

The Universal Proxy Gains Traction

Lessons from the 2018 Proxy Season

Introduction

Despite recent reports that it has been shelved as an item on the SEC’s agenda, the universal proxy card, which makes it easier for shareholders to pick-and-choose from a combination of management and dissident nominees in a proxy contest, found new life this year as it was used for the first time in a proxy contest involving a US-listed company, and was on the verge of being implemented in at least two other contests that were settled prior to the proxy being mailed. The universal proxy card has long been a topic of discussion among regulators and industry practitioners, and it looked like the initiative had gained sufficient traction in October 2016 as then-SEC Chair Mary Jo White proposed a new rule on the issue. However, the new SEC administration had reportedly put the universal proxy on the back burner and shifted its attention towards other rulemaking initiatives. It is somewhat surprising, then, that the private ordering that occurred this year primarily emanated from issuers rather than activists, who have historically been more outspoken in their support of the universal proxy. A closer look at these situations confirms what we have suspected for some time: that the universal proxy card can, in certain situations, be more advantageous for issuers than for activists.

Universal Proxy vs. Proxy Access

From the outset, we should distinguish the concept of the universal proxy from proxy access. Proxy access permits qualifying shareholders or groups of shareholders to nominate a certain number of directors (usually 20% of the board or two nominees, determined by the company specific bylaw), which are included on management’s proxy card. Shareholders using proxy access do not produce their own proxy materials, nor are they necessarily required to solicit proxies. On the other hand, a universal proxy card is used by one or both sides in a proxy contest, in which a dissident shareholder solicits proxies for one or more nominees to the board using its own proxy card. Dissidents in a proxy contest are not bound by the same holding requirements that accompany proxy access bylaws. Though the universal proxy would allow the dissident’s nominees to appear together with management’s on a single card, the dissident is required to file its own proxy materials. Most proxy access bylaws also contain a carve-out provision that restricts proxy access in the event of a proxy contest.

	Proxy Access	Universal Proxy
Is the dissident required to file and mail its own proxy solicitation materials?	No. Its nominees are simply included on management’s proxy card.	Yes, as in any standard proxy contest with two opposing proxy cards.
Is there a limit on number of dissident nominees?	Yes, as determined by company’s proxy access bylaw (usually 20% of the board or two nominees).	No (other than the number of seats that are up for election).
Does the dissident have any holding requirement?	Yes. Here too, the requirement is determined by the specific bylaw (typically 3% for 3 years).	No, there is no minimum holding requirement for a dissident to run a proxy contest and use a universal proxy card.

The Regulatory Environment

The contents of corporate proxies are currently governed by the requirements of Regulation 14A and Schedule 14A of the Securities Exchange Act of 1934, collectively referred to as the “proxy rules.” The rules currently stipulate that, in a proxy contest, a nominee’s name can only appear on a proxy card if they have “consented to being named in the proxy statement and to serve if elected.” This is referred to as the “bona fide nominee rule.” Given the expectation that no nominee would consent to being on the opposing party’s card, the practical implication of this rule is to force both slates onto two separate proxies.

Prior to 1992, this rule effectively meant that shareholders faced a choice of voting for management’s nominees, or less than a full slate of dissident nominees. The passage of the “short slate” rule resolved this issue to a certain extent, allowing dissident shareholders to obtain authority to vote for some of management’s nominees that were not named on its proxy card, but left an important issue unresolved: What if the dissident was not seeking authority to vote for one or more of management’s nominees that a shareholder wanted to vote for? If neither slate was satisfactory on its own, but some combination of the slates might be, how should shareholders vote?

Historical Context

Historically, there was no true solution to this conundrum. Though the SEC had considered implementing the universal proxy in 1992 along with its wider overhaul of the proxy system, it declined to do so. The issue remained largely dormant for the next 20 years, until a dramatic rise in shareholder activism (with short slates being significantly more frequent than proxy contests for board control) prompted renewed attention from, investors the SEC and shareholder rights advocates such as the Council of Institutional Investors. The issue emerged in proxy contests at Target, Tessera Technologies, and Shutterfly, but was rejected in each instance, with the opposing party voicing concerns regarding its implementation. Likewise, the SEC hosted a roundtable discussion on proxy voting in February 2015 which, despite a spirited debate, failed to lead to the Commission taking a firm position on the issue.

