

CONSIDERATIONS REGARDING UNIVERSAL PROXY

Considerações sobre os pedidos de procuração pública universal
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Área do Direito: Comercial/Empresarial

Resumo: O memorando aborda a forma como um Conselho de Administração pode avaliar as melhores práticas e estratégias para as novas regras de procuração pública universal. O memorando fornece uma visão geral de alto nível de questões importantes que devem orientar as discussões do Conselho de Administração ao se preparar para a primeira temporada da Companhia sob as regras de procuração pública universal, incluindo: (i) as alterações materiais e processuais ao abrigo das regras de procuração pública universal e o seu impacto nas eleições contestadas; (ii) a necessidade de revisão dos documentos organizacionais da Companhia, incluindo os procedimentos de nomeação de membros do Conselho de Administração e as disposições legais de notificação prévia; (iii) a composição, pontos fortes e potenciais lacunas da chapa da Companhia, na perspectiva de um ativista; (iv) o engajamento com os acionistas sobre as suas preocupações relativamente à Companhia e ao Conselho de Administração, e a força da chapa da Companhia; e (v) a importância de monitorar a evolução do mercado em resposta às regras de procuração pública universal.

Palavras-chave: Regras de Procuração Pública Universal - Conselhos de Administração - Composição - Engajamento de Acionistas - Governança Corporativa

Abstract: The memorandum addresses how a Board of Directors may evaluate best practices and strategies for the new universal proxy rules. It provides a high-level overview of important issues that should guide the Board's discussions when preparing for the Company's first proxy season under the universal proxy rules, including: (i) the substantive and procedural changes under the universal proxy rules and their impact on contested elections; (ii) the need for review of the Company's organizational documents, including director nomination procedures and advance notice bylaw provisions; (iii) the composition, strengths, and potential gaps of the Company's slate from the perspective of an activist; (iv) engagement with shareholders on their concerns regarding the Company and the Board, and the strength of the Company's slate; and (v) the importance of monitoring market developments in response to the universal proxy rules.

Keywords: Universal Proxy Rules - Boards of Directors - Composition - Shareholder Engagement - Corporate Governance

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To:	[The Board of Directors/[BOARD COMMITTEE] [and Senior Management/[NAME AND TITLE OF OTHER OFFICERS]] of [COMPANY]
From:	[[NAME OF AUTHOR(S)]/[FIRM NAME (if authored by outside counsel)]]/[NAME AND TITLE OF AUTHOR(S) (if authored by in-house counsel)]
Date:	[DATE]
Re:	Universal Proxy

As we have discussed, the Securities and Exchange Commission ("**SEC**") has adopted new universal proxy rules, which became effective for contested director elections held after August 31, 2022. Historically, in a contested election, the target company and the dissident would each distribute a separate proxy card to shareholders that showed only their respective slate of director nominees. As a result, shareholders voting by proxy (which is the most common method of voting) could generally vote only for those nominees on either the company's card or the dissident's card, while shareholders voting in person at the meeting had the ability to mix-and-match nominees from both slates. Under the new rules, however, the target company in a contested election must include both its own nominees and those on the dissident's slate on the company's proxy card, and if the dissident sends out a proxy card, it must include both its own nominees and the company's on it. This allows shareholders voting by proxy to select nominees across both slates, as they could in-person at a shareholder meeting.

Because the universal proxy rules make it easier for shareholders voting by proxy to choose a mixed slate, shareholder support for at least some of a dissident's nominees could increase, improving the dissident's likelihood of winning board seats. Therefore, a dissident may be more willing to bring a proxy contest at a company where the dissident previously may not have perceived a sufficient chance of victory. Dissidents may now be incentivized to seek at least partial victories through the universal proxy ballot. These considerations could give US public companies, including [COMPANY] (the "**Company**"), greater exposure to proxy contests and activist-nominated directors in the near future.

