

EY Center for Board Matters

## Universal proxies: what boards should know and how companies should prepare

For decades, contested director elections at US publicly traded companies have largely followed the same competing proxy card format, forcing shareholders to choose between mutually exclusive slates of directors and turning high-profile proxy contests into real-life exercises in game theory. That process is about to change and companies, as well as their boards, must be vigilant in preparing a new approach to contested director elections.

### What is changing?

In November 2021, the U.S. Securities and Exchange Commission (SEC) finalized the adoption of changes to the rules governing contested director elections, or proxy contests. These rule changes were being discussed as far back as 2014 and were formally proposed by the SEC in 2016 but were not meaningfully advanced until recently.

In a proxy contest, both the company and the dissident have historically distributed separate proxy cards. Each side's proxy card has listed only its own nominees. Shareholders not attending the annual meeting and voting by proxy could only vote on a single card, limiting their choices to either the nominees on the company card or nominees on the dissident card, with no

#### In brief

- ▶ Beginning in September 2022, new rules will allow shareholders to elect directors from a full list of candidates nominated by both the company and a dissident in contested board elections.
- ▶ Universal proxies will give investors more effective means to influence the makeup of the board.
- ▶ The new rules may lead to a higher volume of proxy contests and could mean that more individual directors become targets.

option to mix and match. Conversely, shareholders voting in person could select candidates nominated by either side.

For all shareholder meetings at US publicly traded companies after August 31, 2022, new rules will require companies and dissidents alike to use a universal proxy card listing all candidates properly nominated by the company or a shareholder. While each party in a proxy contest may still produce and distribute proxy cards and accompanying proxy solicitation materials, candidates from the opposing slate will now be included in each party's card.

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voices have been vocal and steady advocates for changing the proxy voting rules and have been key to seeing these changes finally adopted.

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## Notable changes to the proxy rules

- ▶ **“Bona fide nominee” rule change.** Under the new rules, consenting to being named on one proxy card is equivalent to consenting to being named on all proxy cards, regardless of who is producing that proxy card.
- ▶ **Nomination notice period requirements.** While companies may have more restrictive notice periods, the new rules provide minimum timing with respect to each party disclosing its nominees. Dissidents must provide notice at least 60 days prior to the anniversary of the prior year's annual meeting, while companies must provide notice within 50 days.
- ▶ **Elimination of short slate rule.** The new rules eliminate the ability in a contested election for a dissident to seek a shareholder's proxy to vote for a partial company slate in order to complement the dissident's own candidates when nominating less than a full slate.
- ▶ **Solicitation requirements.** Dissidents nominating individuals for the board must solicit proxies from shareholders holding at least 67% of the total voting shares outstanding.

## Implications for boards

To understand the implications for boards, directors need to understand how universal proxy rules will impact shareholders.

Until now, most shareholders have had to adopt an “our card vs. their card” mentality rather than being focused on the individual nominees. This has left many shareholders feeling constrained in their ability to support moderate changes to the board. Now these shareholders will have more options to express their opinion on the optimal makeup of the board. When faced with more candidates for election than seats on the board, investors no longer must first decide if dissatisfaction rises to the level of pushing them to abandon the company card in order to effectuate changes to the board.

For dissident shareholders, the impact of the new rules likely depends on the individual activist. For the largest, highest-profile activists, these changes may provide incentive to move forward with the occasional marginal contest that would not have previously been pursued. This is because activists know that shareholders may be more comfortable voting for marginal change at the board level than wholesale slate changes.

The real impact on the dissident side will be with small- and medium-sized activists where these changes make running a proxy contest much more palatable from a cost perspective. Also, the increased ability to attract shareholder votes shifts the leverage in favor of the activists in any settlement negotiations, which could further increase activists’ incentives to initiate

a proxy contest in the first place. As a result, some activist campaigns that would have not been viable from the dissident’s perspective, and thus never initiated, will now see the light of day.

In addition to typical activist shareholders, other groups such as shareholder advocacy groups and special interest groups may see these new rule changes as a way to increase their voice on matters related to environmental, social and governance (ESG); diversity, equity and inclusion (DE&I); and employee rights either via threatened or actual proxy contests.

