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Universal Proxy Developments: SEC Interpretations and ISS Special Situations Research Note

By: Sean M. Donahue

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The universal proxy rules will apply to all shareholder meetings held on or after September 1, 2022. Last week, the SEC issued three Compliance and Disclosure Interpretations (CDIs) on the universal proxy rules and ISS' Special Situations group issued a Research Note providing its preliminary views on universal proxy matters. The SEC's CDIs address over nominations of directors, situations in which there are multiple activist slates, and disclosure of the Rule 14a-19 universal proxy deadline in proxy statements. The ISS Research Note provides that boards "*will be far less able to shield their weakest contributors*" and also indicates some initial skepticism of proxy contests that are purely focused on ESG issues.

SEC Compliance and Disclosure Interpretations

CDI 139.01 addresses the issue of over nominations where an activist attempts to nominate more candidates than are up for election at the meeting. There are several activists that employ this tactic, especially at companies with classified boards (47% of public companies according to FactSet), as it keeps the company guessing as to what the activist's ultimate slate of nominees will be. Some advance notice bylaws prevent over nominations of directors but many are silent on this issue. The CDI provides that "*[t]he Rule 14a-19(b) notice must contain only the names of nominees for whom the dissident shareholder intends to solicit proxies*". In other words, a dissident is prohibited from including in its universal proxy notice more nominees than there are director seats up for election without the intent of actually soliciting proxies for all of its nominees. The CDI does provide dissidents with the ability to include alternative nominees in their universal proxy notice to account for a potential withdrawal of one of its nominees or an increase by the company in the number of seats up for election, so long as the notice clearly identifies the persons who are being presented as additional or alternate nominees.

CDI 139.02 addresses the situation where more than one dissident shareholder intends to present a slate of director nominees. There have been proxy contests where multiple activists have nominated slates. In such a case, under the CDI the company is required to inform each dissident shareholder about any universal proxy notice that it received with respect to persons nominated by other dissident shareholders. This requirement to inform dissident shareholders who submit a universal proxy notice of additional shareholder nominees also applies to any "proxy access" nominees.

CDI 139.03 addresses disclosure of the Rule 14a-19 universal proxy notice deadline when a company's advance notice bylaw imposes a deadline that is earlier than the deadline imposed by Rule 14a-19, which is the case for many public companies. Rule 14a-19(b)(1) requires that a dissident shareholder provide notice of its election contest, generally, no later than 60 calendar days before the anniversary of the prior year's annual meeting date. The CDI provides that where a company's advance notice bylaw requires notice earlier than the time required by Rule

14a-19(b)(1), a company is permitted to disclose only its earlier advance notice bylaw deadline to satisfy Rule 14a-5(e)(4). Importantly, the CDI also notes that, to the extent that the company's advance notice bylaw does not set forth the same requirements outlined in Rule 14a-19(b), the company's proxy statement must clearly state the need for the dissident shareholder to comply with the additional requirements of Rule 14a-19(b).

Many public companies' advance notice bylaw requires notice to be provided no earlier than 120 days and no later than 90 days prior to the first anniversary of the prior year's annual meeting. In addition, in our experience, many companies' bylaws do not mandate that a nominating shareholder provide all of the information required by Rule 14a-19(b) because they do not include the 67% percent solicitation requirement of such Rule. While some companies have amended their bylaws to include such requirement, many have not, given that the universal proxy rule was adopted less than a year ago. Given the foregoing, where applicable, we recommend that public companies add the following sentence to their proxy statements, in the section disclosing the various deadlines required by Rule 14a-5(e): *"In addition, shareholders who intend to solicit proxies in support of director nominees other than the company's nominees must also comply with the additional requirements of Rule 14a-19(b)".*

ISS Special Situations Research Note

The ISS Special Situations Research Note provides two notable insights from ISS. The first is that while ISS' two-pronged framework for analyzing proxy contests will remain largely unchanged, ISS will clearly be focused on the quality of the dissident's nominees as compared to the quality of the company's nominees.

The ISS framework for proxy contests will continue to be: Is there a case for change? And if so, how much change? Thus, dissidents will still need to provide a case for change before ISS will determine how much change is warranted. In other words, a dissident that has one or more highly-qualified director nominees on its slate as compared to one or more of the company's nominees, may still not obtain ISS support if they make a weak case for change. That said, even though ISS may not directly support an activist solely on the basis of its nominees' qualifications, it will point out to clients those nominees from either slate that appear to be particularly well-qualified. ISS goes on to note that certain investors may embrace the opportunity to improve board composition by replacing, for example: *"a long-tenured, overboarded director who seems disengaged with a new nominee who brings clearly-relevant skills to the board, or perhaps enhances diversity"*.

The last sentence of the Research Note provides that *"[b]oards should quickly realize that under the [universal proxy card] regime, they will be far less able to shield their weakest contributors"*. Even though the two-part test remains largely unchanged, ISS will clearly be focused on the quality of the dissident's nominees as compared to the quality of the company's nominees. This could lead to more split-ticket recommendations from ISS where they recommend for some of the company's nominees and some of the dissident's nominees.

The second point worth noting is that ISS acknowledges that some shareholders may run ESG-centered proxy contests. Interestingly, they indicate that *"[c]ampaigns purely focused on ESG issues would appear to be better suited for proxy access, rather than proxy fights"*. In this regard, ISS seems to be expressing some skepticism regarding these so-called issue-only proxy contests. That said, it is still within the realm of possibilities that ISS could recommend in favor of one or more of a dissident's nominees in an ESG-centered proxy contest. Furthermore, even though ISS may have some skepticism of campaigns purely focused on ESG issues, ESG will likely continue to be an important theme in proxy contests as we have discussed [elsewhere](#).