

Proxy Contests

WARREN S. DE WIED, FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP,
WITH PRACTICAL LAW CORPORATE & SECURITIES

Search the [Resource ID numbers in blue](#) on Westlaw for more.

An overview of proxy contests. This Note explains the dynamics of the proxy contest process, risk-mitigation strategies, and how to maximize a company's chances to prevail in a contest.

A proxy contest is a campaign to solicit votes (or proxies) in opposition to management at an annual or special meeting of stockholders or through action by written consent.

Today the most common types of proxy contests are contests by activist stockholders seeking board representation or control, generally with the objective of maximizing return on the activist's investment in the short-term. The proxy contest serves as a tool to drive change, including:

- Adding directors who are sympathetic to the activist's goals or who bring fresh perspectives to the board, orchestrating a change in executive management or corporate policy, or securing other changes in corporate governance.
- Catalyzing changes in strategy, changes in capital allocation, a sale or break-up of the company or other value-enhancing transactions—changes that the activist may instigate or accelerate even if its efforts to change composition of the board are unsuccessful.

Besides traditional proxy contests, investors today have other tools available to express dissatisfaction and drive change, including solicitations exempt from the proxy rules such as “withhold the vote” campaigns (see *Solicitations by Persons Not Seeking Proxy Authority*) and, in the case of companies that have adopted proxy access bylaws (of which there are now more than 500 in the US), rights of eligible stockholders to nominate a minority of candidates for director in the company's proxy statement. For form by-laws allowing eligible stockholders to include director nominees in the company's proxy materials, see *Standard Document, Proxy Access By-Laws* ([w-010-8857](#)).

Although the number of proxy contests that go to a stockholder vote in any particular year is low, stockholder activists routinely threaten to conduct a proxy contest and frequently initiate the process to

conduct a proxy fight, including nominating directors, engaging in investor and public relations activities, and making preliminary filings with the SEC. It is therefore important for general counsel and securities lawyers to develop a familiarity with the legal and practical aspects of a proxy contest, including:

- The market forces that drive proxy activity (see *The Market Environment*).
- The steps companies can take in advance of a contest to lower their risk profile (see *Advance Preparation*).
- Timing and strategic considerations for companies confronted with a proxy contest (see *Timing and Strategic Considerations*).
- Assembling a team of professional advisors (see *Assembling the Team*).
- The key legal considerations under federal and state law (see *Key Legal Considerations*).
- How to conduct a proxy campaign (see *Fighting the Campaign*).
- Options for resolving a proxy contest (see *Settlement*).

THE MARKET ENVIRONMENT

Proxy contests are, in essence, like political campaigns. It is critical to understand prevailing voter or, in this context, stockholder sentiment. To run a successful proxy campaign, the company needs to have answers to these fundamental questions:

- What are the hot button issues of the electorate going into the proxy fight?
- What actions or arguments are likely to sway the key swing voters?

As in the political arena, the electorate is typically confronted with competing narratives, and the objective of each side is to present the most compelling possible narrative.

Proxy contests of this type, not accompanied by a takeover bid, were once rare. Developments since the late 1990s, however, have made proxy contests much more challenging for companies and correspondingly more attractive to dissident investors. These developments include:

- A general increase in investor skepticism about incumbent boards and management.

- High profile failures in corporate oversight (for example, Enron, WorldCom, the global financial crisis, and stock options backdating).
- The shortened investment horizon of many investors.
- The rise of stockholder activism, led by activist hedge funds that are sometimes larger than the companies they target and that have formidable financial and intellectual resources.
- The near disappearance of the individual investor (who historically was pro-management).
- The influence of proxy advisory firms, such as Institutional Shareholder Services (ISS).
- The decline of structural takeover defenses.
- The internet and social media, which offer a plethora of tools to foment investor dissatisfaction.

Importantly, changes in federal regulation of proxy solicitation have dramatically reduced the compliance burdens and costs associated with communications by and among stockholders, making it possible to initiate proxy contests without material expenditure by the dissident.

Simply put, the environment favors dissidents.

