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Preparing for the 2023 Proxy Season in the Era of Universal Proxy

The [universal proxy card](#), which came into effect on September 1, 2022, represents an important development in shareholder voting: for the first time, all shareholders will be able to vote for their preferred mix of board and dissident director nominees at a contested meeting. While the framework by which major institutional shareholders and the influential proxy advisers ISS and Glass Lewis evaluate proxy contests remains unchanged—dissidents will still need to make a compelling case for change and propose proportionate solutions and qualified nominees—the universal proxy card may meaningfully change the dynamics of contested elections. One consequence is clear: individual director candidates will face increased scrutiny by shareholders and proxy advisors. Shareholders will be able to engage in “elective surgery” and opt away from individual board-nominated candidates whose skills, backgrounds, experiences and contributions compare unfavorably in their view relative to those of individual dissident nominees. With shareholders—and the proxy advisory firms—now able to “cherry pick” from among the entire set of board candidates in a contested election, both the board and dissidents will be expected to more clearly communicate and demonstrate the strengths of each individual nominee.

The universal proxy card rules also come at a key juncture in the economic cycle. Macroeconomic headwinds, trading multiple compression and a bearish earnings outlook have all aided the resurgence of shareholder activism. Investor focus on ESG issues also remains strong. The past proxy season saw a record number of shareholder proposals and continued uptick in private engagement. It is possible that some proponents (including smaller social activists that have previously submitted Rule 14a-8 proposals) may seek to leverage the lower cost of entry created by the new universal proxy card rules to nominate directors as part of ESG-oriented campaigns.

The new universal proxy rules will require a review of company bylaws to ensure that appropriate amendments are implemented to provide sufficient notice and time to prepare for a contested election. Companies would also be well advised to review their preparatory practices prior to their next annual meeting, including board and management readiness, shareholder engagement and outreach, proxy statement and related public disclosures, and board refreshment and composition strategies. We summarize our recommendations below.

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Summary of Key Rule Changes

The universal proxy rules require the use of proxy cards listing the names of all director candidates in a contested election, regardless of whether the candidates were nominated by the board or shareholders. Shareholders will be able to “mix and match” their votes for dissidents and board nominees. The new rules also set forth minimum solicitation and notice requirements, including the requirement that dissidents solicit holders of a minimum of 67% of the voting power of shares entitled to vote in the election. Unlike proxy access, the universal proxy rules do not impose minimum ownership thresholds or holding periods nor do they cap the number of nominees. Each side will need to conduct its own solicitation and may use notice and access to deliver its proxy materials and comply with the requisite solicitation requirements. In addition, the “short slate” rule has been eliminated, and the “bona fide nominee” rule has been amended to include nominees that consent to being named in any proxy statement for the applicable shareholder meeting.

Notably, the Securities and Exchange Commission (“SEC”) has not mandated identical universal proxy cards. The new rules require proxy cards to list all nominees, to distinguish among board, dissident and proxy access nominees, to use the same font type, style and size to present all nominees, and to disclose the maximum number of nominees for which voting authority can be given, but the board and dissidents have free reign to make tactical decisions on how to group nominees, including whether to identify nominees recommended or opposed by their side. The likelihood is that dissidents nominating fewer candidates than seats will specify which board-nominated candidates they oppose and which they do not oppose.

Bylaw Amendments

The scope of bylaw amendments in response to the universal proxy rules should be considered in the context of a company’s overall governance profile and structural defenses, but we recommend that all companies at least consider making the following changes:

- Requiring the dissident’s nomination notice to include a representation that the dissident intends to solicit proxies from shareholders representing at least 67% of the voting power of shares entitled to vote on the election of directors;
- Requiring the dissident to comply with the universal proxy rules and to provide reasonable evidence thereof prior to the shareholder meeting; and

- Requiring the dissident to use a proxy card color other than white, which will be reserved for the company's exclusive use.

In addition, to the extent companies are considering updates to their advance notice bylaws, such amendments should be unambiguous and reasonably serve to provide the company and shareholders with relevant information. Bylaw updates adopted on a "clear day" will receive greater judicial and shareholder deference than changes adopted amid a proxy contest, and in light of the possibility of an increase in proxy contests in the years ahead, now may be a good time to review and update bylaws to reflect evolving market practices.

Proxy Season Engagement

The best preparation for any proxy contest occurs in peacetime, and companies should continue to build relationships and credibility with their investors in the context of their ongoing engagement meetings with investors for the benefit of all board members. Given the limited opportunities for directors to meet with investor stewardship teams during the year, companies should consider how to strike the right balance between introducing newer directors to investors and bringing familiar faces who are more experienced with shareholder engagement. Meeting agendas may also need review; additional time may need to be allocated to allow a robust discussion of board composition and effectiveness. During a proxy contest, it will be helpful if most or even, in certain circumstances, all directors are prepared to engage with key shareholders and proxy advisors.

Proxy Disclosures

As directors face more scrutiny and their roles become ever more complex, it may be time to take a closer look at proxy materials and related disclosures and processes, including D&O questionnaires, director skills matrices and director biographies. Heightened expectations regarding oversight of risk, climate, human capital, cybersecurity and other issues have led to growing investor and regulatory demand for disclosures, as evidenced by the SEC's recent rulemaking and comment letters. The director skills matrix provides companies an opportunity to communicate and explain the specific substantive skills they believe are critical to the business and the order of priority given to such skills. A well-crafted director skills matrix can effectively highlight the strength of the company's overall board composition and demonstrate the contribution each director brings to the board. Director biographies can also be leveraged to support the case for each director, highlighting particularly relevant or valuable aspects of their experience.

Board Composition and Refreshment

While dissidents will still need to make the case for change to secure the support of shareholders and proxy advisors, directors who are publicly perceived as having vulnerabilities such as lacking independence, having long tenure, being “overboarded” or just underperforming will face greater scrutiny, and likely face a higher risk of defeat in a proxy contest. Whereas in the past, companies have been able to successfully focus on the *collective* strength of the board, ISS has already indicated that it “will continue to highlight to clients those nominees from either party who, during our engagements, appear particularly well-qualified.” In preparation for future proxy contests, in addition to providing clarity on strategic and business priorities, boards may need to further refine their approaches to board refreshment and composition (along with director training and education), including paying particular attention to concerns regarding long tenure, overboarding, diversity and relevant expertise and skillsets. In the universal proxy era, shareholders and proxy advisors may be more focused on the individual qualities and skill sets of the director candidates from each side.

Universal proxy marks a new phase of corporate governance. A direct consequence of the rules is increased scrutiny of individual directors and their role on the board. In addition to bylaw amendments to ensure clear understanding of the voting process and timely compliance with the new rules, companies should also look to leverage public and private opportunities to build investor confidence and trust in the board as a whole as well as each member of the board.

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