The universal proxy has, however, been used in Canada in the proxy contest at Canadian Pacific in 2012. The dissident, Bill Ackman’s Pershing Square, had lobbied hard for the use of a universal proxy, as it had at Target three years earlier. In Canada, however, there is no equivalent to the “bona fide nominee” rule, and Canadian Pacific preempted the dissident by adopting its own universal proxy card listing the dissident’s nominees; Pershing Square then followed suit, the result being that there were now two versions of the same universal proxy: one for management, and one for the dissident. The universal proxy was also used by Carl Icahn at Transocean, a Swiss company, in 2013. More recently, a universal proxy card was used by activist fund FrontFour Capital at Granite REIT, a Canadian company. In that case, the dissident had only nominated a minority slate of three directors, but used a universal proxy in order to provide a more compelling option for shareholders; whereas the management card only listed its own eight nominees, the dissident’s card listed all 11 potential nominees, which likely represented a more appealing option for shareholders wishing to vote for some degree of change.

The Universal Proxy in Practice

While sometimes regarded as a tool that favors dissidents, our experience suggests that the universal proxy could actually change the dynamics of contested elections in a way that is beneficial to management, particularly in contests for board control.

Suppose that a shareholder voting in a proxy contest wishes to support some board-level change, but is wary of potentially ceding majority control of the board to an activist investor. Under the current rules, shareholders in this situation have only a limited choice, each with its own inherent risks. Voting on the dissident’s card for three out of seven nominees can ensure that the board undergoes some level of change; however, because voting on the dissident card deprives four of management’s nominees of votes, it can inadvertently lead to an unwanted change-in-control. On the other hand, a vote on management’s card, withholding votes from certain disfavored incumbent directors, only increases the chances that there are spots left open for some dissident nominees; it does not guarantee that the dissident nominees that are ultimately elected are the ones that the shareholder actually supports.

A universal proxy, however, can allow shareholders to vote for some dissident nominees without depriving certain management nominees of votes, thereby reducing the likelihood of a potential change in majority control. For that reason, the universal proxy can be a powerful strategic tool for management teams, particularly those whose odds of defeating all of a dissident’s nominees in a proxy contest for board control are uncertain.

The universal proxy can also benefit management by disadvantaging the dissident. For example, suppose there are ten board seats up for election, and the dissident nominates a short slate of four. Two of its nominees are highly-qualified, while the other two are less so. With the universal ballot, shareholders can more easily avoid supporting the dissident’s less-qualified nominees, thereby reducing the likelihood that the entire short slate will be elected.

The table below illustrates how a potential “unintended consequence” scenario can play out in practice.

Current System (Without Universal Proxy)						
	Management Proxy		Dissident Proxy		Total	Outcome
	Votes For All Mgmt. Nominees	Votes For Partial/Split Slate	Votes for All Dissident Nominees	Votes For Partial/Split Slate		
Management 1	30	5	No voting for management nominees permitted on dissident card		35	2 Mgmt. & 3 Dissident nominees elected
Management 2	30	5			35	
Management 3	30				30	
Management 4	30				30	
Management 5	30				30	
Dissident 1	No voting available for dissident nominees permitted on mgmt. card		40		40	
Dissident 2			40	25	65	
Dissident 3			40	25	65	
	Shares Voted on Mgmt. Card	35	Shares Voted on Dissident Card	65		

On the other hand, as show below, a universal proxy could improve the alignment of the result with the apparent intention of shareholders in this specific situation.

