

UNIVERSAL PROXY CARDS AND THE CONTINUED SALIENCE OF THE CASE FOR CHANGE

What directors need to know about the impact of universal proxy cards on proxy contests.

By Kai H.E. Liekefett, Derek Zaba and Eric S. Goodwin

PERHAPS THE MOST CRITICAL QUESTION ARISING

from the introduction of the universal proxy card is whether it will make it easier for shareholder activists to threaten boards of directors without having a compelling vision for the future of the company, either by elevating critiques about board composition or reducing the activist's burden of proof in an election. A universal proxy card enables shareholders to vote for any combination of validly nominated director candidates on a single proxy card. Universal proxy cards are now mandatory for contested director elections under new SEC rules.

Proxy contests have historically been viewed as an extraordinary intervention to change corporate policy, and activists have been required to prove the superiority of their thesis in order to prevail over the incumbent board. Some have argued that the ability to vote for any director nominee on the universal proxy card means that proxy contests should become a referendum on director qualifications, or that there is no harm in voting for one or two activist nominees. These shifts in shareholder voting practices would minimize, if not entirely disregard, the merits of the activist's case and would consequently expand the universe of companies vulnerable to activism.

ISS, Glass Lewis and many institutional investors have stated that they intend to treat proxy contests with a universal proxy card similarly to past elections. However, as we approach the one-year anniversary of the mandatory use of the universal proxy card in contested director elections, it is not yet clear whether proxy advisors and institutional investors have continued to require that the dissident prove a compelling case for change before supporting any dissident nominees.

To be sure, activists and companies have tended to emphasize candidate qualifications more in recent proxy contests. But proxy contests have not devolved into a kind of "external nominating committee" where one side can prevail solely because it has assembled a strong candidate slate.

The principal impact of the universal proxy card so far appears to be a better calibration between the level of change proven by the activist and the number of activist candidates



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supported. For instance, in our view, ISS recommendations this year have appeared to split the difference between activist and company slates at an uncommonly high rate. In several of these situations, ISS determined that the activist had proven a case for change on a certain level but acknowledged that the boards were composed of highly qualified directors with relevant skill sets. These recommendations suggest that activists will be unable to achieve significant influence on a board merely because they have proven that some level of change is desirable.

In response to these trends, boards should regularly evaluate their composition in light of the company's strategic and operational priorities and the total mix of qualifications on the board. In the universal proxy card era, the least vulnerable directors have skills and experience that are additive to the company's near- to medium-term strategy in a differentiated way not represented by other directors.



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