With the Company's director nomination window opening soon, the Board of Directors (the "**Board**") must understand the new universal proxy rules and prepare for the resulting changes that could arise this proxy season. To assist the Board in evaluating best practices and strategies, this memorandum provides a high-level overview of important issues that should guide the Board's discussions when preparing for the Company's first proxy season under the universal proxy rules, including:

The substantive and procedural changes under the universal proxy rules and their impact on contested elections.

The need for review of the Company's organizational documents, including director nomination procedures and advance notice bylaw provisions.

The composition, strengths, and potential gaps of the Company's slate from the perspective of an activist.

Engagement with shareholders on their concerns regarding the Company and the Board, and the strength of the Company's slate.

The importance of monitoring market developments in response to the universal proxy rules.

1. Key Changes Under the Universal Proxy Rules and Implications for Companies

The SEC adopted Rule 14a-19 under the Securities Exchange Act of 1934 and amended the existing proxy rules to, among other things, require the use of a "universal proxy card," meaning a proxy card that includes all duly nominated director candidates, by both the company and the dissident in all non-exempt director election contests, except for those involving registered investment companies and business development companies. Additionally, amended disclosure requirements for the proxy cards and proxy statements are applicable to all director elections (whether or not contested) to provide more clarity on the voting options available to shareholders voting by proxy and the consequences of those options. The changes impose certain formatting, minimum solicitation, and notice requirements, which are discussed below.

A. Universal Proxy Cards

Under the universal proxy rules, all proxy cards in contested elections must permit shareholders voting by proxy to instruct in favor of any candidate, regardless of the nominating party. (In a full slate contest, where the dissident has nominated the maximum number of nominees that a shareholder may elect, the universal proxy card may permit shareholders to instruct in favor of each slate as a whole.)

Perhaps the most significant implication of this new requirement is the narrative shift that it is likely to cause in a contested election. From the perspective of a shareholder voting by proxy, who is no longer constrained to make a binary choice between the company's slate and a dissident's slate, the flexibility to choose among all nominees may seem very attractive and the decision to support some of the dissident's nominees may seem less drastic than in the "winner takes all" context. Previously, a dissident seeking to nominate less than a full slate of directors had to strategically choose which of the company's nominees to include on the dissident's proxy card. Under the new rules, the dissident can pass the choice of which company nominees to replace directly onto shareholders by adding all of the company-nominated directors to its proxy card.

However, a dissident is still likely to focus on individual directors on the company's slate to convince shareholders that certain company nominees are "weak links" that should be replaced with a stronger candidate. Dissidents, especially those launching proxy contests that focus in whole or in part on a company's environmental, social, and governance ("ESG") performance, may rely on the new universal proxy rules to win some seats on the board by appearing to fill gaps in expertise or experience that the company failed to address. These dissidents may emphasize how their nominees could enhance the function of the current board and work better with existing directors than some of the company nominees. Therefore, the shift away from a binary voting choice for shareholders may also lead to more personal contests. Instead of more traditional contests focused on differentiating the overall platforms of dissidents and their target companies, campaigns under the new rules may focus more on soliciting votes for the activist's strongest candidates and away from the company nominees that the activist perceives as the weakest.

Under this mix-and-match approach, even if most of the company's nominees enjoy majority support, one or more directors nominated by the dissident could be seated on the board. As we have previously discussed, a partial victory that results in an activist director gaining a board seat could have a disproportionate impact on the company and its incumbent directors, including the board's ability to work together effectively as a whole. Historically, a partial victory for a dissident often resulted from a settlement, where the company and the dissident negotiated and agreed on which of the dissident's nominees would be added to the board. If the activist directors are selected not through negotiation involving the company but through a contested election (perhaps one that involves personal attacks on both sides), the potential for disruption and a lack of board unity could be further magnified.

