



# *Preparing for the 2023 Proxy Season*

*February 9, 2023*

*Melissa Sawyer  
June Hu*

# Roadmap

- *In this presentation, we will focus on the following developments related to the 2023 proxy season:*
  - Universal Proxy
  - Officer Exculpation
  - Shareholder Activism Preparedness—Antitrust, Board Composition and Bylaws Considerations
  - Preview of 14a-8 Proposals in 2023



# *Universal Proxy*

# Overview

- On November 17, 2021, the SEC adopted a new Rule 14a-19 and amendments to existing proxy rules that, among other things, require the use of a “universal proxy card” (i.e., a proxy card that includes all duly nominated director candidates) by both the target company and the activist(s)
  - The new rule applies to contested director elections from September 2022 onwards
- Under the universal proxy rules, all proxy cards in contested elections must permit shareholders voting by proxy to instruct in favor of any duly nominated candidate, regardless of the nominating party
  - As a result, shareholders voting by proxy can more easily “mix and match” candidates nominated by the activist and the target company by voting for some or all the activist nominees and some of the company nominees (which do not in the aggregate exceed the number of directors being elected).\*

\* In a full-slate contest, where the activist has nominated the maximum number of nominees that a shareholder may elect, the universal proxy card would permit shareholders to vote in favor of each slate as a whole as well as “mix and match”

# Key Legal Requirements

*Continued*

- Universal proxy cards must prominently disclose the maximum number of nominees that a shareholder may vote for and the treatment of under- and over-voted proxy cards
- Each party's proxy statement must refer shareholders to the other party's proxy statement for information regarding the other party's nominees
- As a check on potential abuses of the universal proxy card by activists seeking to free-ride off a target company's proxy solicitation efforts, the universal proxy rule imposes a minimum solicitation threshold that requires a dissenter to solicit at least 67% of the target company's voting power (at its own expense)
  - However, the cost of launching a board seat fight on a universal proxy card will be lower if the activist uses "notice and access" for delivering proxy materials to satisfy the new 67% minimum solicitation requirement

# Early Observations

- So far, we have seen two proxy contests fought under the new universal proxy rules
  - Land & Buildings Investment Management (“L&B”) obtained one seat on Apartment Investment and Management Company’s (“AIMCO”) classified board
  - Capital Returns Management, LLC (“CRM”) sought two seats on Argo Group International Holdings, Ltd’s (“Argo”) board. However, CRM withdrew its nominations days before the annual stockholder meeting
- The universal proxy card may have encouraged some shareholders to choose one or more activists (instead of choosing the full management slate)
- As a result of shareholders’ ability to “mix and match” candidates nominated by the activist and the target company, campaigns might become more personal
  - Activists are comparing the perceived “weakest” company nominees with the activist nominees
  - Instead of, or in addition to, differentiating their overall platforms, the activist and the target company will in some cases focus more on individual director qualifications (for example, tenure/expertise on ESG issues) in contests fought on universal proxy ballots

# Potential Impact

*Continued*

- Lower costs of running a proxy contest may result in new/nontraditional activists launching more campaigns, particularly those focusing on social issues
- Universal proxy may reduce activists' willingness to negotiate a “partial win”
  - Because universal proxy may make it easier for the activist to win at least one or two seats, activists may perceive going to a shareholder vote as potentially more advantageous than negotiating a settlement
- Given the novelty of the universal proxy process, smaller non-retail investors (i.e., not major institutional investors) may be somewhat more likely to rely on the recommendations of ISS/GL when voting for directors for the first proxy season(s) after the adoption of universal proxy



# *Officer Exculpation*

# Overview

- Effective August 1, 2022, Delaware allows corporations to exculpate (i.e., eliminate or limit the personal liability of) senior officers for monetary damages arising out of breaches of their fiduciary duties of care
- Before this change, Delaware only allowed exculpation of directors
  - To take advantage of the Delaware law change, companies will need to amend their charters to specifically provide for officer exculpation
- If companies amend their charters to include officer exculpation to the extent permitted by Delaware:\*

## **The following officers would be covered:**

- CEO, President, COO, CFO, Chief Legal Officer, Controller, Treasurer and/or Chief Accounting Officer
- Any “named executive officer” in the company’s SEC filings
- Anyone who consents in a written agreement with the company to being identified as an officer for purposes of accepting service of process

