



What The First Universal Proxy Card Contests Say About the Future of Activism

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The Spring 2023 proxy season is in full swing, and each week we are seeing more contested proxy statements filed and settlements with activists announced. This proxy season is shaping up to be an uncommon tempest for companies and shareholders alike: macro-economic conditions are stressing corporate performance, trading multiples are depressed, and—last, but not least—the universal proxy card regime has finally come into effect.

Universal proxy cards dramatically alter how shareholders vote for directors at contested shareholder meetings. Whether they will cause companies, dissidents, proxy advisors, and shareholders to change their behavior in proxy contests has been hotly debated by market participants and observers since even before the universal proxy card rule was originally proposed by the Securities and Exchange Commission (SEC) in 2016. Now that universal proxy cards are mandatory for all contested director elections, these predictions are starting to give way to preliminary observations.

This post discusses how the mandated use of the universal proxy card has changed the tactical and legal considerations of a proxy contest through the lens of some of the first proxy contests and attempted proxy contests of the universal proxy card era. The following key observations are discussed in more detail below.

- Success in a proxy contest has not been guaranteed by having a slate composed of highly qualified candidates, nor by having a compelling argument that is disconnected from the composition of the slate.
- Dissidents are seeking to exploit the change to candidate-based voting in the universal proxy card to warp settlement negotiations in their favor, leading certain activists to take aggressive settlement positions.
- Taking advantage of the elimination of the “short slate” rule in the universal proxy card rules, some activists are more frequently nominating larger and “control” slates to achieve favorable leverage in negotiating settlements.
- Because only validly nominated candidates must be included on a universal proxy card, advance notice provisions are even more important for companies to obtain relevant information about dissidents and their candidates and ensure that dissidents comply with the requirements of the new rules.
- Special interest and other non-traditional activists may seek to leverage the universal proxy card to make nominations and launch proxy campaigns with non-traditional

objectives, but despite expressed interest these activists have not yet successfully taken advantage of this possibility in large numbers.

We wish to emphasize that these are only initial observations of a rapidly evolving environment. Concluded campaigns in the universal proxy card era are currently a small sample size, and market participants are dynamically responding to the lessons learned from each campaign. Going forward, we expect the dynamics of proxy campaigns to remain in flux for several years as activists, companies, and other market participants continue to assess and respond to the impact of the new universal proxy card regime.

THE PARADIGM SHIFT OF UNIVERSAL PROXY CARDS

A universal proxy card allows shareholders to vote for any combination of validly-nominated director candidates on a single proxy card, regardless of whether the candidate was nominated by the board of directors or a dissident shareholder. Use of the universal proxy card by companies and dissidents is now mandatory for contested director elections under Rule 14a-19 under the Securities Exchange Act of 1934, which was adopted by the SEC in November 2021.

Prior to the adoption of Rule 14a-19, shareholders could, from a practical perspective, only vote for director candidates from either the company's slate or the dissident's competing slate. If the dissident had nominated a minority of the board, shareholders voting for the dissident slate could also vote for the company's candidates not opposed by the dissident, but could not vote for the company's candidates opposed by the dissident. While shareholders could support only a partial slate from either the company or the dissident by "withholding" on candidates whom they did not support, they could not vote for their preferred mix of candidates from either slate.

The change from slate-based voting to candidate-based voting in the universal proxy card represents a paradigm shift in the way that shareholders vote for directors.

DIRECTOR QUALIFICATIONS AND THE COMPELLING CASE FOR CHANGE

The shift to candidate-based voting on the universal proxy card could mean that proxy advisors and shareholders could become an "external nominating committee" that votes on the basis of competing nominees' skills and qualifications—minimizing, if not entirely disregarding, the merits of the dissident's broader case for change.

