

Welcoming the Universal Proxy

What you need to know about the most dramatic change in the US proxy system in a generation



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On 17 November 2021, the US Securities and Exchange Commission (SEC) adopted new Rule 14a-19 and amendments to existing rules under the Securities Exchange Act of 1934 to require the use of 'universal' proxy cards in all non-exempt director election contests at publicly traded companies in the US.

The new rules contain only slight modifications from rules the SEC first proposed in October 2016. When the SEC reopened the public comment period in 2021, members of Sidley's Shareholder Activism & Corporate Defense Practice sent a formal comment letter to the SEC regarding the proposed rules. We argued that the rules create the equivalent of 'proxy access on steroids'. While comparable to the vacated Rule 14a-11, which allowed shareholders holding at least three per cent of a company's outstanding shares for three years to put dissident directors on the company's proxy statement, the Universal Proxy Rules confer substantially more significant rights to shareholders without any minimum ownership requirements (i.e. owning only one share for one minute will be sufficient). Unfortunately, the SEC proceeded to adopt these rules without meaningful safeguards against misuse.

The new rules will significantly change the methods by which proxy contests at public companies have been conducted for decades. Public advocates of shareholder activism have championed the adoption of the new rules. Their enthusiasm may reflect a premonition that the universal proxy rules will afford dissidents additional leverage when negotiating with boards and, ultimately, allow them to place more dissident candidates on boards. As such, we expect a significant increase in proxy contests and threats thereof once the universal proxy rules take effect for shareholder meetings after 31 August 2022. It is nothing less than the most dramatic change in the US proxy system in a generation.

CURRENT PROXY CARD V. UNIVERSAL PROXY CARD SYSTEM

The new rules affect the central feature of a contested corporate election: the proxy cards. At all contested elections, shareholders are asked to vote by proxy for two competing slates of director nominees. The company slate is assembled by the incumbent board of directors, and the dissident slate is assembled by one or more dissident shareholders.

Under existing SEC rules, shareholders voting by proxy are not able to selectively pick candidates from both the company and the dissident slate. Unless a shareholder attends and votes at the company's annual meeting, they must choose between selecting candidates from either the 'company proxy card' or the 'dissident proxy card'. Within the selected card, the shareholder can choose whether to vote for or withhold on any nominees.

Under the new system, however, both the company and the dissident are required to use a universal proxy card. Each proxy card will be required to include all nominees for that year's election, whether nominated by the company or dissident. Shareholders will still pick between placing their votes through the 'company card' or 'dissident card', but they have the option to give voting instructions in favour or any combination of nominees, up to the number of authorised seats for election at the meeting.

Although all candidates must be included in universal proxy cards, the company and dissident are each permitted to provide their distinct proxy voting recommendations on their own proxy cards. Also, cards must list nominees in two separate groups – company nominees before the dissident nominees. They are additionally permitted to choose different colours for their proxy cards.

REQUIREMENTS OF THE NEW RULES

The new rules also include new and specific requirements for companies and other persons soliciting proxies for director nominees. Dissidents who fail to comply with these requirements are prohibited from using the universal proxy card and continuing with their solicitation of proxies.

The specific requirements include regulations on the timely notice of nominees, filing deadline and scope of solicitation. These requirements are in addition to obligations to comply with provisions stated in the company's governing documents.

First, the company and the dissident must provide 'timely notices' to each other in connection with proxy contests. The dissident must provide notice to the company of the names of all dissident nominees at least 60 days prior to the anniversary of the prior year's annual meeting. The company must provide notice to the dissident of the names of all nominees at least 50 calendar days before the anniversary of the prior year's meeting.

Second, the dissident must file a definitive proxy statement by the later of 25 calendar days prior to the date of the meeting or five calendar days after the date that the company files its definitive proxy statement.

Third, the dissident must solicit the holders of shares representing at least 67 per cent of the voting power of shares entitled to vote on the election of directors. However, as the SEC made clear, a dissident may choose to use the less costly e-proxy delivery method (i.e. the 'notice and access' method of mailing a notice of internet availability and posting the proxy materials on a website) should it desire. Dissidents may also incorporate, by reference, information that is contained in the company's proxy statement, making it less difficult and costly to prepare their own proxy statement.

In addition to rules governing the appointment and listing of nominees, the Universal Proxy Rules contain updates to other features of proxy statements. The company and the dissident must each include a statement referring voters to the other party's proxy statement for information on those nominees. The company must also disclose in its annual proxy statement the deadline for shareholders to give notice of dissident nominations in connection with the next annual meeting.

PRACTICAL GUIDANCE

We provide the following practical guidance for consideration, in advance of the new rules taking effect for shareholder meetings after 31 August 2022:

- The new rules contain few guardrails to protect against misuse. To the extent a company has not been thoroughly evaluating its shareholder activism preparedness, this is a good time to start
- Advance notice bylaws have become all the more important as a means of obtaining information regarding dissidents and their nominees, to help ensure the quality of dissident directors
- Public companies should review the applicability of the new rules to their proxy statement disclosure requirements
- The SEC is likely to be vigilant with respect to compliance in proxy materials in contested elections in the upcoming proxy seasons because of the new rules. 🗳️