## **The following actions would NOT be covered:**

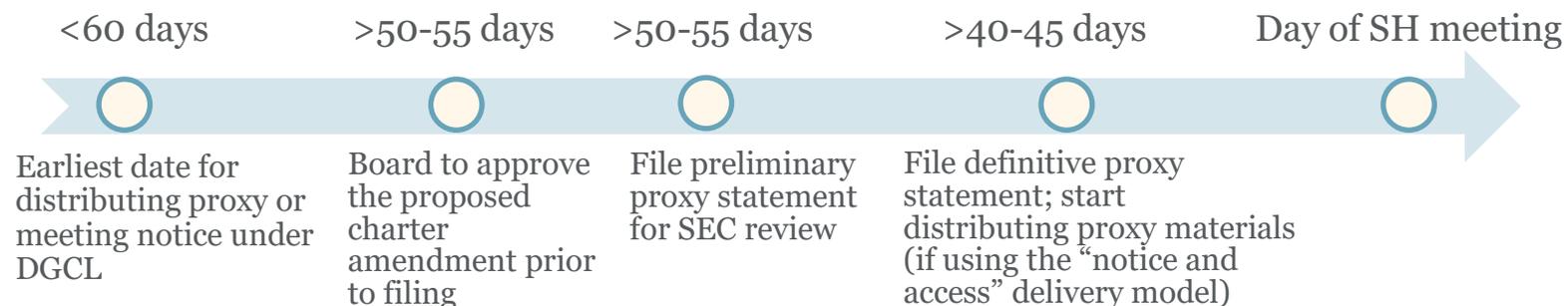
- breach of duty of loyalty; acts in bad faith or involving intentional misconduct or a knowing violation of law; transactions involving improper personal benefit (same as director exculpation)
- claims brought directly by the company or derivative suits brought by stockholders (less favorable than director exculpation)

\*Claims like those in the recent McDonald’s “Caremark” case would likely not be covered by an exculpation provision amended to align with the updated DGCL

# Implementation Considerations

- Stockholders must approve an amendment to company charters
- Charter amendments require the filing of a preliminary proxy statement, so companies seeking to make this amendment will need to build additional time into their proxy timeline
  - Preliminary proxy statement must be filed at least 10 days before starting to distribute the proxy materials
  - Best practice suggests an additional 5-day buffer to ensure timely distribution of proxy

- **Illustrative timeline:**



# Stockholder Perspectives

- Recent Voting Results (as of January 20, 2023)
  - At least 15 companies have included officer exculpation amendments in their proxy materials
    - Each voted amendment proposal has received high levels of shareholder support (80-99% of votes cast)
    - A few companies have failed to receive the requisite support of a majority (e.g., Akoustis) or supermajority (e.g., TSR) of votes outstanding due to a high number of broker non-votes
- ISS has officially adopted a “case-by-case” approach but has consistently recommended in favor of Delaware-aligned officer exculpation
  - ISS has stated that exculpation arrangements “are likely to become commonplace with respect to officers, and the failure to provide indemnification and limited liability could potentially put a company at a disadvantage in recruiting or retaining executives”
  - ISS seems most concerned with exculpation of duty of loyalty claims, which is not permitted in Delaware but is permitted in states like Nevada
- Glass Lewis’s policy on officer exculpation is to generally recommend against, unless:
  - The board can justify officer exculpation with a “compelling rationale” (e.g., concrete rather than hypothetical examples of challenges in recruiting or retaining executives); AND
  - The amendment is “reasonable” (i.e., aligned with the Delaware General Corporation Law)



# *Shareholder Activism Preparedness*

*Antitrust, Board Composition and Bylaws Considerations*

# Overview of 2022 Activism Trends

- Activism levels have rebounded from the COVID-19-induced slowdown impacting 2020-2021 activity
  - Despite significant market volatility and macroeconomic uncertainty (which hampered activism activity levels in 2020), overall activism activity in 2022 generally returned to pre-pandemic levels
- Activists changed the nature of their demands in order to adapt to the challenging macroeconomic environment
  - Campaigns targeting corporate strategies and operations, such as cost-cutting measures, increased throughout 2022, while campaigns focused on capital allocation and M&A transactions (traditionally, two of the most common objectives) declined
- Activist campaigns focused on changes in company management rebounded in 2022 after a two-year decline in such campaigns
  - From the perspective of the activist, these campaigns achieved considerable success, with 28% of the 54 management-change campaigns resulting in a c-suite leadership change during our measurement period

