Diligent Market Intelligence

Proxy Season Review

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The universal proxy regime – The results are in!

The introduction of the universal proxy card fostered a rise in both settlements and contentious corporate bylaw amendments in the first half of 2023, writes Andrew Freedman, chair, shareholder activism practice group, Olshan Frome Wolosky.

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The 2023 proxy season saw strong momentum following a record-breaking season in 2022. There have been 403 companies in the U.S. that were subject to activist demands, which is slightly below trend compared to last season as some activists have taken a "wait and see" approach to how the Securities and Exchange Commission's (SEC) new universal proxy card (UPC) rules play out.

We also witnessed robust activity in Canada, Europe, and Asia. Things are getting particularly interesting in Japan, where it has been reported that more than 80 companies were subject to upwards of 370 shareholder proposals in June alone as the Tokyo Stock Exchange (TSE) continues to put pressure on listed companies to become more shareholder-friendly.

Here in the U.S., the results are in as far as how the "mix-and-match" format under the new UPC rules impacted shareholder activism during the 2023 season. As we predicted, we saw more minority slate campaigns seeking to replace the most vulnerable incumbent directors and a significant uptick in early-stage settlements as institutions seemed eager to test out "mix-and-match" voting.

We continue to see campaigns settle as companies and activists alike feel their way through the new UPC regime. This penchant for compromise has resulted in some seasoned activists securing more than just board seats at high profile companies. Shake Shack entered into an agreement with Engaged Capital that not only resulted in the appointment of the former chief financial officer of Domino's Pizza to the board, but also secured the company's commitment to retain a consulting firm and eliminate the founder's director designation rights.

Meanwhile, warnings by company advisors that UPC would open up the floodgates to first-time activists because the rules would purportedly make it easier and cheaper to run contests turned out to be a fallacy. The number of U.S. campaigns commenced by first-time activists as a percentage of all campaigns stayed relatively flat compared to prior years, and the data clearly shows that budgets for most activist campaigns still run in the hundreds of thousands of dollars, if not millions.

Unfortunately, the same company advisors who claimed that UPC would make proxy contests more accessible to shareholders have actually driven up the cost of running an election contest by counseling companies to weaponize their advance notice bylaw procedures in order to make it easier for them to invalidate nomination notices and bypass the UPC requirements at their annual meetings.

However, these tactics backfired in a big way against some of these companies, like at Masimo where the board adopted advance notice bylaws that required information from the nominating shareholder that went well beyond what is necessary and reasonable.

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Only after being challenged in court by Politan did the company rescind these bylaw provisions and terminate its recently adopted poison pill. But the damage was already done – in its recommendation to shareholders fully supporting the dissident slate, Institutional Shareholder Services (ISS) described these nomination requirements as "an affront to shareholders" that "did not even approach the definition of reasonable."

It remains to be seen whether lessons will be learned from Masimo and companies will be less cavalier with their defense tactics in the second half of 2023 and beyond. In any event, Olshan remains committed to continuing to stand up for the rights of shareholders against any abuse of the corporate machinery or any other inventive machination designed to suppress shareholder democracy.

The impact of universal proxy

An interview with Elizabeth Gonzalez-Sussman and Ryan Nebel, vice chairs of the shareholder activism practice group at Olshan Frome Wolosky.

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Now that the dust has settled, how has universal proxy card (UPC) changed the shareholder activism landscape and defense tactics?

Elizabeth Gonzales-Sussman (EG): One of the unfortunate outcomes of the new UPC rules this proxy season was the increased weaponization by companies of their advance notice bylaw provisions to invalidate nomination notices, in order to allow them to sidestep the use of a UPC for their annual meetings. Late last year, the Securities and Exchange Commission (SEC) issued guidance stating that if a company invalidated a nomination notice, it would not need to use a UPC that listed the dissident's nominees and the company's nominees on their proxy cards. As a result, we saw a number of entrenched boards adopt this playbook and attempt to hold their annual meetings naming just the company's nominees on their proxy cards.

In undertaking these efforts, dissidents were forced to spend significant resources fighting unilateral decisions by boards to invalidate otherwise valid nominations. In most cases, our clients were successful in defending against such unscrupulous actions, with companies backtracking from their positions shortly after being challenged in court or receiving overwhelming negative feedback from shareholders. Companies and their advisors should understand that these entrenchment tactics can often backfire, as a board's decision to deny shareholders the ability to vote on a dissident's candidates could be interpreted to suggest the board's indifference to shareholders' competence and ability to evaluate for themselves purported deficiencies.