Of course, financial market conditions are a critical driver of proxy activity. The long running post-recession bull market has meaningfully insulated dissident investors from downside risk. In 2018, the financial markets have become more challenging and investor returns have suffered. When the inevitable downturn eventually occurs, proxy activity will moderate and the current balance of power between activists and issuers is likely to shift.

ADVANCE PREPARATION

Public companies of all sizes and with widely varying financial performance and structural defenses may be faced with a proxy contest. In general, however, companies that are undervalued or underperform their peer group are at the highest risk.

The best proxy fight is the fight that never happens. The optimal time for a company to deal with the threat of an activist campaign or proxy contest is before it becomes a target. Given the prevalence of financial activism, it is prudent for companies to conduct regular self-assessments to evaluate their risk profile, focusing on:

- Financial and stock price performance. This should include a review of one-, three- and five-year performance and total return, with particular focus on performance relative to peers
- Available value-creation strategies, including:
 - recapitalization;
 - divestitures and other business separations;
 - sale of the company;
 - acquisitions;
 - operational improvements; and
 - capital allocation.
- Environmental, social and corporate governance (often referred to as ESG) issues, such as:
 - board and committee leadership, qualifications, diversity, tenure, and effectiveness;

- compensation;
- related-party transactions;
- environmental, health and safety, and sustainability issues;
- political activity;
- human capital issues, including workforce diversity, pay equity and workplace atmosphere (including, for example, handling of harassment and discrimination in the workplace); and
- other “red flag” issues, such as accounting restatements, FCPA issues, code of ethics violations, or other compliance issues.
- Corporate communications, emphasizing:
 - effective communication of strategy, value-creation drivers, and business prospects;
 - accessibility of senior management to investors (via quarterly calls, non-deal roadshows, and periodic investor days); and
 - responsiveness to stockholders (transparency of communications, handling of stockholder proposals, withhold votes) and receptivity to investor feedback.
- Structural defenses, including:
 - board structure—annual elections of all directors versus a classified board system;
 - charter and by-laws giving stockholders the ability to call a special meeting or act by written consent;
 - proxy access by-laws;
 - advance notice by-laws requiring stockholders to give advance notice to the corporation in order to propose nominations or other business at a stockholders’ meeting; and
 - stockholder rights plans or poison pills.
- The company’s stockholder base and its relationships with key holders. This includes maintaining awareness of:
 - the presence of significant supportive investors;
 - the mix of long-term versus short-term holders;
 - hedge fund ownership;
 - insider ownership;
 - known activists or “wolf pack” investors; and
 - investor turnover.

Companies that recognize their potential areas of vulnerability and are proactive in taking steps to improve their risk profile will significantly reduce their risk and increase the odds of prevailing if a contest occurs. A company can improve its risk profile by delivering strong financial results, or by developing, disclosing, and implementing a plan to improve performance or evaluate specific strategic initiatives. Time is of the essence because a company tends to get less credit (and the dissident may get disproportionate credit) for measures announced after a dissident surfaces, even if the measures had been in process for some time and have no causal connection with the dissident’s activities. In addition, even in the absence of significant business or financial changes, enhancing communication with stockholders can increase stockholder support for management’s strategy and reduce their susceptibility to value-creation or governance-related arguments a dissident might raise.

TIMING AND STRATEGIC CONSIDERATIONS

TIMING

Proxy contests overwhelmingly occur in connection with the company's annual meeting of stockholders. Although companies may permit stockholders to add or replace directors at a special meeting, dissidents rarely conduct a proxy contest through a special meeting, because:

- It is typically time consuming to call a special meeting.
- The vote requirements (depending upon the company's charter and by-laws) may be more burdensome than the vote required at a regular annual meeting.
- It may be harder to galvanize stockholder support than through the regular annual meeting process.

Some companies permit stockholder action by written consent, but this in many states requires the vote of a majority of the outstanding shares (as opposed to a plurality) and is subject to procedural complexities that can diminish its attractiveness. In addition, neither a written consent nor the special meeting process can be used to change the composition of the board in either of the following cases:

- Removal of directors without cause is not permitted under the company's organizational documents (and the stockholders do not have the right to amend these provisions) and the size of the board cannot be changed by the stockholders (and therefore the stockholders do not have power to expand the board to create vacancies that they would then fill).
- Even if the stockholders have the power to create vacancies, the board controls the filling of vacancies and this power cannot be changed by the stockholders.