The bottom line: Boards should expect a higher volume of proxy contests in coming years, with more individual directors being targeted and more shareholders potentially willing to vote for change.

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## How to prepare

Companies and boards should prepare for the possibility of becoming targets of an activist campaign and recognize that the campaign may involve dissident director nominees. While the traditional rules of activism preparation continue to apply, companies and boards must be even more focused on key issues related to the board itself to dissuade or defend against a contested election. Some key actions companies and boards can take to best prepare themselves are:

- ▶ **Seek education for the board and senior management about the new proxy rules and the potential implications.** Incremental risks should be fully understood, as should the steps the company is taking to mitigate those risks.
- ▶ **Prepare a holistic activist vulnerability analysis, and take action based on the findings.** Share price performance is only one data point that activists use to identify potential targets. Companies should look at total shareholder return, top- and bottom-line growth, operating efficiency, and other key metrics from both an absolute and a relative perspective. In addition, an introspective review of the company's business and asset mix should be undertaken to identify areas that shareholders may focus on for divestment.
- ▶ **Engage proactively with shareholders on issues important to them.** It is important to tell a robust strategy story tied to sustainable value creation for shareholders. In many cases, shareholders who vote for a dissident nominee are simply voting for change, not specifically for the activist's agenda. The company should proactively make the case that change is not needed. Highlight the company's perspectives and accomplishments on ESG and DE&I, recognizing that these issues are of higher importance to shareholders than ever and are significant drivers of calls for board change. Demonstrate to shareholders that the existing management team and board have the skills necessary to move the company's ESG agenda forward.
- ▶ **Look closely at the board's composition and make changes now, if necessary.** Many boards use a board skills matrix to assess whether the board has the right mix of experience to support management's execution of the strategy and oversee changing risks and opportunities.
- ▶ **Oversee how the board's qualifications and effectiveness are communicated.** The proxy statement should provide a compelling view into how the board's talent and skills align to the needs of the company. Best-in-class companies often publish their skills matrix in their proxy. Doing so helps

shareholders understand, and buy into, the rationale for each director's role on the board and can help undermine a dissident's potential call for change. Also consider whether the proxy statement can more effectively communicate steps the board is taking to enhance its effectiveness, including rigorous board assessments, ongoing education and training.

- ▶ **Review existing articles and bylaws to ensure they are up to date and make changes where necessary.** While the new proxy rules provide minimum requirements with respect to advance notification and information regarding nominees, companies can implement more robust requirements via their articles and bylaws. Many companies' organizational documents were written well before the advent of modern shareholder activism and do not provide the type of protection from dissidents that has become standard today.
- ▶ **Have a plan in the event an activist does emerge.** No amount of preparation can completely inoculate a company against the prospect of a dissident targeting the company and taking advantage of these new proxy rules. In these cases, companies must be adequately prepared to defend the strategy, management team and board from an activist attack. A response plan positions the company to retain control of the narrative, and credibility with the shareholders, in the initial days of an activist approach and provides a structured framework to respond to, and successfully defend against, an activist proxy contest.

The status quo is no longer acceptable as shareholders demand more than just a rising share price from their portfolio companies. The changing proxy contest rules will make it easier for traditional shareholder activists and others to seek board representation. Management teams and boards should recognize these changes now and act decisively to prepare.



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## Questions for the board to consider

- ▶ Do the board and senior management team understand the new universal proxy rules and the potential implications for the company?
- ▶ Has the company conducted a holistic activist vulnerability analysis and taken action based on the findings? Does that include directors believed to be vulnerable?
- ▶ How is the board regularly challenging and refreshing its composition in light of strategic and risk oversight needs? Does the proxy statement clearly communicate the rationale for each director's role on the board?
- ▶ Does the company have direct dialogue with shareholders to understand their views on the company's strategy and governance? Do select individual directors participate in those conversations? Are board composition and skills regularly discussed with shareholders?
- ▶ What is the company's response plan in the event an activist does emerge? Does the board understand its role and has it participated in simulation exercises?
- ▶ Has the company reviewed and updated its articles of incorporation and bylaws since formation to address potential shareholder activism risks?

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