Along with a foreseeable increase in dissident nominations, more proxy contests could go to a shareholder vote. Dissidents secured almost all board seats (91% of the 75 total board seats won) by settlement agreements in the first half of 2022, with only nine proxy contests going to a final vote and activists prevailing in only three of those final votes (see Lazard, H1 2022 Review of Shareholder Activism). Under the new rules, dissidents may view a shareholder vote as a less high-risk outcome because they could achieve a partial victory even if they do not win on their entire slate, and therefore may be less inclined to settle. On the other hand, dissidents could also use the new leverage they have under the universal proxy rules to pressure companies to settle more quickly or on more favorable terms for the dissident.

B. Formatting Requirements

The company and the dissident are each free to choose the design of their proxy card but must adhere to certain formatting rules to ensure a clear and neutral presentation of each party's nominees. For example:

The proxy card must clearly distinguish between the company's nominees, the dissident's nominees, and any proxy access nominees.

Nominees must be:

grouped together according to the nominating party;

presented in the same font type, style, and size; and

listed alphabetically by last name within each group.

Additionally, proxy cards must prominently disclose the maximum number of nominees that a shareholder may vote for and the treatment of under- and over-voted proxy cards. Furthermore, each party's proxy statement must refer shareholders to the other party's proxy statement for information regarding the other party's nominees.

In light of these requirements, the Company may need to reconsider the design and content of its proxy card. The Company should also consult with its proxy solicitor on emerging best practices because many companies will be facing similar redesign considerations.

C. Minimum Solicitation Requirement

As a check on potential abuses of the universal proxy card by dissidents seeking to "free-ride" off of a company's proxy solicitation efforts, the universal proxy rules impose a minimum solicitation threshold that requires a dissident to solicit holders of shares representing at least 67% of the voting power of shares entitled to vote on the election of directors. However, the rules do not mandate a specific method for dissidents to furnish proxy materials. A dissident may meet the minimum solicitation requirement using the less costly "notice and access" method, which involves mailing only a one-page notice advising shareholders of the availability of proxy materials, rather than a full set of proxy materials. While dissidents have historically preferred delivering a full set of proxy materials to shareholders because notice and access solicitations were less successful under the previous rules, the new requirement for the company's proxy card to include dissident nominees and reference the dissident's proxy statement may shift dissidents' calculus towards conducting less costly notice and access solicitations.

If notice and access solicitation is available to dissidents under a company's governing laws and organizational documents, the reduced cost of solicitation may provide additional incentives for a dissident to launch a board seat contest. The SEC has noted that dissidents' median estimated total solicitation costs for proxy contests initiated during 2017 to 2020 were \$750,000 (Universal Proxy, SEC Release No. 34-93596 (Nov. 17, 2021) (Final Rule Release) at IV.B.2.b.). Using notice and access solicitation would dramatically reduce these costs by eliminating most of the costs of preparing and distributing a full set of proxy materials to shareholders. It is unlikely that the new 67% minimum solicitation requirement would deter potential dissidents because they have historically solicited a substantial majority of the shareholder vote despite not being subject to any minimum solicitation requirement. In fact, the SEC has estimated that these dissidents would only bear an incremental cost of \$5,400 to meet the 67% solicitation threshold using notice and access solicitation (Final Rule Release at IV.C.2.a.).

Therefore, the economics in a proxy contest are likely to favor the dissident under the new rules. The SEC has noted that registrants' median estimated total solicitation costs from 2017 to 2020 were \$1,650,000 (Final Rule Release at IV.B.2.b.). These costs are likely to increase if a dissident launches a contest using universal proxy, which, in turn, may increase the leverage that dissidents have in negotiating board seats or other settlements with a target company.

D. Advance Notice of Director Nominations

Under the universal proxy rules, dissidents must provide the names of their nominees to the target company no later than 60 calendar days prior to the anniversary of the previous year's annual meeting. This notice obligation is in addition to the dissident's obligation to comply with any applicable advance notice provision in the Company's governing documents. As is typical for US public companies, the Company provides for a nomination deadline of 90 calendar days prior to the anniversary of the previous year's annual meeting, so a dissident would need to continue complying with the 90-day advance notice requirement rather than the shorter 60-day deadline. However, the Company should still review its bylaws and consider whether to make any updates (see Bylaws and Proxy Statement Review below).

