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## Practical Guidance

# Corporate Governance, Professional Perspective - The Universal Proxy: New Rules & Perspectives

## The Universal Proxy: New Rules & Perspectives

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On Sept. 1, 2022, the recently-adopted universal proxy rules took effect. Among other things, the rules require parties to a non-exempt, contested director election to use universal proxy cards that include options to vote on all director nominees presented for election at a shareholder meeting when soliciting investor support.

The universal proxy rules represent an evolution of shareholder democracy and address a fundamental shortcoming in the mechanics of contested director elections. At the same time, the universal proxy rules provide new opportunities for companies to claim that shareholders soliciting votes for director slates have “foot-faulted” and invite shareholder-unfriendly boards of directors to attempt to explore new avenues to disqualify shareholder nominations.

### Universal Proxy Rules & the New Regime

The universal proxy rules apply to all director election contests, other than election contests at registered investment companies and business development companies. The new Rule 14a-19 will also not apply to consent solicitations.

The following is an overview of the key portions of the rules.

- **Universal Proxy Card:** All non-exempt, contested director elections must use a universal proxy card that lists all candidates duly nominated and presented for election. While the Securities and Exchange Commission (SEC) left the design details of the universal proxy

card to each party, it established guidelines for the information presented on the card. In particular, each universal proxy card must do all of the following:

- Set forth the names of all duly nominated director candidates
- Provide a means for shareholders to grant authority to vote for the nominees set forth on the card
- Clearly distinguish among company nominees, shareholder nominees, and any proxy access nominees
- List, within each group of nominees, the nominees in alphabetical order by last name on the proxy card
- Use the same font type, style, and size to present all nominees on the proxy card
- “Prominently disclose” (a) the maximum number of nominees for which authority to vote can be granted and (b) the treatment and effect of a proxy card executed in a manner that grants authority to vote for more or fewer nominees than the number up for election (or that fails to grant authority to vote with respect to any nominees).
- **Nomination Notice Deadlines:** Shareholders intending to nominate directors must provide the names of those nominees to the company at least 60 calendar days prior to the anniversary date of the previous year's annual meeting.

It is important for nominating shareholders to note that this notice requirement is in addition to, and not in lieu of, any applicable advance notice provisions in the company's governing documents. In other words, the universal proxy rules represent a minimum notice period and do not override or supersede any longer period established by the company's governing documents.

The company must provide the soliciting shareholder with the names of the company's nominees at least 50 calendar days prior to the anniversary of the previous year's annual meeting date. If there are any changes in their respective nominees, each party must promptly notify the other of such changes.

If the company did not hold an annual meeting during the previous year, or if the date of the meeting has changed by more than 30 calendar days from the previous year, the universal proxy rules require that (i) the shareholder provide notice by the later of (a) 60 calendar days prior to the date of the annual meeting and (b) the tenth calendar day following the day on which public announcement of the date of the annual meeting is first made by the company and (ii) the company provide notice no later than 50 calendar days prior to the date of the annual meeting.

- **Minimum Solicitation Threshold:** The shareholder's nomination notice and proxy statement (or form of proxy) must state that it intends to solicit shareholders representing at least 67% of the voting power of shares entitled to vote on the election of directors.

Although the SEC did not specify a compliance mechanism to ensure that the solicitation threshold is met, it did explicitly state that failure to fulfill the solicitation threshold requirement would expose the shareholder to the same liability as would violation of any other proxy rule. Because a shareholder must include in its proxy materials a representation that it intends to satisfy the minimum solicitation requirement, a shareholder would be subject to liability under Rule 14a-9 (the federal proxy rules' antifraud provision) if such statement were false.

- **Proxy Statement Filing Deadline & Substance:** Soliciting shareholders must file their definitive proxy statement by the later of:

- 25 calendar days before the shareholder meeting, and
- Five calendar days after the company files its definitive proxy statement.

The consequences of missing the relevant deadline are significant. In such case, the company may disseminate a new, non-universal proxy card including only the names of the company's nominees.

The company proxy statement for the prior year's annual meeting must include the deadline by which a shareholder must notify the company that it intends to nominate candidates for election to be included on a universal proxy card at the upcoming annual meeting. The universal proxy rules also require each party in a contested election to refer shareholders to the other party's proxy statement for information about the other party's nominees and note that shareholders can access the other party's proxy statement on the SEC's website. The parties may also refer to information that would be furnished in a filing of the other party to satisfy their disclosure obligations.

