholders with a universal proxy card that includes the names of both management and dissident nominees (which would allow shareholders to vote by proxy for the combination of nominees of their choice).
- Amend the definition of "bona fide nominee" in Rule 14a-4(d) of the Securities and Exchange Act of 1934 (the "Act") to include a person who agrees to be named *in any* proxy statement relating to a company's next meeting of shareholders at which directors are elected. Under the current Rule 14a-4(d), one party's director nominee may not be included on the opposing party's proxy card unless the nominee gives his or her consent to the opposing party (i.e., without such consent, there must be two proxy cards).
- Eliminate the "short slate rule" (i.e., Rule 14a-4(d)(4) of the Act). The short slate rule permits a dissident to (1) propose a slate of dissident nominees that would constitute only a minority of the board; and (2) "round out" the proxy card (in the dissident's discretion) by identifying management nominees that the dissident would not vote for (which results in the shareholder's votes being cast for the unnamed management nominees). Universal proxy cards would make any such rounding out unnecessary.
- Require proxy contestants to notify each other of their respective director candidates. A dissident would be required to provide the company with the names of the nominees for whom it intends to solicit proxies no later than 60 days prior to the anniversary of the previous year's annual meeting. The company would then be required to provide any such dissident the names of the nominees for whom it intends to solicit proxies no later than 50 days prior to the anniversary of the previous year's annual meeting.
- Require dissidents to solicit shareholders representing at least a majority of the voting power of shares entitled to vote on the election of directors (in order to trigger the use of the mandatory universal proxy card).
- Require proxy contestants to refer shareholders to the other party's proxy statement information about that party's nominee, and inform shareholders that they can access the other party's proxy statement for free on the SEC's website.
- Subject universal proxy cards to presentation and formatting requirements to help ensure that universal proxy cards clearly and fairly present information.

Proposed Amendments in All Director Elections. In addition to the proposed amendments regarding contested elections, the SEC has proposed the following amendments relating to voting options and standards that would apply in all director elections:

- Amend Rule 14a-4(b) of the Act to provide that proxy cards would be required to (1) include an "against" voting option for the election of directors when there is a legal effect to a vote against a nominee (as is the case where the registrant has a majority voting standard); and (2) provide shareholders the ability to "abstain" in a director election governed by a majority voting standard.
- Amend Item 21(b) of Schedule 14A (pursuant to Section 14(a) of the Act) to require that a company that applies plurality voting standards for director elections to disclose in its proxy statement the treatment and effect of a "withhold" vote in the election (i.e., that a "withhold" vote has no legal effect).

Proxy Access. The proposed amendments regarding a universal ballot would have a significantly different impact than the "proxy access" bylaws that many companies have adopted over the past two years (which permit shareholders to nominate candidates for inclusion in the proxy materials distributed by a company – typically those shareholders who have held at least 3% of the company's shares for at least three years). For example, unlike proxy access bylaws, using a universal proxy card would require shareholders to prepare and file their own proxy materials, disseminate those materials, and solicit other shareholders.

The SEC will seek public comment on the proposed amendments for 60 days following the publication of the comment request in the *Federal Register*. The complete release of the proposed amendments and rules is available here.

SEC Adopts Amendments to Rules 147 and 504, Adopts Rule 147A and Repeals Rule 505

On October 26, the Securities and Exchange Commission adopted final rules amending (1) Rule 147 promulgated under the Securities Act of 1933 (Securities Act) to modernize the existing safe harbor under Section 3(a)(11) of the Securities Act for intrastate securities offerings and (2) Rule 504 of Regulation D under the Securities Act to assist capital raising and to provide additional protections to investors. The SEC also adopted new Rule 147A to establish a new intrastate offering exemption and, in connection with the amendments to Rule 504, repealed Rule 505 under Regulation D. The SEC's proposal for these Rules was discussed in the November 6, 2015 edition of the *Corporate & Financial Weekly Digest*.

The SEC's amended Rule 147 provides a safe harbor under the Section 3(a)(11) exemption from the registration requirements of Section 5 of the Securities Act for issuers that are both organized and principally doing business in the same state to make offers and sales of securities to purchasers that are resident in that state. Although the SEC also adopted the new exemption for intrastate offerings discussed below, the SEC elected to keep and modify Rule 147 as a safe harbor under Section 3(a)(11) to allow issuers to continue to rely on state law exemptions that are conditioned upon compliance with Section 3(a)(11) and Rule 147.