Ryan Nebel (RN): It has been well documented that UPC has engendered an environment where companies are much more willing to settle compared to prior years, after quickly realizing that their attempts to insulate their weakest directors in a UPC contest format could be an uphill battle. Digging a little deeper, settlement discussions are commencing much earlier in the process, are being negotiated at lightning-fast speeds, and are often finalized and announced prior to either side even filing its preliminary proxy. Many of these negotiations have been less hostile than in the past and my clients have not had to cave on material terms for which they have established precedent in prior settlements like the duration and scope of their standstills, minimum ownership thresholds and expense reimbursement.

In a sense, UPC has brought out the best and worst of board behavior. While it is encouraging to see reasonable resolutions being reached early in the engagement process in many situations, the scorched-earth tactics utilized in others is reason for concern.

Elizabeth, can you talk a little more about the types of advance notice bylaw changes you observed this proxy season?

EG: Many companies updated their bylaws to conform the timing and notification requirements of their shareholder nomination procedures to those of the new UPC rules. Unfortunately, however, many of these bylaw amendments went well beyond the changes that were needed to address the new rules or that are otherwise required by law. Rather, companies used this as an opportunity to expand their advance notice bylaws with so-called "disclosure enhancements" that make the process for shareholders to nominate directors unnecessarily costly and sometimes completely impractical from a business standpoint.

Some of the more egregious disclosure requirements were challenged in court – like asking for the names of the nominating hedge fund's limited partners. Other offensive bylaw provisions that emerged from UPC include asking for copies of the nominating shareholder's proprietary and highly confidential fund documents. While some of our clients challenged these problematic provisions in court, many companies waived compliance with them before a court could weigh in on their enforceability. As such, a dissident may face the same hurdles next season.

> *"In a sense, universal proxy has brought out the best and worst of board behavior."*

Ryan, what was the root cause of so many companies adopting these bylaw amendments and potentially exposing them to lawsuits from shareholder activists, like we saw at Masimo?

RN: There are a handful of company advisors that are directly responsible for convincing boards that the UPC format would make it much easier for first-time gadfly activists to run a competing slate of candidates and that boards needed to protect themselves from the impending threat of a new wave of frivolous contests that UPC would unleash. This false narrative made amending advance notice bylaws to further complicate the nomination process an easier sell to boards.

But, at the end of the day, the tsunami of frivolous contests never came. UPC is a voting mechanic – it did not create a new way for shareholders to seek board seats or make running a proxy contest less expensive. As a consequence, companies like Masimo that bought into these false narratives have now been put on the defensive by concerned shareholders and advocacy groups for adopting these ill-advised amendments.

"Companies and their advisors should understand that entrenchment tactics can often backfire, as a board's decision to deny shareholders the ability to vote on a dissident's candidates could be interpreted to suggest the board's indifference to shareholders' competence."

What were some other trends you saw this proxy season?

EG: Heeding Institutional Shareholder Services' (ISS) warning last year that activists who may have, in the past, "overreached" with respect to the size of their slates and that padding the number of nominees in the UPC regime could "backfire," a vast majority of our clients decided to run minority slates over majority slates. As Ryan discussed above, most of these settled in the early stages of the campaign.

Interestingly, since our clients settled for fewer board changes than they may have wanted, a little more emphasis was given to settlement terms designed to give them more confidence that strategic or governance changes would, in fact, be implemented. For example, some of our clients required more specific terms for capital return plans, some demanded the CEO resignation as part of their settlement, and some reversed recent bylaw amendments.

Do you think this trend of running smaller slates will continue?

RN: Each situation is unique, but there's no doubt that most of our activist clients took extremely calculated approaches to targeting one or two of the most vulnerable incumbent nominees and highlighting with surgical precision every attribute and skill possessed by their proposed replacement nominees, as measured against those of the incumbents.

However, control contests may not necessarily be a thing of the past – I think many activists decided to show some restraint this season, in light of ISS' guidance on slate sizing and wanted to test the waters under UPC with more skeletal slates. We could see activists get a little more aggressive on slate sizing next proxy season but expect them to continue to tailor their slates to the specific situation to maximize their chances for success.