With Universal Proxy

	Votes For All Mgmt. Nominees	Votes For Partial/Split Slate	Votes for All Dissident Nominees	Votes For Partial/Split Slate	Total	Outcome
Management 1	30	5		25*	60	3 Mgmt. & 2 Dissident nominees elected
Management 2	30	5		25*	60	
Management 3	30			25*	55	
Management 4	30				30	
Management 5	30				30	
Dissident 1		5*	40		45	
Dissident 2		5*	40	25	70	
Dissident 3		5*	40	25	70	
Total Shares Voted		100				

*Indicates those votes that are now allowed due to ability to choose from management and dissident nominees on a universal card

Alternatives to the Universal Proxy

Today, there are a few workarounds that allow you to split your vote, although none is wholly satisfactory. First, beneficial owners obtain a legal proxy and vote in-person (or have their representative do so) at the meeting. Here, street holders will have to contact their bank/broker (or Broadridge) to have a legal proxy issued in the shareholder’s name. By issuing a legal proxy, the bank/broker is handing over the authority to vote to the beneficial owner. Shareholders who elect to have a legal proxy issued will then have to attend the shareholder meeting and ask for a ballot which typically includes all nominees from both management’s slate and the dissident’s slate. Only on this ballot will the shareholder be able to pick-and-choose between the different slates. Note that this method applies only to beneficial owners; registered shareholders are already the legal (direct) owners of the shares and may therefore simply attend the meeting and fill out the ballot as per their registration with the transfer agent to vote as they wish, without having to go through the extra step of obtaining a legal proxy. Unfortunately, this method is the only truly foolproof and non-challengeable method of splitting votes without the use of a universal proxy.

Other methods of splitting votes involve manipulating proxy cards. First, you can simultaneously date and mail separate proxy cards, crossing out or otherwise limiting your vote so that you are not also withholding on the nominees you wish to elect. Second, you can use only one proxy card, scratching out the name of any nominee you do not wish to elect and writing in the names of any nominee from the opposing slate that you do wish to elect. In either case, you would then write an additional statement on the face of both cards. The language would state something to the effect of, “This [color management/dissident] proxy card dated [date] authorizes the proxy committee to vote only as directed on this card and may not confer the authority to either side’s proxy committee to vote on other proposals and other matters.”

Though both methods have been used in prior proxy contests—Blockbuster and Charming Shoppes, most notably—many shareholders find this process cumbersome and time-consuming. Back offices may balk at processing the voting and, even with assurances from both management and the dissident, the cards may be challenged, discarded, or incorrectly processed by the back office staff. And, most importantly, these methods can only be used if there is an agreement reached between the shareholder and both management and the dissident that any shares voted using this method will be voted as such on their respective master ballots. It should also be noted that, even if an institutional shareholder feels strongly about the issue and wishes to split its vote, many are reluctant to do so, fearing that the precedent will require them to split their vote in all subsequent proxy contests, which would make for a logistical nightmare for index funds whose holdings number well into the tens of thousands.

Lessons from the 2018 Proxy Season

2018 was a banner year for the universal proxy, which was used in three separate contests during the proxy season. Though only one of these contests ultimately went to a vote, proof-of-concept has been established, which could open the door to more widespread use in the future.

The first instance took place at Cars.com, where well-known activist Starboard Value had nominated four directors, which was just short of a majority of the eight-person board. Starboard has an incredibly strong track record of placing directors on boards, and so a traditional proxy contest using two separate cards may have created significant risk for the company: Starboard's credibility as an astute investor support for at least some of its nominees, and the use of separate cards presented the possibility that all of its nominees would be elected.

On the other hand, Starboard too faced risk under the traditional two-card system. With Cars.com only having been a public company for a few months, the case for a 50% board-level change was not particularly strong. As a result, there was also the possibility that many investors would be swayed into voting on management card, with none of Starboard's nominees getting elected—a defeat that might have damaged a reputation that Starboard has spent more than a decade building.

While this proxy contest ultimately settled before either side filed a preliminary proxy statement, both sides had agreed in principle to a mutually acceptable framework that would have allowed for the use of a universal proxy. This would have been a notable first in the United States, but instead, the mantle was taken up contemporaneously by another company targeted by Starboard, Mellanox Technologies.

