

UNIVERSAL PROXY

Lessons From the First Few Contests under the Universal Proxy Rules, and the Outlook for 2023

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The Securities and Exchange Commission's (SEC) new universal proxy rules, which took effect for meetings after August 31, 2022, require the use of "universal" proxy cards in all director election contests, except for elections held by registered investment companies and business development companies. Previously in contested elections, the company and the dissident stockholder each distributed separate and different proxy cards.

Stockholders not attending the meeting in person and voting by proxy could only vote on a single card, limiting their choices to either the nominees on the company card or the dissident card, with no option to "mix and match." By contrast, stockholders voting in person could select any combination of candidates nominated by either side.

The new rules seek, among other things, to bridge this gap by giving stockholders voting by proxy the ability to "cherry pick" between each side's slate of nominees as all candidates up for election are listed on both sides' cards—the "universal" proxy card.

While the new rules are still in their early days, Skadden represented the target companies at two of the first three proxy fights following the new rules and there have been a few lessons learned.

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Recent Universal Card Proxy Fights

To date, a handful of contested elections have been launched since the new rules took effect, and several of those companies have held annual meetings, including the two in which Skadden was involved:

1. Land & Buildings' contest against Apartment Investment and Management Co. (Aimco), in which Land & Buildings sought two of the three seats up for election on Aimco's classified board; and
2. Capital Returns Management, LLC's (CRM) contest against Argo Group International Holdings, Ltd. (Argo), where CRM sought two of seven board seats.¹

It is worth noting that neither Aimco nor Argo were strangers to activist engagement. Land & Buildings' campaign against Aimco represents the continuation of an engagement that began in 2020, when Land & Buildings opposed Aimco's then-proposed spin-off. That same year Argo entered into a cooperation agreement with Voce Capital, resulting in the appointment of three new directors to its board. More recently in August 2022, Argo also appointed Voce Capital's chief investment officer to its board.

After facing a likely defeat at the ballot box, in part, because proxy advisory firms did not recommend its nominees (as discussed below), CRM withdrew its nomination at Argo. Land & Buildings secured one seat at Aimco's annual meeting on December 16, 2022.

Technical Considerations

The new rules require a number of technical additions and considerations to a company's proxy

statement, including the presentation of director nominees on the proxy card, disclosure of the deadline to give notice of a solicitation in support of a dissident's nominees and the treatment of undervoting and overvoting.

Proxy Mechanics. One goal of the new rules is to harmonize the company's and the dissident stockholder's proxy cards to avoid confusion at the ballot box. In order to achieve this, the new rules require, among other things, (1) both the company and dissident to list all nominees on their respective proxy cards² and (2) the proxy card to be presented in a clear, neutral manner.

Notwithstanding the neutrality requirement, in both contested elections under the new rules, the proxy cards clearly distinguished between the company and dissident candidates and contained recommendations of the soliciting parties. The dissidents' proxy materials also targeted individual company directors, identifying which directors were "not acceptable" to the dissident.

Notice of Deadlines. Under the new rules, companies are required to state the deadline for providing notice of a solicitation of proxies in support of director nominees other than the company's nominees for the next annual meeting. Typically, companies include such information as a standalone paragraph under their "stockholder proposals for next year's annual meeting" section of the proxy statement.

Undervotes and Overvotes. In addition, the new rules require that each universal proxy card must disclose the treatment of proxy cards containing undervotes (when a stockholder votes for fewer nominees than the number of seats up for election) and overvotes (when a stockholder votes for more nominees than there are seats up for election).

Both Aimco and Argo disclosed that, if an undervote occurs, those "unused" votes will not be counted toward any remaining nominees, and if an overvote occurs, all of such stockholder's votes in the election of directors will be deemed invalid and not be counted.

Going forward, we expect companies without a significant retail stockholder base will follow

substantially similar mechanics if faced with a contested election so long as the commonly used Broadridge system for processing proxy cards is not capable of supporting an alternate approach.

Director Qualifications

Prior to the new rules, a dissident stockholder would often attempt to convince stockholders that its full slate of nominees, taken as a whole, was more qualified or better positioned to enhance stockholder value at the company than the company's nominees, taken as a whole. However, now that the new rules expressly allow for stockholders to "cherry pick" candidates from either the company's or a dissident's slate, there appears to be enhanced scrutiny on the qualifications of individual nominees. In both the Aimco and Argo contests, the companies and dissidents focused a great deal on the qualifications of their individual nominees, and criticized the qualifications of the opposing nominees.

Going forward, in preparing for a potential universal proxy fight, companies should not only consider the increased need to clearly communicate their rationale and strategy on approaches to board refreshment and composition as a whole, but also pay particular attention to individual directors who may be vulnerable to an attack due to, among other things, long tenure, service on multiple boards, or either a lack of relevant expertise and skill sets, or redundancy of expertise in the boardroom.

