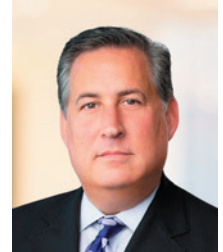


A Wild Card

The SEC's Universal Proxy Ballot



Spencer Klein
Morrison Foerster

The SEC does of course make changes to its rules and procedures but only rarely and never lightly. The universal proxy card, which made its debut recently, certainly does not come as a surprise. The SEC first proposed the new system on October 26, 2016. Then, in April 2021, the SEC reopened the comment period for the proposal. On November 17, 2021, the SEC formally adopted the changes but the amended rules were held at bay and only applied to shareholder meetings after August 31, 2022, a quiet time in the corporate calendar.

This spring, the season when most corporate annual meetings are held, will be the first time that the universal proxy card will be distributed by all public companies and their dissidents for the election of boards of directors. The M&A world is on edge, waiting to see what effect the card may have on this year's annual meeting results and how it could affect the future of shareholder activism itself.

Back in the old days, not so long ago, shareholder voting was different, explains Spencer Klein, the co-head of M&A at Morrison Foerster. If you attended a shareholder meeting in person, you would be given a ballot that contained a list of all the nominees up for election and, as a voter physically present at the voting booth, you could check whichever boxes you wanted. However, as is well known, most shareholders do not attend meetings in person.

"They vote by proxy," notes Mr. Klein, "and that is not how proxies worked. For proxy voters, both the company and the insurgent shareholder would submit a proxy card listing its nominees and the shareholders would vote for one or the other slate. They could not mix and match. That is what is different under the new system. Now both the dissident shareholder and the company

are required to name both sets of nominees on the proxy card and shareholders can vote for some of the company's candidates and some of the dissident's nominees."

Here is the SEC in its Fact Sheet about the universal proxy rules for director elections: "Currently, shareholders voting by proxy in contested director elections are unable to vote for a combination of director nominees from competing slates, as they could if they voted in person at the shareholder meeting. Universal proxy cards, which list all duly nominated director candidates from all parties, allow shareholders to vote through the proxy process in the same manner as they could voting in person..." Under new Rule 14a-19, the universal proxy card must include all director nominees presented by management and shareholders for election at the upcoming shareholder meeting. To facilitate the use of universal proxy cards, the Commission amended the current proxy rules so each side can list the other side's director candidates on its universal proxy card.

And here is Mr. Klein and his associate Tyler Miller with their list of the general requirements of the new rules, which they summarized in a recent client alert. "In general, the universal proxy rules mandate the use of a universal proxy card in contested elections that includes the names of both company and dissident nominees, as well as certain other shareholder nominees resulting from proxy access; require dissidents to notify companies of their intent to solicit proxies and the names of their nominees no later than 60 calendar days before the anniversary of the previous year's annual meeting; require companies to notify dissidents of the names of their nominees no later than 50 calendar days before the

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anniversary of the previous year's annual meeting; require each side in a proxy contest to refer shareholders to the other party's proxy statement for information about the other party's nominees; require dissidents to solicit the holders of at least 67 percent of the voting power of the shares entitled to vote at the meeting; specify formatting and presentation requirements for universal proxy cards; and require that proxy cards (i) include an "against" voting option for director nominees where such options have legal effect, (ii) include an "abstain" option for director elections where a majority voting standard applies, and (iii) require disclosure about the effect of a withhold vote in director elections."

Proxy contests are already hardly the province of the meek. "Proxy contests have always been unpleasant by nature," says Mr. Klein. "They are not what a company wants to be doing. They're disruptive. They're costly. They can include personal attacks. Unfortunately, the advent of the universal proxy card could make proxy contests even more unpleasant, with more intense personal antipathy. It's no longer just about the activist slate versus the company slate. Now it's about Candidate X, who is nominated by the activist, versus Candidate Y who is nominated by the company. It's more about each individual candidate and therefore, since you can pick and choose, the levels of vitriol could intensify."

The number of victorious minority slates could also see a surge. One can imagine, for example, says Mr. Klein, that shareholders who are reticent to hand over control of an entire board to an activist might well be convinced to support a smaller group of dissident nominees. Voters could be convinced that there is little harm done by bringing into the boardroom a short slate of voices to add to the mix.

Activists can certainly argue that dissent is not a bad thing. They would assert that the boardroom should be a place of open and honest dialogue exchanging views that can be strongly held. They would ask what harm could be caused by putting one or two highly qualified activist nominees on the board? That could be a good thing, says Mr. Klein, but only up to a point. Are these really high quality candidates? Do they add diverse backgrounds and viewpoints to the board? Are they beholden in one way or another to the activist? Are they likely to be disruptive and unhelpful? If national politics is any portent, one might end up with boards of

directors composed of embittered rivals recently emerging from a brutal election campaign and now expected to run a business together.