The situation at Mellanox, an Israeli semiconductor company, was similar to the one at Cars.com in that you had the same activist, Starboard Value, nominating a majority slate. Unlike Cars.com, however, Mellanox opted, because of requirements under Israeli law, to take the question of whether or not to use a universal proxy card directly to shareholders at an extraordinary general meeting in advance of the director election vote at the annual meeting, rather than requesting Starboard's consent to do so. In this case, part of the reason for the company's decision stemmed from the relative paucity of precedent; the board was unaware of any instances in Israel where a target company had used a majority voting standard (which could be problematic in a proxy contest, where in theory it is possible that neither side's nominees receive a majority) or separate proxy cards in a contested election, and there was uncertainty with respect to how the contest would play out. To mitigate that uncertainty, the company determined to hold a shareholder vote with proposals to first adopt a plurality voting

standard in a proxy contest (something unheard of at Israeli companies) and then require that any nominees submitted by a dissident shareholder grant their consent to appear on the company's proxy card, in order to ensure that the election had the requisite procedural safeguards and facilitate the use of a universal proxy.

At the extraordinary general meeting in May 2018, both proposals received overwhelming support from shareholders, confirming that most investors support the concept of the universal proxy insofar as it increases the choices available in a contested election. However, as with Cars.com, both sides reached a settlement prior to the annual meeting, negating the need for a universal proxy.

The 2018 proxy season did finally afford one opportunity to utilize a universal proxy in a contested election—at SandRidge Energy, which was targeted by Carl Icahn. There, Icahn had nominated a full slate of five directors for election at the company's annual meeting. Faced with the prospect of a full-board turnover, the company initially determined to expand the board to seven, which would have ensured that Icahn would receive at least two seats, but may have helped to prevent a change-in-control at the board level. Icahn then delivered an updated nomination notice with an additional two nominees to constitute a full slate of seven.

Following the company's emergence from bankruptcy, the company's shareholder base was heavily comprised of creditors—among which were several notable event-driven investors—which had their debt holdings converted to equity. As such, the stock was predominantly held by hedge funds, rather than a mix of index funds and long-only active investors that is typically the case. Due to this fairly unique mix, SandRidge was perhaps more vulnerable than many companies to having its entire board usurped in a proxy contest, especially one involving Carl Icahn.

However, in a possible oversight by Icahn in the submission of his nomination materials, his nominees consented in writing to be named as nominees for directors in SandRidge's proxy statement, enabling the company to use a universal proxy card without having to first go through the process that Mellanox had. Since SandRidge had the requisite consent of the Icahn nominees, there was no need for the issue of the universal proxy to be privately negotiated or subjected to a shareholder vote. So SandRidge developed a unique card that offered up both its own five nominees and Icahn's seven nominees as potential choices, but, crucially, recommended that shareholders vote only for its five nominees and two of the three other nominees that were deemed independent of Icahn. The move received praise from various constituencies, including the Council of Institutional Investors, which wrote a letter to the company's board expressing its support.

However, SandRidge's use of a universal proxy card still did not prevent the kind of strategizing that occurs during a traditional two-card proxy fight. Just days before the meeting, SandRidge became aware of rumors that Icahn was attempting to persuade other shareholders to reallocate their votes among their chosen candidates towards those who were not supported by ISS and Glass Lewis, with the goal of bolstering his prospects of achieving majority control of the board. Ultimately, on the day of the annual meeting, SandRidge and Icahn reached a settlement, with five Icahn nominees and three nominees put forward by the company being appointed to the board.

At first glance, this arrangement may have appeared to represent a significant loss for SandRidge and perhaps even a setback for the use of the universal proxy, as Icahn still managed to win the majority control that the company had sought to prevent. However, it should

be noted that, had the company used a traditional proxy card, it is highly likely that even more shareholders would have used Icahn's gold proxy card to vote for some or all of his nominees, increasing the possibility that Icahn would have won control of the entire board.

In that sense, the first use of the universal proxy card in the United States was a qualified success. Its use allowed shareholders greater flexibility in selecting their preferred candidates, and likely dissuaded some holders from voting for Icahn's nominees on his card. Furthermore, despite the historical protestations of Broadridge, the universal proxy card did not present any significant logistical challenges with respect to vote processing. And in its first use at a US company, the universal proxy card proved its benefit to management in certain cases as many had theorized, rather than being a one-sided dissident-friendly tool.