Rule 147A provides a similar exemption from the Section 5 registration requirements, which will also permit issuers that are incorporated in a different state to offer and sell securities in the state of their principal place of business, so long as sales are limited to residents of that state. For example, Rule 147A will allow an issuer that is organized in Delaware, but whose business is principally conducted in New York, to make offers and sales of securities to New York residents. Additionally, Rule 147A will allow issuers to make offers of securities across state lines, including via the internet, so long as sales are limited to residents of the state of their principal place of business.

Both amended Rule 147 and new Rule 147A include:

- a requirement that the issuer has its "principal place of business" in the state of the offering and that the issuer satisfies at least one "doing business" requirement demonstrating the nature of the its business in the state of the offering;
- a new "reasonable belief" standard in the determination of residence of a purchaser at the time of the sale of securities, which will allow an issuer to rely on the Rules so long as the issuer has established a reasonable belief as to each purchaser's state of residence, even if it is ultimately determined that one or purchasers did not reside in the state of the offering;

- a requirement that issuers obtain a written representation from each purchaser as to the purchaser's residency;
- for a period of six months following the sale by the issuer to the purchaser, a restriction on resales of the securities to persons that were not resident within the state or the territory of the offering at the time of the offering;
- a safe harbor preventing the integration of the applicable offering with prior or certain future offers and sales of securities; and
- disclosure requirements to offerees and purchasers about the limitations on resales.

Prior to the amendments, Rule 504 provided certain private issuers with an exemption from registration for offers and sales of up to $1 million of securities, subject to certain restrictions. Rule 504 allows companies to solicit or advertise their securities to the public and sell securities that are not restricted if the issuer (1) registers the offering exclusively in one or more states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors; (2) registers and sells the offering in a state that requires registration and disclosure delivery and also sells in a state that does not have such requirements, so long as the issuer delivers the disclosure documents required by the state where the issuer registered the offering to all purchasers, including those purchasers in states that have no such requirements; or (3) sells solely according to state law exemptions that permit general solicitation and advertising, so long as sales are made only to accredited investors.

The amendments to Rule 504 increase the aggregate amount of securities that may be offered and sold by an issuer in a 12-month period from $1 million to $5 million. In addition, the amendments apply to Rule 504 the "bad actor" disqualifications of Rule 506 of Regulation D. In light of the changes to Rule 504, the SEC repealed Rule 505 of Regulation D (which permits offerings of up to $5 million annually, subject to specified conditions). The SEC noted that by increasing the size of offerings under Rule 504, it was decreasing the incentives to use Rule 505, which was not widely utilized prior to the amendments to Rule 504.

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

The SEC's amendments are available here.

ISS Opens Data Verification Period

On October 31, proxy advisory firm Institutional Shareholder Services Inc. (ISS) opened the data verification period for QualityScore (formerly QuickScore), its corporate governance rating system, which will remain open until 8:00 p.m. (ET) on November 11. During the data verification period, companies are encouraged to access ISS's data verification site on Governance Analytics, which can be found here, to verify the ISS data that will be included in QualityScores and provide feedback. Companies that do not have a login can request one via email here.

ISS updated several existing factors and added 15 new factors for its QualityScore ratings. Updated QualityScore scores will be released on November 21. The 15 new factors are as follows:

Board Structure
- What proportion of non-executive directors has been on the board less than six years?
- Does the board have any mechanisms to encourage director refreshment?
- Does the company disclose the existence of a formal CEO and key executive officer succession plan?
- What is the proportion of women on the board?
- Has the board adequately responded to low support for a management proposal?

Shareholder Rights and Takeover Defenses
- Does the company have an exclusive forum provision?
- Does the company have a fee shifting provision?
- Does the company have a representative claim limitation or other significant litigation rights limitations?
- What is the ownership threshold for proxy access?
- What is the ownership duration threshold for proxy access?

- What is the cap on shareholder nominees to fill board seats from proxy access?
- What is the aggregation limit on shareholders to form a nominating group for proxy access?
- Can the board materially modify the company's capital structure without shareholder approval?