Most public companies have advance notice provisions in their by-laws relating to stockholder nominations for directors and stockholder proposals. Advance notice provisions establish a window during which nominations and (non-Rule 14a-8) proposals may be submitted, generally in the range of 60 to 90 or 90 to 120 days before the anniversary of the preceding year's annual meeting. (For an overview of the process for submitting proposals under Rule 14a-8 of the Securities Exchange Act of 1934, as amended (Exchange Act), see Rule 14a-8 Shareholder Proposal Process Flowchart ([7-508-8268](#).) These provisions require the nominating stockholder to include detailed information about the nominating stockholder, its nominees, and its security holdings in its nomination notice. If the advance notice provision is properly drafted, a stockholder who fails to provide a compliant nomination notice in a timely fashion and cannot demonstrate that enforcement of the deadline would be inequitable in the circumstances is foreclosed from proposing nominees. For an example of an advance notice by-law, see Standard Clause, By-Laws (DE Public Corporation): Advance Notice ([0-383-2443](#)).

A sophisticated dissident contemplating a proxy contest will take a series of preliminary steps well in advance of the nomination deadline, including:

- Accumulating a significant ownership stake (in the case of smaller issuers, typically more than 5%) if it is not already a substantial stockholder.
- Communicating with other investors it believes may support a dissident campaign.

- Agitating privately or publicly for change at the target company.
- Recruiting candidates to serve on the dissident's slate.

Often the company knows the dissident's intentions in advance and expects its notice of nominations. However, some activists have concluded that there is little to be gained by previewing their intentions with the issuer and it cannot be taken for granted that a company will receive advance warning, other than, potentially, disclosure of the existence of the dissident's position in a Form 13F filing. 13F filings are not necessarily informative, however, since they are filed quarterly and up to 45 days after each calendar quarter, yet only provide information as of the last day of the quarter, and may exclude positions for which confidential treatment has been sought by the dissident.

Companies concerned that they will be caught unawares by a dissident's nominations can use advance notice by-laws to gain advance information. Some advance notice bylaws now require the dissident to complete a questionnaire furnished by the issuer as part of its nomination packet, which necessitates some advance communication to the issuer to obtain the questionnaire.

Dissidents typically include additional items in their notice of nomination, including:

- Purporting to include alternative nominees.
- Reserving the right to nominate replacement candidates if any of their nominees are unable to serve.
- Asserting the right to nominate additional candidates if the size of the board is increased before the meeting.

Dissidents may also submit one or more proposals in accordance with the company's by-law regulating submission of stockholder proposals, such as:

- Proposals to fix the size of the board.
- Proposals to rescind any amendments to the by-laws made by the company after the date of the notice and prior to the meeting.
- Precatory proposals relating to elimination of takeover defenses or exploration of strategic alternatives.

Submission of the nomination notice does not mean that a proxy contest will ensue. The dissident can withdraw its nominations at any time and does not have to start a proxy contest in earnest until closer to the annual meeting. In addition, unless the dissident is a Schedule 13D filer, it is not required to disclose publicly its nominations or proposals, and the issuer has no obligation to make public disclosure of receipt of nominations or proposals prior to filing its proxy statement. This means that in many cases there can be private dialogue between the issuer and the nominating stockholder to reach an understanding, without the existence of nominations becoming publicly known.

While occasionally dissidents submit nominations at the eleventh hour, it is more common to submit earlier, in case the company objects to the notice as deficient. In any case, since the proxy solicitation seldom actively begins until four to six weeks before the meeting, parties generally have ample time for dialogue before the contest is truly joined and many proxy contests settle before a proxy statement is even filed (see Settlement).