The Future of the Universal Proxy

Whether or not the universal proxy will ever be widely adopted, let alone mandated, is likely dependent on, among many other factors, general agreement on the key terms of any proposed SEC rule. In its press release announcing the proposed amendments in 2016, the SEC included a "Fact Sheet" highlighting their key features. Some of these features are obvious. For example, the definition of a "bona fide nominee" in Rule 14a-4(d) would be changed to include a person who agrees to be named in any proxy statement at the company's next shareholder meeting. The "short slate" rule would be eliminated, with dissidents no longer having to "round out" their slates with management nominees.

Some concerns regarding the universal proxy, however, are left unaddressed. For example, the SEC's release states only that the universal proxies would be "subject to presentation and formatting requirements," but does not go into detail as to what these requirements might be in order to ensure that the formatting of the universal card is consistent and does not disadvantage either party. As strange as it may sound, a candidate with the last name of "Zeller" could be substantially disadvantaged by a universal proxy with the 15 nominees arranged alphabetically that instructs shareholders to "Pick the first 10." Nor does the release describe any procedures for electronic tabulation, or explain what the proxy card might look like if there are multiple dissidents submitting competing slates, or if a proxy contest is run concurrently with a shareholder proxy access campaign. Another consideration is the likely increase of voting errors, particularly voting "For" more nominees than there are seats up for election (which cannot happen under the current two-card system) and the resulting disenfranchisement of shareholders due to such inadvertent errors.

The SEC, to its credit, seems cognizant of the fact that this particular amendment could have a significant influence in proxy contests, which themselves are viewed as having outsized importance within the context of corporate governance. It has received nearly 40 comment letters in response to the proposed rule, the most recent of which was filed by the Council of Institutional Investors in September 2017. Many of the respondents were institutional shareholders that were, predictably, supportive of the proposed rule and the prospect of increased choice in director elections. However, some respondents urged caution, warning of the risks of unintended consequences from introducing far-reaching changes into a process that works "reasonably well." Indeed, the threat of potentially creating new and more significant problems (e.g., an increased number of proxy contests) was a common argument among those that opposed the proposed rule. Where the two sides agreed, however, was that the "form and presentation" of the universal proxy card is a critical element for discussion, and one that should not be overlooked.

Despite the consensus from a variety of constituencies that its widespread adoption would be a net-positive for corporate governance, the future of the universal proxy remains uncertain. On the one hand, support from the investor community is fairly widespread. Additionally, its use at SandRidge Energy this year—without any significant logistical challenges and without conferring an apparent undue tactical benefit to either side—is likely to provide a much needed proof-of-concept for the universal proxy in the United States. On the other hand, the issue of the universal proxy seems to lack the kind of champion at the SEC it had in Mary Jo White. And in July, Reuters reported that the current SEC administration had “shelved” the issue, with the universal still remaining on the SEC’s long-term agenda but having fallen off its list of 12-month priorities.

For the supporters of the universal proxy, however, a glimmer of hope arrived in August 2018, when the SEC announced plans to convene a roundtable to discuss the proxy process. Though the release indicates that the focus of the discussion will be predominantly on the “plumbing” of the voting system, it did make relatively brief mention of the 2016 proposed universal proxy amendments to the proxy rules. The logistical information regarding this roundtable has yet to be released, but the proposed agenda should provide some indication as to whether the universal proxy will be a focal point or merely a side issue.

Conclusion

With the current SEC administration, there are questions over whether the universal proxy will be adopted at all. However, with the issue having gained a considerable amount of momentum over the past five years, shareholders appear to be eager to test out the universal proxy on an expedited timeline. During our experiences with the universal proxy card this past spring, the feedback we received from investors was overwhelmingly positive. For the time being, however, the spread of the universal proxy is likely to be ad hoc, driven by private ordering rather than legislative initiative. This is not necessarily a bad thing; by remaining something that is privately negotiated rather than mandated will allow the parties to a proxy contest some flexibility in creating a body of acceptable “best practices” around the universal proxy, which could encourage its further use and may even provide a template for a future legislative initiative.

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