Additionally, the Board should be aware that the universal proxy rules require a target company to notify dissidents of the names of the company's nominees no later than 50 calendar days prior to the anniversary of the prior year's annual meeting, unless the names have already been provided in a proxy statement filed by the Company. This requirement limits the amount of time for a company to adjust its slate of nominees in light of a dissident's proxy contest (see Board Composition below).

2. Bylaws and Proxy Statement Reviews

In light of the new universal proxy rules, the Company should conduct a review of its organizational documents. The Board and its Nominating and Governance Committee should coordinate with internal and external legal counsel to conduct a review of the Company's director nomination and advance notice bylaws, in particular. Both generally and in light of the universal proxy rules, a company's director nomination and advance notice bylaws should give the company, its board, any potential dissidents, and any other shareholders clarity on timing, informational, eligibility, and procedural requirements and reflect current shareholder expectations and industry best practices.

A. Legal and Proxy Advisor Considerations

In reviewing the advance notice bylaws, the Company should be aware of legal requirements that limit the scope of director nomination bylaws. Delaware courts have repeatedly protected shareholders' right to nominate and elect directors. Any bylaw update that unduly limits the right to nominate could attract litigation and be scrutinized by a court.

Additionally, the Company should be aware of the latest guidelines from proxy advisors. For example, under the 2023 Institutional Shareholder Services Inc. (ISS) Proxy Voting Guidelines, a reasonable window for shareholders to provide notice of director nominees is no more than 120 days and no less than 90 days prior to the anniversary of the prior year's meeting. A bylaw update that creates a longer advance notice requirement, if unilaterally approved by a company's board, may cause ISS to recommend against the board or individual directors. Because a 90/120-day window is currently the market norm, a longer window may also attract negative attention from shareholders.

The Company should also make sure that there is a clear process and timeline for a shareholder to request and receive any director and officer questionnaires or consent forms that must be completed by the nomination deadline. The Company should review the informational requirements set out in its advance notice bylaw provision, with respect to both the nominating shareholder and its nominees, to ensure that the requirements reflect current best practice and provide the Board with necessary information (including to assess director independence and understand the relationships between a dissident and its nominees).

Finally, the Company should discuss with legal advisors whether it has sufficiently clear procedures in place for excluding nominees that have not been duly nominated, whether before or during a shareholder meeting.

To be effective for contests in the 2023 proxy season, these updates should be adopted before companies' advance notice windows open. Companies that are considering updating their advance notice and other bylaws in light of the universal proxy rule should make those updates proactively and without any connection to an ongoing activist campaign.

Many companies are reviewing their organizational documents in light of the universal proxy rules, and new standard terms are emerging. It will be undoubtedly helpful to consult with legal advisors for guidance on market practice, especially at companies that are similarly situated compared to the Company.

B. Proxy Materials

The Company should work with its internal and external advisors to conduct a thorough review of its 2023 proxy statement, proxy card, and related materials. Given the changes mandated by the new rules, the Company may need to budget additional time and resources to ensure compliance with the new requirements, which include, among other things, specific mandates relating to how "against," "abstain," and "withhold" voting options should be used and described in proxy materials. The Company may also wish to conduct a benchmarking of peer proxy statements, proxy cards, and related materials filed with the SEC after the effectiveness of the universal proxy rules to identify other necessary and advisable updates.

3. Board Composition

The Board and Nominating and Governance Committee should consider improving the Company's activism preparedness by conducting a self-evaluation of the Board's composition from the perspective of a potential dissident. This evaluation should provide the Board with insight on its strengths and potential gaps at an individual, committee, and full-board level. Factors that the Board or Nominating and Governance Committee may wish to evaluate include:

How the qualifications, experience, expertise, and background of individual directors relate to setting and advancing the Company's strategy and performance.