Yet, so far, proxy contests remain driven by persuading proxy advisors and shareholders of the need for operational or strategic change at the target company. Companies and dissidents alike have emphasized director qualifications more in the initial campaigns of the universal proxy card era than we have seen in past years. However, we are seeing dissidents have success where they have both demonstrated a compelling thesis and connected their nominees' qualifications to advancing that thesis. Crucially, ISS and Glass Lewis have stated that they will continue to demand that dissidents advance a compelling case for change as the threshold issue in making voting recommendations, eschewing the opportunity to focus only or principally on director qualifications.¹

Retaining emphasis on strategic and operational claims ensures that activist campaigns continue to turn on the primary drivers of shareholder value. This model empowers shareholders to evaluate and choose between competing visions of the company. Candidate quality of course

¹ See also Sidley Austin LLP, *Shareholder Activism Update: ISS Provides Guidance on the Universal Proxy Card, Puts "Weakest" Directors on Notice* (Aug. 24, 2023), <https://www.sidley.com/en/insights/newsupdates/2022/08/iss-provides-guidance-on-the-universal-proxy-card-puts-weakest-directors-on-notice>.

remains relevant; proxy advisors and institutional investors will consider individual candidates once the dissident has proven that board change is critical to enhance corporate performance. We also expect that candidate quality will have greater salience in campaigns with stark differences in candidate quality and those where the company and dissident have each advanced strong strategic and operational arguments. But even in the universal proxy card era, neither companies nor dissidents are likely to prevail solely because they have compiled a strong candidate slate.

This dynamic is illustrated by the contrast between the first two universal proxy card campaigns that received proxy advisor recommendations. While each campaign had unique circumstances, their outcomes support what proxy advisors and institutional investors have said about the universal proxy card so far: that it will not change their voting frameworks' requirement that the dissident prove a case for change.

Land & Buildings elected one of its nominees to the board of Apartment Investment and Management Co. (also known as Aimco) after receiving a partial ISS recommendation. The dissident focused its thesis on the company's trading discount to its net asset value, which it argued was driven in part by insufficient investor communications. ISS agreed with the dissident's case for change and recommended in favor of a dissident nominee with sell-side analyst experience in the company's sector, whom ISS believed would improve the company's investor relations program. On the other hand, Glass Lewis recommended for all of the company's directors based on the company's performance and recent governance enhancements, while also questioning the relevance of the dissident nominees' skillsets.

By contrast, Capital Returns withdrew its contest against Argo Group International Holdings Ltd. after ISS and Glass Lewis recommended against its candidates, with both proxy advisors concluding that it had failed to make a compelling case for change. The dissident focused its thesis on the company's ongoing strategic review, but ISS concluded that it had not proven that the review process was being run improperly or that any necessary qualifications were lacking from the strategic review committee.

ATTEMPTS TO WARP SETTLEMENTS

Most of the attention on universal proxy cards has naturally focused on how it has changed the ways shareholders can vote for director candidates. However, this discourse has overlooked the ways that activists are seeking to exploit these changes to warp settlement dynamics in their favor. If activists are successful, settlements in the universal proxy card era will not only be more frequent than in prior years, but also more dissident-favorable. Since far more activist campaigns result in settlements than contested elections (particularly among mid-cap and larger companies), any changes to settlement negotiations will dwarf the impact on shareholder voting from the universal proxy card rules.

The likelihood of a settlement and the negotiation of its terms are greatly impacted by each side's prediction of the outcome at the ballot box in a contested director election. The universal proxy card has challenged well-worn expectations about proxy contests. We are seeing dissidents attempt to exploit this uncertainty by making more aggressive initial settlement demands than in prior years in pursuit of unusually dissident-favorable settlements. Most notably, we have seen certain dissidents appear to be less willing to settle for one or two new director appointments, which was the typical settlement in recent years.

Driving this increased aggressiveness is an apparent belief by activists that universal proxy cards significantly enhance their leverage in a settlement negotiations. However, whether this is true largely depends on whether proxy advisors and large institutional investors will continue to

require activists to prove their operational or strategic theses. If they do, settlements will continue to turn on whether the activist has identified a compelling case for change at the company.

By contrast, if proxy contests are detached from corporate performance and reduced to a referendum on director qualifications, activists can target companies—even those without performance vulnerabilities—with a highly credible threat of beating the weakest incumbent candidates. The likelihood of a partial electoral success will increase activist’s demands in settlement negotiations, including demanding settlements that are worse for the company than the anticipated electoral outcome. In other words, activists will use the leverage of replacing the weakest incumbents at an election to demand the appointment of activist-aligned candidates or other dissident-favorable changes in a settlement. Companies may be willing to enter into unfavorable settlements to avoid the cost and distraction of a proxy contest, to have greater control over which directors will be added and replaced, and to subject the activist to standstill provisions.

