

Practical takeaways of universal proxy card voting in contested director elections

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We consider the practical takeaways of new SEC Rule 14a-19 and universal proxy card voting in contested director elections. The change to universal proxy cards is a prompt for companies to renew their focus on preparedness, including having a state of the art stock watch program in place, updating their vulnerability assessment, reviewing defenses and updating the board.

Under new SEC Rule 14a-19, universal proxy cards must now be used by management and shareholders soliciting proxy votes for their candidates in contested director elections involving domestic companies. The universal proxy card must include all director nominees presented by management and shareholders for election at the upcoming shareholder meeting.

The key difference from practice before this rule change is that shareholders previously voting by proxy in contested director elections could essentially only vote for one slate and were unable to vote for a combination of director nominees from competing slates (as they could if they voted in person at the shareholder meeting). This has meant that shareholders have had “an all or none choice” – vote the management proxy card (that would not have dissident slate names) or the dissident proxy card (that would only have dissident slate names). Using the universal proxy card, shareholders can now “pick and choose” a combination of candidates from each slate in a contested election.

Are there likely to be more proxy contests?

We don't consider it likely that the new universal proxy rule will stimulate seasoned, well-resourced activists to initiate proxy contests where they otherwise wouldn't have. They were not shy before the new rule.

It is probably likely that lesser known or new activists will be encouraged to launch campaigns as the universal proxy card lowers the barriers to success for a minority slate campaign.

Is this likely to affect the outcome in contested elections?

Most activist campaigns today seek a minority slate rather than a majority of the board. We believe that giving shareholders the ability to pick and choose from a combination of management and dissident candidates makes it more likely that a dissident succeeds in electing one or two of the dissident's candidates (in a minority slate). Shareholders can use either the management or dissident card, each with the full menu of names. Using one proxy card with the full menu of names from both slates will make it easier for a shareholder to pick one or two dissident names, while still being able to support most of the management slate, and thereby support some change without overwhelming disruption or upheaval.

Equally, with shareholders able to pick and choose from both slates and having the ability to support the dissident while avoiding undue disruption or excessive change, we believe it will be less likely for a dissident to succeed in winning a

majority of the board.

Will the 67% solicitation requirement impose an expense that will be a barrier to bringing campaigns?

Rule 14a-19 requires shareholders presenting their own director candidates to solicit holders of a minimum of 67% of the voting power.

In most cases, this should not be a deterrent for the activist. For most companies, the dissident should be able to comply with the 67% requirement relatively inexpensively, given the prevalence of electronic voting thereby avoiding an expensive retail campaign, especially if the goal is one or two board seats.

Campaigns at companies with a widely dispersed holding or significant retail shareholder base may be more costly, in which case the 67% requirement may be something of a deterrent.

Will there be confusion for shareholders using universal proxy cards?

There is potential for confusion, especially in the early years of using universal proxy cards. For example:

- Shareholders may find it less than obvious how to mark the proxy card for each candidate to show voting in favor as opposed to withholding their vote.
- In addition, unlike the dissident card, which will indicate the management slate directors being targeted, the company card is unlikely to indicate which management-slate-directors are being targeted by the dissident. Accordingly, a shareholder using the company card may not find it obvious which management slate directors to support if they want to mix and match between the two slates.

What bylaw changes may companies wish to consider?

We are in the early innings of seeing how companies will react to universal proxy with any bylaw changes. A few companies have taken quite aggressive positions, which will likely end up being negatively perceived by shareholders once highlighted by the dissident in the context of a campaign or may be litigated.

We recommend that any changes of course be implemented in a “clear day” before any campaign is initiated.

Here are a few bylaw changes to consider, that we believe are reasonable:

- A requirement that the proponent comply with Rule 14a-19 and provide a certification as to such compliance.
- A requirement that the shareholder solicit 67% of the voting power. The SEC’s CD&I indicates that absent this bylaw, the company’s proxy must disclose this requirement.
- Expand the advance notice bylaw to include more detailed information on parties with whom the proponent is collaborating (or from whom the proponent is receiving funding to fund the proxy proposal and related expenses), rather than just information on the record and beneficial owner.
- Require that the proponent not use the white card. The white card is typically used by management, so this bylaw requirement would prevent the dissident from being able to act quickly to “claim the white card” and gain some advantage by printing and mailing a white proxy card which shareholders might expect came from management.
- Require that the proponent specify whether it or any party with whom the proponent is collaborating will make any other proposal at the same meeting.
- Require that the proponent provide notice and information on whether any nominee is a principal, employee or affiliate of the proponent or of any party with whom the proponent is collaborating.
- Specify that in providing shareholder lists in the context of a contest, the company will not be required to include electronic mail addresses or other electronic contact information.

Bottom line

Activist campaign levels continue to be high, and this is likely to be further fueled by the current market volatility and downturn.

The threat from the ease that universal proxy cards affords to shareholders in mixing and matching from both slates probably will give activists more leverage to push for settlements.

Late fall and winter are the most frequent time for an activist to make initial (most typically quiet) contact to initiate a campaign, before the nomination deadline looms.

The change to universal proxy cards is a prompt for companies to renew their focus on preparedness, including having a state of the art stock watch program in place, updating their vulnerability assessment, reviewing defenses, and updating the board.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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