One trend that Morrison Foerster's M&A department is watching intently is what they call the "occasional activist trend." Unlike the regular dedicated activist funds such as JANA Partners or Elliott Investment Management, these are investment funds or groups of shareholders who do not routinely deploy activism as a weapon but instead are turning to it as a means to accomplish a specific purpose. "It could be a founder of a company who still has a meaningful interest in the business but who doesn't like the way things are going under current management," says Mr. Klein, "or it could be a fight between certain incumbent board members and other sitting directors."

Mr. Klein explicates the "important consequences" of this new proxy card as follows in his recent memorandum:

- With shareholders able to cherry-pick nominees from competing slates, it seems more likely that dissidents will win minority representation. Shareholders previously reticent to use all their votes on a short slate of director nominees can now make use of all their votes, using some for the dissident's short slate and some for company nominees. It is also possible that dissidents will be more likely to nominate short slates rather than full slates and continue the trend of nominating industry experts with extensive qualifications instead of the activist's employees or affiliates. On the other hand, the shareholders' ability to pick and choose from proxy cards may make it less likely for dissidents to succeed in electing a majority of the board unless shareholders perceive the need for radical change or the dissident is proposing an acquisition favored by the shareholders.
- Although the universal proxy card may not materially affect an established activist investor's willingness to commence a proxy contest, the enhanced ability to elect a minority slate might be attractive to smaller, newer, or "occasional" activists who might have otherwise shied away from the expense and resource requirements of a proxy contest, given the uncertain outcome.
- The shareholders' ability to choose individual director nominees instead of entire slates will likely result in a greater focus

on individual nominees' skills and credentials, not only in relation to one another but also in terms of the board's overall composition. Shareholders will expect clear communication and detailed disclosure of the nominee's qualifications and experience. It is possible that companies and dissidents will both resort to more personal attacks on the opposition's nominees in heated proxy contests. In addition to raising the stakes for the director nominees themselves, this could make proxy contests even more hostile and contentious.

- The influence of proxy advisor firms such as ISS and Glass Lewis could increase further, as some shareholders may search for additional guidance and expertise in making their voting decisions from among a broad array of choices rather than the previous binary decision between the company slate or the dissident slate. There is also an enhanced risk of inconsistent recommendations from the proxy advisory firms.
- The considerations noted above could affect the dynamics of, and relative leverage in, settlement negotiations between a dissident and the company.

The SEC notes that the new rules include a substantial list of details that must be followed. For example, shareholders presenting their own director candidates in the contest are required to solicit holders of a minimum of 67 percent of the voting power of shares entitled to vote in the election.

What's more, the new rules also change the formatting and presentation requirements. The new proxy card must set forth the names of all duly nominated director candidates. It must provide a means for shareholders to grant authority to vote for the nominees set forth in the proxy card and must clearly distinguish among company nominees, dissident nominees, and proxy access nominees, who have to be listed in alphabetical order within each group. The proxy card must present all nominees in the same font type, style, and size and must prominently disclose the maximum number of nominees for which authority to vote can be granted. The campaigners on both sides must "prominently disclose" the treatment and effect of a proxy executed in a manner that grants authority to vote for more nominees than the number of directors being elected, or in a manner that does not grant authority to vote with respect to any nominees."

Mr. Klein points out that the new proxy card

has emerged in the midst of an era of increasing shareholder activism which continued "unabated" in 2022 with "very little to suggest" that these campaigns will soon subside. This does not mean that victories abound among dissidents. "Activists," Mr. Klein writes, "continue to struggle to consistently win board representation when proxy contests have gone all the way to a shareholder vote," noting that of the 70 contests that went to such a vote last year, only 34 of them got seats on boards. "Indeed," the alert says, "several large and prominent activists lost shareholder votes in 2022. For example, Starboard Value's campaigns for board representation at both Box, Inc. and Huntsman Corporation, and Ancora Advisors' campaign for board representation at Blucora, Inc., all failed with the management slates elected in full."

It is an unpredictable see-sawing battle among defenders and attackers of public companies and now the new mandatory universal proxy card is in the mix. "Anything that changes the balance between opposing groups is sure to be the subject of a lot of scrutiny," says Mr. Klein. "We're at an interesting juncture as we embark on annual meeting season, where we will see how this plays out. It all used to be so clean and clear-cut before," Mr. Klein says. "You would say, 'Here are the management nominees and here is a separate list of the dissident nominees.' Now, you can vote for any nominee on any slate. This is the most important change we've seen from the SEC in quite a number of years."

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