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SEC Staff Issues Revised Guidance on Unbundling of Shareholder Votes in M&A Deals

The staff of the U.S. Securities and Exchange Commission (SEC) Division of Corporation Finance (Staff) recently published revised guidance regarding the "unbundling" of matters presented for shareholder votes in connection with mergers and acquisitions. The guidance is contained in new Compliance and Disclosure Interpretations and replaces the unbundling interpretations that the Staff issued in 2004.

Unbundling Rule

The requirement that a company "unbundle" the matters presented in its proxy materials for a shareholder vote stems from Exchange Act Rule 14a-4(a)(3), which requires that a proxy identify clearly and impartially each separate matter intended to be acted upon, and Exchange Act Rule 14a-4(b)(1), which requires the proxy to provide separate voting boxes for shareholders to choose from for each separate matter. The SEC adopted these requirements in 1992 to allow shareholders to communicate to a company's board of directors their views on each of the matters presented for a vote and to prohibit electoral tying arrangements that restrict shareholder voting choices.

In 2004, the Staff published interpretations that provided guidance on how to apply the unbundling rule in the context of M&A. For example, under the 2004 guidance, a proposal to approve a transaction must generally be presented separately from proposals to approve a material charter amendment if:

- the proposed amendment was not previously part of the company's charter;
- the proposed amendment was not previously part of the acquiring company's charter; and
- shareholder approval of the proposed amendment would be required under state law, exchange listing standards or the company's charter if it was presented on its own.

If the transaction involved a newly formed acquisition vehicle that would survive the transaction, and the material provisions of its governing documents differed from those of the company soliciting shareholder approval, then the soliciting company was required to present separate votes for approval of those material provisions.

Revised Guidance

The Staff's revised unbundling guidance replaces the 2004 guidance and provides a revised framework for determining the need to unbundle matters in the context of M&A. The revised framework should not result in significant changes to the matters companies present for separate votes by shareholders in transactions. The following is a summary of the revised framework.

Target Company's Shareholder Vote on Acquiring Company's Amendments. Under the revised guidance, if the acquiring company is required to present a proposed amendment to its organizational documents separately on its form of proxy for shareholder approval, then a target company subject to the SEC's proxy rules also must present this proposed amendment separately on the form of its proxy for approval by its own shareholders. The unbundled vote by the target company's shareholders is required even if a separate vote is not required under state law or if the proposed amendment is the only matter that the acquiring company is submitting for a shareholder vote. In the Staff's view, unbundling is required because the proposed amendment is a term of the transaction and would effect a material change to the equity securities that the target company's shareholders are receiving in the transaction. As a result, these shareholders should be allowed to express their separate views on changes that would establish their substantive shareholder rights.

The Staff emphasized that only material matters must be unbundled under the revised guidance and that companies should consider the extent to which a proposed amendment to a company's organizational documents substantively affects the rights of shareholders. The Staff highlighted examples of material matters that would require unbundling, including amendments to a number of governance and control-related provisions, such as classified or staggered board, limitations on the removal of directors and supermajority voting provisions. Matters that the Staff noted would be viewed as immaterial and would not require unbundling include changes to the company's name, restatements of charters and technical changes (*e.g.*, those resulting from anti-dilution provisions). The target company also is not required to separately present a proposed amendment to increase the number of authorized shares of the acquiring company's equity securities as long as the increase is limited to the number of shares reasonably expected to be issued in the transaction.

As was previously the case, the Staff clarified that companies are permitted to condition the completion of a transaction on shareholder approval of any separate proposals. In this case, the company must clearly disclose such conditions in the proxy materials submitted to shareholders.

M&A Acquisition Vehicles. The Staff clarified that the revised unbundling guidance also applies to transactions in which the parties form a new entity to act as an acquisition vehicle and issue equity securities in the transaction. In this case, the party whose shareholders are expected to own the largest percentage of equity securities of the acquisition entity following the completion of the transaction would be considered the acquiring company for purposes of the unbundling analysis. The acquiring company would be required to separately submit for shareholder approval any material provision of the acquisition entity's organizational documents if (1) those provisions are material changes from the acquiring company's organizational documents, and (2) the changes would require approval of the acquiring company's shareholders. This would not apply to provisions required by the law of the governing jurisdiction of the acquisition entity. To the extent that the acquiring company must present separately any provision of the acquisition entity's organizational documents for approval by its shareholders, or would be so required if it were conducting a solicitation subject to the SEC's proxy rules, then the target company must also do the same for its shareholders.

Implications of Revised Guidance

Although the Staff's revised unbundling guidance should not result in significant changes to the matters companies present for separate votes by shareholders in mergers and acquisitions, it may result in outcomes that differ from current practice under certain circumstances.

In contrast with the 2004 guidance, under the revised guidance, the target company shareholders may be required to be presented with a separate vote on proposed amendments to the acquiring company's organizational documents — even if the target company's organizational documents have similar or comparable provisions. The 2004 guidance stated that unbundling "would not be required when the company whose shareholders are voting on the transaction already had the same or comparable provision in its charter or bylaws before the transaction was negotiated." The revised guidance does not include this carve-out from the requirements.

The revised guidance also alters the unbundling analysis in the acquisition vehicle context. Under the 2004 guidance, it was possible to conclude that the target company would be required to separately present for shareholder vote the provisions of the acquisition entity's organizational documents if those provisions differed from the ones in the organizational documents of the target company. Under the revised guidance, the analysis focuses on whether the proposed amendments to the acquisition entity's organizational documents constitute changes from the acquiring company's organizational documents. If such changes are material and would require approval of the acquiring company's shareholders, the acquiring company would be required to separately submit for shareholder approval any material provision of the acquisition entity's organizational documents. As described

above, if the acquiring company's shareholders are required to vote on the proposed amendments, then the target company also would be required to separately present the amendments for a vote by their shareholders.

Finally, the Staff's guidance does not address the consequences if the target company's shareholders reject the proposed amendments, including to what extent such a vote would affect the ability to complete the transaction. It also is unclear from the Staff's guidance whether the vote on an unbundled provision can be nonbinding. Companies considering these matters may want to discuss them with the Staff before filing proxy materials with the SEC.

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We will continue to monitor developments in this area and provide any relevant updates regarding the guidance and its impact.

The revised guidance is available here.

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