Waiver of Advance Notice Provisions

Under certain circumstances, companies may be required by a court to waive compliance with their advance notice provisions. This occurred in 1991 in a Delaware case, *Hubbard v. Hollywood Park Realty Enterprises, Inc.*, where the Court found that a post-deadline settlement with a dissident, in which a majority of the board effectively shifted from opposing to supporting the dissident's agenda, represented a "material change of circumstances" that made enforcement of the advance notice deadline inequitable (1991 WL 3151, at *12 (Del. Ch. Jan. 14, 1991)). However, the circumstances in *Hubbard* were unusual in that the company whose by-law was at issue and an affiliate jointly controlled a key asset, and the settlement impacted the interests of the affiliate—itsself a stockholder of the company—in that shared asset. Consequently, a sudden shift in support for the dissident's agenda may have raised the specter of a conflict of interest that required the court's intervention.

Since *Hubbard*, there has been much speculation as to what might constitute a "material change of circumstances" requiring a Delaware corporation to waive its advance notice bylaws. The practice of settling proxy contests after the nomination deadline has passed has become commonplace and absent unusual facts is not likely to be viewed as a material change. Among the rare challenges to advance notice provisions were those by:

- Carl Icahn in 2012 at Amylin Pharmaceuticals, a Delaware company, involving a post-deadline unsolicited bid for Amylin (see *Icahn P'rs LP v. Amylin Pharm. Inc.*, 2012 WL 1526814 (Del. Ch. Apr. 20, 2012)).
- HealthCor Management in 2012 at Allscripts Healthcare Solutions, also a Delaware company, involving the post-deadline resignation of the CFO and four of nine directors at Allscripts (see *HealthCor Mgmt., L.P. v. Allscripts Healthcare Solutions, Inc.*, C.A. No. 7557-CS (Del. Ch. May 25, 2012) (ORDER)).
- Icahn and Darwin Deason at Xerox, a New York company, involving post-deadline purportedly material disclosures by Xerox about a previously announced merger with Fujifilm (see *In re Xerox Corp. Consol. S'holder Litig.*, Index No. 650766/18 (N.Y. Sup. Apr. 27, 2018)).

In all three cases, the board ultimately elected voluntarily to waive the deadline.

The most recent significant Delaware case on the subject is *AB Value Partners, LP v. Kreisler Manufacturing Corporation*, 2014 WL 7150465 (Del. Ch. Dec. 16, 2014). In that case, the Court took pains to emphasize the limits of *Hubbard*. The Court framed the question as whether the board had shifted direction so markedly in the narrow period of time after the advance notice deadline and before the annual meeting that the stockholders should have the ability to put forward a competing slate and propose a different business direction for the company. The Court held that a dispute over management's compensation and the potential for greater disputes in the near future were not sufficiently compelling issues to warrant the unusual remedy of enjoining a company's bylaw so that a last-minute proxy contest could occur. After *Kreisler*, Delaware courts are likely to re-open a closed advance notice window only in very limited circumstances.

STRATEGY

The strategy in a proxy fight—from the time the issuer first suspects that it may be confronted with a proxy contest—must always be informed by one basic question: will this action win or lose votes. Because every vote counts, every strategic or tactical decision, every communication, must be viewed through this lens.

Generally, there will be at least two weeks (and there may be several weeks) between the filing of the nomination notice and the date the company files definitive proxy materials with the SEC and effects a mailing of its materials or e-proxy notice. The company therefore has time to assess its options, which may include making changes to the annual meeting calendar, to the extent that this is to the company's advantage—before it starts a public fight with the dissident. Considerations include whether:

- The company is advantaged by an earlier or later record date for the meeting.
- There are potential developments relating to the company's business that could materially increase or decrease its chances of success in the proxy contest.
- The company needs time to implement a specific response plan, such as:
 - negotiating with other key investors;
 - recruiting new board members it believes investors may prefer to the dissident slate; or
 - pursuing strategic or financial alternatives that the company believes will obviate, or shift the balance in, a proxy fight.
- The company prefers to negotiate with the dissident before mailing its proxy statement.