How individual directors complement each other and collaborate as a team in serving on the Board and its committees.

What skillsets, expertise, or perspectives could be added to the Board given the challenges and opportunities faced by the Company and the expectations of its key stakeholders.

Given the likely more personal nature of proxy contests going forward, the Board's self-evaluation will help the Company anticipate the types of attacks that individual directors may face from a dissident and assess which are the most likely to resonate with the Company's shareholders. For example, given the focus of institutional investors on board diversity, director independence, and ESG risk oversight, the Board and Nominating and Governance Committee should consider whether the Board has any potential vulnerabilities on those fronts.

4. Shareholder Engagement

Proactive and ongoing engagement with institutional investors will help a target company understand the views of investors and, if done effectively, will help the target company in achieving a victory for its slate. With the ability to mix-and-match nominees under the new universal proxy rules, there will be more focus on directors' individual qualifications, so it is more important than ever for companies to use the time provided by the advance notice window to familiarize institutional investors with the company's nominees, especially those who are (or are likely to be) targeted by a dissident, or directors in board leadership positions.

The Company should work with its advisors to review and enhance its proxy statement and other public disclosures regarding individual nominees and the Company's overall corporate governance to highlight how individual directors contribute to the Company. To improve the likelihood of electing the full slate of company nominees in a contested election, it is also important to communicate to shareholders the unity and teamwork of the incumbent board, including by creating board videos or other materials highlighting the work of the board as a whole. Conversely, the Company may also consider requesting from dissidents' nominees information about litigation or any other conflicts with either the Company or directors who are on the Board, to understand relationships that could contribute to unhelpful tension on the Board if a dissident's nominee is elected.

In addition to gathering support for its nominees, the Company should make sure that shareholders support the Board's vision and strategy for the Company. The Board should coordinate with its investor relations team and other advisors to prepare directors and executives for individual shareholder engagement meetings. In particular, the Board should be aware of, and prepared to address, any shareholder concerns on the matters identified by the dissident and prepare company representatives to speak to those issues.

All communications of the Board and the Company must be consistent, including with the Company's SEC filings and other public disclosures. Because the SEC is currently focused on disclosures related to ESG issues, the Company and its legal advisors should carefully review these disclosures to ensure that any ESG-related statements made to shareholders in connection with a proxy contest are consistent with those made in the Company's other public statements and filings, as well as accurate and in compliance with securities and other applicable laws. In particular, the Company should ensure that any shareholder engagement is conducted in accordance with its Regulation FD policy to avoid discussing material nonpublic information.

5. Monitoring Market Developments

Because the universal proxy rules are new, it is crucial for the Company to stay up to date on the latest developments during this transition period, including by working closely with appropriate stakeholders and advisors. The Company should monitor the status of proxy contests at other companies, including peer companies, and review the disclosures and strategies used by both the dissident and the target company in those contests. The Company's investor relations personnel and external proxy solicitor should monitor the Company's shareholder base, paying particular attention to changes in holdings by hedge funds and institutional investors. The Board should review the voting policies and position statements of the Company's major institutional investors and, together with internal and external advisors, work towards developing an accurate assessment of these investors' priorities. Ordinary-course engagement between the Board and the Company's officers and employees to identify potential vulnerabilities (including any concerns with the Company's financial performance, strategy, and capital structure) as well as hot topics (such as ESG issues) will help the Company remain prepared in the face of the expanded activism exposure that the universal proxy rules may bring. For example, to win board seats, an activist shareholder may raise ESG vulnerabilities to support the argument that incumbent directors are failing to protect shareholder interests. It is essential that the Board, management, and the Company's advisors thoughtfully consider possible activist lines of attack before the attack surfaces. By working closely with external legal and proxy solicitation advisors, the Company can prepare for the potential impacts of universal proxy by anticipating emerging trends in shareholder activism.