



How the New Proxy Rules Will Affect US Companies Facing Activist Campaigns

- New “universal” proxy card rules may increase the number of activist campaigns if activists believe the rules give them a better chance to win seats in contested elections. Smaller companies may be most vulnerable.
- But the benefits to activists may be only marginal, particularly in the case of large cap targets with relatively few retail shareholders.
- The new rules focus attention on individual directors’ qualifications, so companies will need to articulate nominating individuals, particularly those with potential vulnerabilities.
- Proxy advisory firms do not appear to have altered their historical approaches to determining which nominees to support.
- Because the rules make contested elections less predictable, the changes could increase pressure on companies to reach settlements with activists.

Shareholder meetings held this year are subject to new rules that require both companies and activist shareholders to use “universal” proxy cards in contested board elections. Until now, the company and the dissident shareholder each distributed their own cards with only their candidates, so shareholders who did not attend the meeting and voted by proxy were forced to choose between the two cards, *i.e.*, between full, competing slates.

The new rules, adopted by the Securities and Exchange Commission (SEC) last year, require both sides to list *all* candidates — their slate and the alternative nominees — on their respective cards. This allows shareholders to “mix and match,” picking some company and some activists nominees. In the past, only shareholders attending the meeting in person could do that. The rules apply to most public company shareholder meetings held after August 31, 2022.

The goal of the rules is to give shareholders more power over the exact shape of the board, and the change may make it somewhat easier for dissident shareholders to win board seats.

Only a Few Elections Have Taken Place Under the New Rules So Far

Since most annual meetings are held in the spring, few contested elections have been launched since the rules came into effect. Skadden represented the companies in the first two proxy fights under the new rules, offering a glimpse of how such contests may be altered (or not) by the new rules:

- Activist Land & Buildings sought two of the three seats up for election on the classified board of Apartment Investment and Management Co. (Aimco).

- Land & Buildings won one seat, in accord with one proxy advisor's recommend
- Capital Returns Management sought two of the seven board seats at Argo Group International Holdings.
 - Facing a likely defeat at the ballot box, in part because proxy advisory firms did not recommend its nominees, Capital Returns withdrew its nominations.

What Do the New Proxy Cards Look Like?

The new rules require both the company and the dissident to list all nominees on their respective proxy cards in a clear, neutral manner. The rules do not, however, specify the order in which nominees are listed.

In both the Aimco and Argo elections, the companies' and the activists' proxy cards each clearly distinguished between the company and dissident candidates and contained recommendations of the soliciting parties. The activists also indicated which company nominees were acceptable to them and which they opposed.

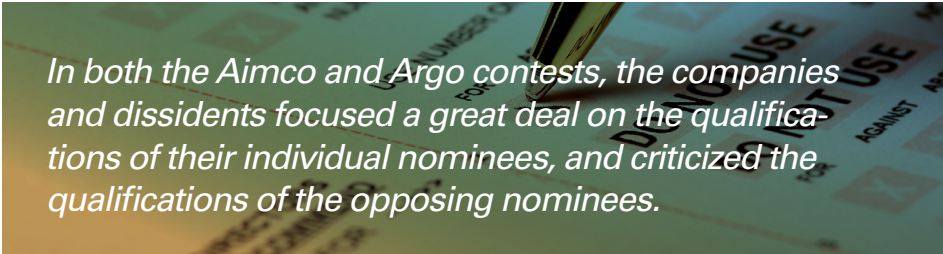
Trian Fund Management, L.P. followed a similar format in the proxy fight with The Walt Disney Company before withdrawing its nomination in early February.

The Rules Put the Spotlight on Individual Directors

In the past, a dissident stockholder would typically argue that its slate of nominees, taken as a whole, was more qualified or better positioned to enhance stockholder value than the company's nominees, taken as a whole. However, now that stockholders can mix and match candidates from either 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.

Likewise, Trian specifically targeted one Disney director, presumably based on a belief that it had the best chance of winning one seat with this approach.

The upshot is that companies will need to (a) clearly communicate their strategy for board refreshment and composition as a whole, and (b) pay particular attention to individual directors who may be vulnerable to an attack due to factors such as long tenure, service on multiple boards, either a perceived lack of relevant expertise or skill sets, or redundancy of expertise on the board.



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Proxy Advisory Services Do Not Appear To Be Altering Their Approaches

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

In Argo's contest, ISS and Glass Lewis both recommended voting for the company's nominees. At Aimco, their advice diverged. Glass Lewis supported the company's nominees, but ISS split its recommendation, advising a vote for two company nominees and one Land & Buildings candidate.

In an example of increased scrutiny of individual nominees, ISS said it declined to support one incumbent Aimco director because he was long-tenured and his qualifications were similar to those of more recently appointed independent directors, and the qualifications and background of one of Land & Buildings' nominees would better complement the current Aimco directors.

While one cannot draw firm conclusions from two proxy contests, it appears that, to date, neither ISS nor Glass Lewis has modified its general framework for evaluating election contests for a minority of the board of directors.

Do Bylaws Need To Be Amended?

Some companies, including 145 of the Fortune 500 as of February 7, 2023, have amended their bylaws in response to the new rules. Many of the amendments closely track the amended rules — requiring, for example, that an activist provide evidence that it solicited proxies from at least 67% of stockholders, as the rule requires. Others have included tangential bylaw amendments: For example, 79 Fortune 500 companies now reserve the right to use a "white" card, which some see as an advantage because they are traditionally identified by shareholders as the company's.

Amending a company's bylaws to include new rules may provide some procedural advantages. For instance, if the company believes an activist has not complied with the new rules, it can simply cite its bylaws; it does not need to wait for the SEC to enforce the rules.

At this early stage, there are a number of reasons to be cautious about bylaw amendments:

- Because the SEC rules are statutory mandates, it is not strictly necessary to amend bylaws to reflect the changes. We expect the SEC to vigorously enforce the new rules if activists skirt them, particularly in contests involving large companies. And the larger, more sophisticated activists that tend to target large companies are less likely to break the rules.
- Becoming an early adopter of bylaw amendments may draw attention to a company, potentially prompting speculation that the company is concerned about an activist campaign.
- Amendments that are seen as “aggressive” may convey a negative “defensive” or “entrenching” posture to shareholders and proxy advisory services, which could color their views of the company’s governance negatively.

The Big Picture

As the 2023 proxy season plays out, it will become clearer if and how the rules alter the dynamics of board contests and, if they do, how companies should respond.

In the meantime, the changes appear to have made the outcomes of these fights somewhat less predictable. To the extent either activists or companies think the new rules increase the odds of activists prevailing, that may spur more campaigns and put pressure on companies to reach settlements with activists. They are also almost certain to make these contests increasingly turn on the qualifications of individual nominees.

Authors

*Richard Grossman / New York
Neil Stronski / New York
Anya Richter Hodes / New York
Alexander J. Vargas / Chicago*

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One Manhattan West / New York, NY 10001 / 212.735.3000