# Overview of 2022 Activism Trends

*Continued*

- Following the success of Engine No. 1's 2021 proxy contest at Exxon Mobil Corp., there has been a considerable uptick in the number of activist campaigns with ESG critiques at the center of the activist's thesis
  - However, ESG campaigns are more likely to succeed when strongly tied to the target company's economic performance or risks
  - Recent and prospective regulatory developments (e.g., the SEC's amendments to Form N-PX) and the pass-through voting policies being adopted by some major institutional investors may also accelerate the number, and success, of ESG campaigns
- Activists generally received higher levels of support from certain institutional investors and proxy advisors in 2022
- However, despite this increased support, activists' overall success rates (as measured by the number of board seats obtained) decreased compared to prior years

# Antitrust Considerations

- In response, companies demonstrated a greater willingness to resist activist demands
- In considering potential defenses, you should also factor in recent antitrust developments:

## **If the activist is demanding board seats, the company should consider potential Clayton Act issues when reviewing activist nominees:**

- Does the individual director nominee serve as a director or officer of a competitor of the Company?
- Is the director nominee a “deputy” of a fund or other entity that has another “deputy” serving as a director or officer of a competitor of the Company?

## **Recent antitrust enforcement actions by the DOJ have signaled an increasing level of scrutiny on interlocking directorship issues under Section 8 of the Clayton Act**

Companies should review their D&O questionnaire and ensure that the questionnaire requires director nominees to disclose information regarding the nominees’ past, present and future positions at other companies given the DOJ focus

## **If the activist is demanding an M&A transaction, the company should consider antitrust implications on deal risk:**

- Regulatory headwinds in M&A transactions has led to increased costs and deal uncertainty
- These considerations may deter shareholders from supporting proposed M&A transactions, depending on the assets involved and proposed deal structure

# Board Composition Considerations

## **Assess board composition and director skills:**

- In light of the universal proxy rules, activists, institutional shareholders and proxy advisors will be keenly focused on director tenure, board diversity and the mix of skills represented on the board

## **Director Tenure:**

- In ISS's guidance surrounding the universal proxy rule, the proxy advisor indicated that they are willing to replace a "long-tenured, over boarded director who seems disengaged" with "a nominee who brings clearly-relevant skills to the board, or perhaps enhances diversity"
- BlackRock's 2023 proxy voting guidelines specify that BlackRock may "vote against the most senior non-executive member of the Board when appropriate independence is lacking in designated independence roles"

## **Board Diversity:**

- We expect board diversity to remain in focus as NASDAQ companies begin to comply with their board diversity disclosure requirements
- The SEC is expected to propose new board diversity disclosure requirements in Fall 2023

## **ESG and Other Skills:**

- The SEC has already proposed certain disclosure requirements related to cyber- and climate-related expertise on the board and among management
- The SEC is also expected to propose new human capital management disclosure requirements in Spring 2023, which may include similar expertise requirements
- Regardless of whether these disclosure requirements become effective, companies should expect that stakeholders will analyze director skill matrices to identify gaps in the range of skills represented in the boardroom

# Bylaws Considerations

## **Review advance notice bylaws, which should:**

- Allow the company to obtain enough information from all director nominees to provide shareholders with the benefit of a well-considered nomination process
  - Review information requirements in advance notice bylaws, proxy access provisions and D&O questionnaires
- Outline a clear process for shareholders to make nominations, as well as a clear process for the Company to address any deficiencies
  - Submission deadline and update requirements
  - Form of D&O questionnaire, agreement and representations
  - Proxy card color
  - Deficiency determination
- Be appropriate in light of the company's circumstances and not improperly deter transparent efforts by shareholders to seek board representation
  - Updates should be made without any connection to any ongoing activist campaign (i.e., "on a clear day")
  - Any change should be consistent with the view of the Delaware courts that advance notice bylaws should not interfere with or frustrate shareholders' right to nominate or elect directors