In sum, we expect that activists will exploit any weakening in the requirement that dissidents prove their operational and strategic case for change to warp settlements in their favor. The perverse result would be that shareholders would have less of a voice over board composition because more proxy contests would settle, and settlements would be better for the activist than shareholders’ voting preferences would be.

Consistent with this dynamic, we have begun seeing activist-side advisors arguing that proxy advisors and institutional investors should focus solely on the qualifications of the competing directors. Jeff Smith of Starboard Value LP recently made this argument when addressing the Council of Institutional Investors, where he criticized ISS and Glass Lewis for sticking with the requirement that the dissident prove a case for change and encouraged shareholders to ignore their voting recommendations.

While proxy advisors and shareholders so far appear to be resisting this pressure, we expect that dissidents will continue to seek every opportunity to exploit the universal proxy card to warp settlement dynamics in their favor.

USE OF CONTROL SLATES FOR SETTLEMENT ADVANTAGES

Prior to the adoption of the universal proxy card rules, the “short slate” rule permitted dissidents to include the company’s candidates whom it did not oppose on its proxy card so long as the dissident had nominated a minority of the board. If instead the dissident had nominated a control slate, it could not “round out” its slate with the company’s nominees. A dissident’s minority slate increased the likelihood of at least a partial dissident victory because shareholders could select their preferred dissident candidates while still voting for a majority of the company’s slate. On the other hand, a dissident’s control slate forced shareholders to make a binary choice between the company’s nominees and its nominees, and investors are typically reluctant to cede control of the board to a dissident without the payment of a control premium. As a result, activists rarely pursued control slates under these rules.

Going forward, with the “short slate” rule eliminated, dissidents can nominate control slates to enhance their settlement leverage without facing this electoral downside. Control slates can be used to anchor settlement negotiations, potentially leading to more dissident directors in a settlement than they would have otherwise achieved. Indeed, activists appear to be nominating control slates and taking more aggressive initial positions in settlement negotiations than we have seen in past years. Campaigns during the universal proxy card era in which the dissident has nominated a control slate include those at Ammo Inc., Diffusion Pharmaceuticals Inc., Griffon Corporation, Pitney Bowes Inc., and Rogers Corporation.

We believe that companies need to appreciate that unjustified control slates will likely not survive into the proxy contest. In most circumstances, a dissident control slate is unlikely to be elected in full, in part because control slates face more scrutiny from proxy advisors. For instance, ISS requires that a dissident who has nominated a control slate must provide a detailed plan of action and prove that their plan is preferable to the company's plan, and ISS has cautioned dissidents that slate size in the universal proxy card era should be "proportionate" to the issues targeted by the activist. As a result, we expect many control slates to be reduced to short slates before the contest goes to a vote (potentially justified with an assertion that recent enhancements made by the company support a reduction in the slate).

ADVANCE NOTICE PROVISIONS REMAIN ESSENTIAL

In a recent campaign at AIM ImmunoTech, the dissident could not take advantage of the universal proxy card rules because it failed to abide by the company's advance notice provisions in its submission of director candidates.

In AIM ImmunoTech, after the board rejected the nomination notice for failing to disclose all information required under the company's advance notice provisions, AIM ImmunoTech and the activist each filed definitive proxy materials. The activist distributed a universal proxy card, while the company's proxy card only contained the company's candidates. The Delaware Court of Chancery subsequently denied the activist's request for a preliminary injunction requiring the board to accept the nominations and include the dissident's nominees on the company's proxy card,² and each of the company's nominees were elected at an uncontested annual meeting. This ruling affirms *Rosenbaum v. CytoDyn Inc.*, where the court upheld the board's decision to reject nominations made pursuant to nomination notices that did not comply with a pre-existing advance notice bylaw.³ These successes confirm that advance notice provisions remain the best tool for companies to ensure that activists provide the necessary information about their intentions and their candidates.

We are also seeing companies adopt advance notice provisions intended to ensure that dissidents comply with the scant obligations created by the universal proxy card rules. For instance, a typical provision requires the dissident to provide evidence to the company that it has solicited two-thirds of shareholders in accordance with the rules and disregard any nominations by a dissident who has not complied with the rules. These provisions limit the risk that dissidents will exploit the universal proxy card rules to put their candidates on the company's proxy card without also complying with the rules' obligations on dissidents.