Compensation
- Does the company employ at least one metric that compares its performance to a benchmark or peer group (relative performance)?

Audit and Risk Oversight
- What is the tenure of the external auditor? (non-scored factor)

The full updated QualityScore technical document is available here.

DERIVATIVES

See "CFTC Further Extends No-Action Relief Relating to Certain Swaps Executed as Package Transactions" and "CFTC Issues Orders of Registration to Five Foreign Boards of Trade" in the CFTC section.

CFTC

CFTC Further Extends No-Action Relief Relating to Certain Swaps Executed as Package Transactions

The Commodity Futures Trading Commission's Division of Market Oversight has issued CFTC Letter No. 16-76, extending until November 15, 2017, time-limited no-action relief for certain swaps executed as part of a package transaction.

A package transaction is a transaction involving two or more instruments and: (1) that is executed between two or more counterparties; (2) that is priced or quoted as one economic transaction with simultaneous or near simultaneous execution of all components; (3) that has at least one component that is a swap that is made available to trade and, therefore, subject to the trade execution requirement under section 2(h)(8) of the Commodity Exchange Act (CEA); and (4) where the execution of each component is contingent upon the execution of all other components.

CFTC Letter No. 16-76 extends relief from the requirements of CEA section 5(d)(9) and CFTC Regulation 37.9, permitting swap execution facilities (SEFs) and designated contract markets to continue to offer any method of execution for such component swaps. Additionally, SEFs are not required to offer an order book for any of the swap components of such package transactions, as would otherwise be required by CFTC Regulation 37.3(a)(2).

The relief applies to the swap components of package transactions that include at least one individual swap component that is subject to the trade execution requirement and one or more of the following: (1) at least one individual component that is a bond issued and sold in the primary market; (2) all other components that are contracts for the purchase or sale of a commodity for future delivery; (3) at least one individual swap component that is subject to the CFTC's exclusive jurisdiction, but not subject to the clearing requirement under CEA section 2(h)(1)(A) and CFTC Regulation 50.4; (4) at least one individual component that is not a swap; or (5) at least one individual swap component that is a swap over which the CFTC does not have exclusive jurisdiction.

This relief granted under CFTC Letter No. 16-76 is set to expire on November 15, 2017.

The CFTC's press release is available here.

CFTC Issues Orders of Registration to Five Foreign Boards of Trade

On October 31, the Commodity Futures Trading Commission issued separate Orders of Registration as a foreign board of trade (FBOT) to Eurex Deutschland, CME Europe Limited, ICE Futures Europe, the London Metal Exchange and the London Stock Exchange plc. Registration as an FBOT allows each exchange to provide direct access to the exchange's electronic order entry and trade matching systems to certain persons in the United

States. The Orders of Registration were issued under Part 48 of the CFTC's Regulations. Fourteen other Orders of Registration have been issued since the enactment of the Dodd-Frank Act.

The CFTC's press release is available here.

CFTC Market Risk Advisory Committee To Hold Meeting

The Commodity Futures Trading Commission's Market Risk Advisory Committee (MRAC) will hold a public meeting on November 17 in Washington, DC. At the meeting, the Central Counterparty (CCP) Risk Management Subcommittee will present final recommendations regarding CCPs' preparations for the default of a significant clearing member. The MRAC also will also discuss the Bank of England's coordinated CCP default fire drill. Comments in connection with the meeting must be submitted by November 24.

For details as to how to attend or listen to the meeting, please see the CFTC's press release here.

CFTC Enters Into Information Sharing MOU With an Additional Canadian Province

On November 1, Timothy Massad, chairman of the Commodity Futures Trading Commission, John O'Brien, Superintendent of Securities for Newfoundland and Labrador, and Patricia Hearn, Deputy Minister of Intergovernmental Affairs, signed a counterpart to a memorandum of understanding (MOU) designed to promote the cooperation and exchange of information with regard to entities operating on a cross-border basis between the United States and Canada. The MOU was originally executed in 2014 by the CFTC, the Alberta Securities Commission, the British Columbia Securities Commission, the Ontario Securities Commission and the Québec Autorité des marchés financiers. The MOU allows information sharing with respect to regulated markets, organized trading platforms, central counterparties, trade repositories, intermediaries, dealers and other market participants that are, or have applied to be, authorized or otherwise overseen by one of the signatories to the MOU.