Proxy Advisory Services Recommendations

Based on a review of Institutional Shareholder Services' (ISS) and Glass Lewis' reports, it appears that Glass Lewis takes a more holistic view of a dissident's thesis and, consistent with past practices, Glass Lewis is "reticent to recommend the removal of incumbent directors ... unless certain issues are evident," such as poor corporate governance oversight.³

For Argo, ISS, and Glass Lewis both recommended a vote for the company's nominees. For Aimco, Glass Lewis recommended a vote for the company's nominees; however, ISS split its recommendation, recommending a vote for two Aimco nominees and one Land & Buildings nominee. ISS specifically declined to recommend one of Aimco's nominees, noting that the nominee was long-tenured and his specific background and qualifications were already covered on Aimco's board by more recently appointed independent directors. Conversely, ISS noted that the qualifications and background of one of Land & Buildings' nominees would complement the current Aimco board of directors.

In addition, and consistent with its past practices, ISS recommended that stockholders vote on the activist's proxy card (Land & Buildings'), notwithstanding the fact that only one Land & Buildings nominee was recommended versus two company nominees.

While one cannot draw firm conclusions from two proxy contests as to how the use of the new universal proxy card may influence contests or the recommendations of the proxy advisory firms, it does not appear that either proxy advisory service modified its general framework for evaluating election contests for a minority of the board of directors.⁴

New Rules Compliance and Disclosure Interpretations

As is common for recent amendments adopted by the SEC, the agency has published clarifying compliance and disclosure interpretations (CD&Is) concerning the new rules.⁵ Most notably, CD&Is have clarified that if a company determines a dissident's nomination notice is invalid for failure to comply with the company's bylaws or the new rules, and the dissident challenges this determination by initiating litigation, the company is required to disclose the litigation in its proxy statement and provide the rationale for the company's determination that the nomination is invalid.

Potential Bylaw Amendments

Recently, several companies have amended their bylaws to reflect the new rules, along with certain additional amendments that go beyond the scope of the new rules. However, given the new rules are statutorily mandated, there is no immediate necessity to amend a company's bylaws, as we expect the SEC to vigorously enforce the new rules, decreasing the likelihood that a company by itself would have to enforce them.

Furthermore, some of the additional amendments that companies have recently implemented—for example, requiring disclosure of a dissident stockholder's limited partners—are currently being challenged in the courts and it remains to be seen whether such amendments are enforceable, and how investors and proxy advisory firms will view such bylaws in evaluating a company's overall governance practices.⁶

Companies that are considering amending their bylaws to reflect the new rules should consider the proposed scope of bylaw amendments in the context of their overall governance profile and structural defenses. If a company chooses to amend its bylaws at this time, in order to avoid litigation, it would be wise to refrain from adopting amendments perceived to be "aggressive," and keep any amendments related to the new rules narrowly focused—for example, an amendment that states that failure to follow the new rules and to provide evidence of soliciting proxies from at least 67 percent of stockholders invalidates a nomination under the company's bylaws. By doing so, a company will likely minimize and indeed avoid the potential pushback from stockholders.

Looking Ahead to 2023

The new rules are the latest development in the ever-changing world of corporate governance and contested director elections. Although it is still early and potential ramifications remain to be seen, one consequence of the new rules appears to be enhanced focus on the individual director's qualifications, including whether a specific director is long-tenured.

Another result may be an increase in the number of settlement agreements due, in part, to the increased unpredictability in outcomes of contested elections under the new rules and the somewhat greater likelihood that the proxy advisory firms will recommend in favor of at least one of the dissident's nominees.

Notes

1. Aim ImmunoTech Inc. also faced a proxy contest. However, Aim ImmunoTech prevailed in litigation in the Delaware courts, which found that the dissident stockholders' nomination did not comply with certain of the company's bylaws and was therefore invalid.
2. The new rules, however, do not restrict the order of such listing of nominees, so a company is free to list its nominees at the top and the dissident's nominees at the bottom of the proxy card.
3. Glass Lewis Proxy Paper Report – Argo Group International Holdings, Ltd., December 2, 2022.
4. See ISS 2023 Proxy Voting Guidelines and Glass Lewis 2023 Policy Guidelines for a more detailed description of the proxy advisory services recommendation framework for contested elections.
5. <https://www.sec.gov/corpfin/proxy-rules-schedules-14a-14c-cdi>.
6. A handful of companies have also recently amended their bylaws to preemptively claim the white proxy card. While the benefits of claiming the white proxy card may have been diluted following the use of a universal card under the new rules, it may still be beneficial for companies with a large retail stockholder base.