In recent Compliance & Disclosure Interpretations, the SEC confirmed that companies may omit dissident candidates who have not been validly nominated from their proxy cards.⁴ However, companies should be aware that if a court subsequently overturns the board's rejection of a dissident's nominations, the company must furnish universal proxy cards that include the dissident's nominees to its shareholders, discard previously-furnished proxy cards, and give shareholders sufficient time to receive and cast their votes on the new proxy cards (which may require adjourning or postponing the shareholder meeting).⁵

² *Jonathan Thomas Jorgl v. AIM Immunotech*, No. 2022-0669-LWW, 2022 WL 16543834 (Del. Ch. Oct. 28, 2022).

³ *Rosenbaum v. CytoDyn Inc.*, No. CV 2021-0728-JRS, 2021 WL 4775140, at *2 (Del. Ch. Oct. 13, 2021).

⁴ Division of Corporation Finance, Securities and Exchange Commission, *Compliance and Disclosure Interpretation: Proxy Rules and Schedules 14A/14C*, Question 139.04 (Dec. 6, 2022), <https://www.sec.gov/corpfin/proxy-rules-schedules-14a-14c-cdi>.

⁵ U.S. Securities and Exchange Commission, *Compliance and Disclosure Interpretation: Proxy Rules and Schedules 14A/14C*, Question 139.05 (Dec. 6, 2022), <https://www.sec.gov/corpfin/proxy-rules-schedules-14a-14c-cdi>.

THE NASCENT RISK OF NON-TRADITIONAL ACTIVISM

While the first universal proxy card campaigns have featured familiar faces targeting companies for familiar reasons, we expect that in the coming years special interest groups and other non-traditional activists will leverage the universal proxy card to launch campaigns based on non-traditional objectives.

Director nominations provide a unique vector to focus the media, proxy advisors, shareholders, and other stakeholders on the activist's platform. Under the universal proxy card rules, proxy contests can be far more potent, and in many ways are more accessible, than Rule 14a-8 shareholder proposals commonly used by non-traditional activists. Crucially, companies that have not been vulnerable to activists because of their financial performance may be vulnerable to this non-traditional activism, especially high-profile companies that will attract greater earned media for the activist. Frequent users of Rule 14a-8 to submit shareholder proposals on the company's proxy card have also highlighted the potential of the universal proxy card for proxy contests centered on environmental, social and governance issues.⁶

CONCLUSION AND TAKEAWAYS

Much like the companies targeted by it, the dynamics of shareholder activism never stand still. Since Benjamin Graham wrote to John D. Rockefeller Jr. demanding that Northern Pipeline distribute its excess capital in 1927,⁷ companies and activists have kept pace with each other and with the ever-changing landscape of campaign technologies and tactics, applicable regulatory regimes, shareholder composition and interests, and political and economic conditions. The universal proxy card rule ushers in another stage of activism's evolution.

In response to these dynamics, we believe boards should take certain steps to help ensure that the universal proxy card rules do not result in an unfair advantage to activists seeking to exploit the new dynamics of proxy contests:

- **Boards should regularly evaluate their composition in light of the company's strategic and operational priorities.** Many have observed that the switch to a candidate-based voting system means that directors with long tenure, advanced age, or other individual vulnerabilities are more likely to be targeted by activists and less likely to be supported by proxy advisors and institutional investors. While this is potentially true, companies should not evaluate director qualifications in isolation. In the universal proxy card era, the directors who are the least vulnerable to an activist will not only be qualified individually, but will also be additive to the company's current and near-term strategy in a differentiated way not represented by other directors.
- **Companies should evaluate their vulnerabilities to activism—including to non-traditional activism.** It has become increasingly common for companies to "be their own activist" and regularly evaluate potential strategic, operational, and governance enhancements. Any such enhancements reduce the risk of being targeted and increase success if an activist appears.
- **Companies should review their advance notice bylaws to ensure that they reflect market best practices—and if they do not, consider amending them as soon as possible while they are in a "clear day."** Universal proxy cards mean that companies must solicit votes from their shareholders on behalf of validly nominated dissident candidates. Advance notice provisions are the best way to ensure that the company and

⁶ James McRitchie, *ESG via UPC* (Nov. 8, 2022), <https://www.corpgov.net/2022/11/esg-via-upc-amazon/>.

⁷ Jeff Gramm, *Dear Chairman: Boardroom Battles and the Rise of Shareholder Activism* (2015).

its shareholders learn about the activists' and their candidates' relationships, backgrounds and other pertinent topics.