# *Preview of 14a-8 Proposals in 2023*

# Examples of 2023 Proposals

- Proponents are still focused on ESG issues, and are continuing to submit granular proposals
  - As a result, high-profile public companies will often receive multiple proposals on the same topic
- Social/political proposals constituted the largest category among early submissions:
  - Proponents have brought an unprecedented number of abortion-related proposals in the 2022-2023 season
  - Proponents on both sides of the political aisle are bringing civil rights audit/diversity proposals
- Governance proposals were also robust among early submissions:
  - Proponents continue to submit proposals demanding independent board chairs and 10% special meeting threshold
  - A new “fair election” proposal seeks to require shareholder approval of amendments to advance notice bylaws
- Environmental proposals remain focused on climate-related targets
- In terms of compensation proposals, proponents are focusing on the “2.99x” severance proposals that gained traction at several companies last year

# The SEC's No-Action Posture

- On November 3, 2021, the staff of the Division of Corporation Finance of the SEC issued new guidance under Staff Legal Bulletin No. 14L (“SLB 14L”), which significantly narrowed the standards for the “ordinary business” and “economic relevance” exclusions
- Companies had a significantly lower likelihood of obtaining no-action relief on ESP proposals following the SEC’s release of SLB 14L
  - For the first time, we observed that a majority of ESP submissions reached a vote
  - In the retail sector, 46% of ESP submissions reached a vote (compared to less than 30% in 2021)
- For no-action requests from retail companies,\* success rate decreased from 79% to 48%

Proposal Category	SEC Response Date						YoY Change in % Granted
	November 3, 2020 – April 30, 2021			November 3, 2021 – April 30, 2022			
	Considered	Granted	% Granted	Considered	Granted	% Granted	
Environmental	15	7	47%	18	3	17%	(30%)
Social/Political	67	49	73%	82	21	26%	(48%)
Governance	82	59	72%	58	34	59%	(13%)
Compensation	12	7	58%	8	4	50%	(8%)
<b>Total</b>	<b>177</b>	<b>123</b>	<b>69%</b>	<b>166</b>	<b>62</b>	<b>37%</b>	<b>(32%)</b>

*\* In calculating retail industry data, we looked at companies labelled as “Consumer Goods/Retail” by ISS*

# *The SEC's No-Action Posture*

*Continued*

- So far in the 2023 proxy season, it appears that the availability of no-action relief has further decreased
- As of January 5, 2023, we have not seen a single instance where the Staff granted relief on the basis of “substantial implementation”
  - On July 13, 2022, the SEC proposed rule amendments to change the “substantial implementation” exclusion
  - The proposed amendments would provide that a proposal may only be excluded as substantially implemented if “the company has already implemented the **essential elements** of the proposal”—having implemented the “essential objectives” of the proposal would no longer be sufficient
- Companies have had limited success under the “ordinary business” exclusion with respect to employee-related proposals (e.g., disclose employee work-at-home policies or stock-based compensation paid to employees)
- So far, procedural deficiencies have been the most common bases on which proposals have been excluded under the no-action process

# Speaker Contacts



**Melissa Sawyer**  
Partner, New York  
T: +1-212-558-4243  
E: sawyerm@sullcrom.com



**June Hu**  
Associate, New York  
T: +1-212-558-4356  
E: huju@sullcrom.com



**SULLIVAN & CROMWELL**



*Questions?*

# UPCOMING RILA ESG OFFERINGS

## Post Election ESG Implications

- With the fall 2022 election results finally settled, join the RILA Government Affairs team on **February 15, at 2 PM ET** for an analysis of what it all means for future ESG engagement at the federal and state level. Learn what issues will likely be the focal points of both efforts to advance and limit ESG activities, including anticipated legislative and regulatory activity and the "who's who" of lawmakers most active in pushing these agendas.
  - [Register here!](#)

## RILA Benchmarking Session on preparing for the final SEC Climate Disclosure Rule

- At member request, RILA will be hosting a peer benchmarking session on preparing for the final SEC Climate Disclosure rule. Discussion will focus on the key components of the proposed rule that will most likely be retained in the final rule. To help facilitate and answer questions, we will be joined by a GHG reporting subject matter expert from Boston Consulting Group (BCG) and, depending on topics of interest, may ask a law firm to join as well.
- If interested in participating, please reach out to Erin Hiatt at [Erin.Hiatt@rila.org](mailto:Erin.Hiatt@rila.org).

Thank you!