- **Modified Bona Fide Nominee Rule & Limited Elimination of the Short Slate Rule:**

Under the prior proxy rules, while shareholders voting in person at shareholder meetings had the ability to vote for a mix of board-backed and shareholder-nominated directors, shareholders voting by proxy did not have the option of "splitting the ballot"—they generally had to either vote entirely for the company slate or for the shareholder slate.

Due in part to the "bona fide nominee rule," shareholders voting by proxy historically were restricted to giving their proxy to either the company or the soliciting shareholder (but not both). This undermined the effectiveness of shareholder democracy by cabining shareholder voting optionality and differentiating between shareholders that vote in person and those that vote by proxy. A key provision of the universal proxy rules removes that technical

roadblock by requiring nominees to consent to being named in any proxy statement for the applicable meeting. Under the prior proxy rules, a “bona fide nominee” was a nominee who “consented to being named in the proxy statement and to serve if elected.”

The rules also eliminate, in many cases, the “short slate rule,” which permits shareholders soliciting in favor of an opposing, partial slate that would represent a minority of a board of directors if elected to seek authority to vote for certain company nominees. The universal proxy rules obviate the necessity of the short slate rule for operating companies, in light of the universal proxy card mandate and the modified bona fide nominee rule. However, the short slate rule remains in place for funds, as they are not subject to the universal proxy card requirement.

## **Our Perspective**

The universal proxy rules represent an important advancement in shareholder democracy. Ensuring that shareholders that vote by proxy have the same voting latitude as those that vote in person is fundamental to good corporate governance and fosters the ability of shareholders to select—and hold accountable—those individuals responsible for overseeing their capital.

Nonetheless, the universal proxy rules have been the subject of criticism by market participants, who, among other things, have expressed concerns about the enhanced shareholder rights attending the new rules and attempted to sound the alarm to suggest that the number of proxy contests will increase appreciably.

The purported concerns with the universal proxy rules may be unfounded, without empirical evidence, and not reflective of the practicalities of running a proxy contest because for a soliciting shareholder, the process involves significant costs, risks, and obligations and requires substantial commitment (both financial and otherwise) to the portfolio company and its business.

There are barriers to entry and substantial consequences for initiating a proxy contest. Fund managers have real fiduciary obligations to their investors and must factor for the financial, legal, and reputational import of conducting a proxy contest. This is particularly so in light of the defensive mechanisms designed by corporate advisors to inhibit, complicate, and proscribe shareholder initiatives before they reach the ballot. It is worth noting that, in recent months, we have observed public companies adopting problematic, unreasonable, and inappropriate advance notice bylaws while implementing other bylaw updates that account for the universal proxy rules.

## **New Rule to Change Aspects of the Investor Landscape**

As a matter of campaign volume, it is possible that shareholders who historically have not practiced activism—or which have only practiced it occasionally—may now explore running a

proxy contest under the new regime due to the perceived increase in the likelihood of partial success. Yet, we don't expect that shareholders who pursue activism as part of their primary investment model will now seek to run campaigns that they would previously have passed over.

We may, however, see some changes in campaign strategies. The ability to cast votes for individual directors shifts the emphasis from the slate as a whole to the individual nominee. Well-advised shareholders will intensify the precision of their campaigns by focusing critiques of specific directors who have failed to deliver shareholder value or that have otherwise fallen short in their contributions to the company. Soliciting shareholders will be forced to be clearer about who to vote for and why. But, if the frameworks that institutional shareholders and proxy advisors use to assess campaigns remain generally unchanged, we anticipate that shareholders will continue to pursue strategies that have previously yielded success.

If the rules represent an advance in shareholder democracy, they also hand investor-unfriendly companies and their advisors another set of tools to use to interfere with the nomination of shareholder-supported directors. The universal proxy rules' substantive requirements and deadlines provide opportunities for exploitation for defensive purposes. Companies and their advisors can be counted on to closely watch for and act upon any missteps (as we have increasingly seen in the advance notice provision context).

Shareholders should be mindful of the material consequences of failing to comply with the rules and approach proxy contests with an understanding that any such failure may subject them to liability as if they had violated any other proxy rule, including a prohibition on soliciting proxies for use at a shareholder meeting.

## **Conclusion**

The universal proxy rules should be welcomed by the corporate governance community. Concerns that the rules will lead to distractions for companies and negatively impact boardroom dynamics strike us as fairly hollow.

Irrespective of whether director nominees appear on multiple proxy cards or on a universal proxy card, shareholders should be free to assess for themselves the perspectives of the nominating parties and to vote for the candidates that they believe will be the best corporate stewards.

The universal proxy rules don't reflect a change in the fundamental purposes and objectives of proxy contests, but rather an important refinement of the mechanics by which the veracity of the parties' arguments in support of such purposes and objectives is adjudicated.

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