The CFTC's press release is available here.

UK/BREXIT DEVELOPMENTS

UK Government Must Consult Parliament Before Triggering Withdrawal From European Union, Court Rules

On November 3, a three-member panel of the High Court of Justice's Queen's Bench Division ruled that government ministers do not have the unfettered right to trigger the United Kingdom's withdrawal from the European Union by submitting notice under Article 50 of the Treaty on European Union. In a strongly worded opinion citing English case law from as far back as the early 1600s, the court concluded that longstanding constitutional arrangements limit the Crown's—and therefore ministers'—"prerogative powers" to alter UK domestic law unilaterally. In defense, the government argued that the Article 50 notice represented the exercise of the Crown's traditional prerogative powers in the field of international relations to conclude treaties. However, the judges were persuaded by the claimants that the act of submitting an Article 50 notice would lead inevitably to the UK's withdrawal from the EU, which would necessarily cause the rights afforded to UK citizens under EU law—which form part of UK domestic law due to the European Communities Act 1972 (ECA)—to be withdrawn, and on matters of UK domestic law Parliament is sovereign.

In the contest between the Crown's prerogative powers and the sovereignty of Parliament, the judges relied on the constitutional principle that, unless Parliament legislates to the contrary, the Crown does not have the authority to alter UK domestic law through its prerogative powers. The court then found that, in relation to statutes of "special constitutional significance" such as the ECA, there is a heightened burden in demonstrating Parliamentary intent to permit the Crown to unilaterally exercise its prerogative powers. Finding no evidence of such intent, the court then held that the Crown must give way to Parliament. The court did not, however, specify the form of relief to be granted. The government has announced that it will appeal the court's ruling; the case has been fast-tracked to the UK Supreme Court, which is expected to hear arguments in early December.

The judgement in the case *R (Miller) v. Secretary of State for Exiting the EU* is available here.

HM Treasury Responds to Consultation on Implementation of UCITS V in the UK

On October 31, HM Treasury published its response (Response) to the consultation it conducted in Q4 2015 (Consultation) on the United Kingdom's implementation of the UCITS V Directive (2014/91/EU) (UCITS V). The objective of UCITS V was to make certain changes to the existing UCITS legislative framework to assist in further enhancing the global appeal of the UCITS brand for investors.

The implementation of UCITS V in the United Kingdom was divided between HM Treasury, which was responsible for parts of UCITS V that are more structural in nature, and the Financial Conduct Authority (FCA), which was responsible for implementing changes to the FCA rules and guidance that directly impact industry and investors.

The Consultation by HM Treasury specifically considered the proposed reforms to the UCITS legislative framework proposed relating to:

- depositories (specifically with respect to eligibility to act, delegation and liability for fund assets);
- manager remuneration (to promote sound principles of risk management and discourage excessive risk-taking, ultimately with the intention of creating a uniform standard within the European Union); and
- harmonization of national sanction regimes within the European Union.

The Consultation proposed the legislative action that HM Treasury planned to take to transpose those parts of UCITS V pertinent to those matters set out above, as well as included a draft statutory instrument (Undertakings for Collective Investment in Transferable Securities Regulations 2016) that incorporated the proposed amendments to relevant UK primary and related secondary legislation for doing so. In its proposals, HM Treasury sought to ensure that the objectives set out in UCITS V were adhered to while also ensuring that its actions had minimal impact on industry by avoiding “gold plating,” where possible. Separately, the FCA also published a consultation on proposed changes to the FCA rules and guidance as a consequence of UCITS V for comment by industry and investors. Similarly to that taken by HM Treasury, the FCA’s approach with respect to the implementation of UCITS V was to apply an “intelligent copy-out” so as to implement the Directive in full without augmentation (or gold plating).

The Response summarized those responses received by HM Treasury to the Consultation and confirmed that no changes were required to be made based on them. Accordingly, the Undertakings in Collective Investment in Transferable Securities Regulations 2016 (2016/225) implementing the above, which came into effect in the United Kingdom on March 18 and was consistent with the draft previously circulated as part of the Consultation, required no further amendment.

The original Consultation can be found here and the Response can be found here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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