Delaware companies have significant flexibility with regard to the setting of record dates, because Section 213 of the Delaware General Corporation Law (DGCL) gives companies the ability when they set a meeting date to set a record date that is any date on or before the meeting date (8 Del. C. § 213). Because shares will trade in the market between the announcement of the meeting date and the meeting itself, the "empty voting" problem arises in which the voting rights associated with shares are held by an owner of record as of the record date for the meeting who no longer holds an economic interest in those shares at the meeting date. Setting a record date close to the annual meeting will reduce this problem, but this may not always be to the company's advantage. The company's advisors should be consulted to determine the appropriate strategy.

There may be a benefit to delaying the meeting and, depending on relevant state corporate law, the company may have more or less flexibility to do so. In Delaware, if the annual meeting has not been held within 13 months after its last annual meeting, the Delaware Chancery Court "may" summarily order a meeting upon the application of any stockholder or director (8 Del. C. § 211(c)). However, the court has discretion and, if it is reasonable under the circumstances to delay the meeting, the court may give the company some latitude as to the timing of the meeting. This issue must be reviewed on a case by case basis depending upon applicable state law, as some states are significantly more permissive than Delaware. However, even if delay is permissible under applicable state law, any

perceived benefits of delay must be weighed against the potential disadvantages. The leading proxy advisory firm, ISS, disapproves of any perceived efforts by management to manipulate the proxy process. The risk of adverse impact on ISS's recommendation, or on the views of key stockholders, must be taken into account before deciding to make significant changes in the annual meeting schedule.

ASSEMBLING THE TEAM

Each side in a proxy contest needs a dedicated team, including a variety of professional advisors. The size of the team will be a function of the scale of the target company and the intensity of the contest. Companies that engage in advance preparation may have a team already in place, which can be a significant benefit in the age of instantaneous, pervasive media coverage, where rapid response to emerging developments can play a crucial role in setting the tone for the battle ahead. Generally, the team consists of:

- Senior executives, directors and nominees.
- Members of the company's Investor Relations department.
- Outside legal counsel.
- A financial public relations firm.
- A proxy solicitor.
- Investment bankers.

MANAGEMENT AND BOARD

Senior executives of the company and the dissident play a critical role in a proxy contest. They are typically the primary interface with key stockholders and the principal advocates for each side's respective election platform.

Board members, including the Chairman or Lead Director, also play an important role in a proxy contest; the dissident's nominees may need to participate actively in the contest as well. These individuals may need to attend investor meetings and meetings with proxy advisory firms such as ISS and Glass Lewis. In addition, directors (and nominees) may act as important advocates with specific stockholders by virtue of their business relationships through other corporate boards or executive positions.

INVESTOR RELATIONS DEPARTMENT

The company's Investor Relations (IR) team will be an important component of the company's team. IR will have the closest contact with many investors, be able to facilitate dialogue with investors, and understand the company's timetable of future conferences, trade show and media events and media releases, any or all of which may impact how investors vote.

It is important to recognize that information conveyed to, or by, the IR department concerning the issuer's standing with key investors may not be reliable in the context of a proxy fight. The proxy fight may raise new issues for investors, even if they previously were supportive. Moreover, in many cases institutions turn to a proxy committee or head of proxy services to decide how the institution will vote and the views of portfolio managers at actively managed funds may not be decisive as to how the fund votes. At the end of the day, top management must lead the campaign and make its case directly to the key individuals at each major investor to secure their votes.

COUNSEL

Outside counsel generally plays a central role in crafting the company's or dissident's strategy, tactics and key messages, drafting proxy materials, drafting and reviewing key investor communications, ensuring compliance with the federal proxy rules and applicable state law, and managing the proxy contest day to day. In addition, there is always the possibility of litigation, whether initiated by the company or the dissident, and judgments must be made as to the substantive or tactical benefits of litigation.

FINANCIAL PUBLIC RELATIONS FIRMS

Financial public relations (PR) firms play a leading role in the drafting of press releases, employee communications, investor presentations, website materials and so-called "fight" letters (see Platform and Strategy below), work their client's side of the story with the media, and seek to place favorable coverage. Even in the case of large organizations with a substantial internal PR team, a sophisticated financial PR firm can add real value. In addition, certain of the top PR firms have added individuals with backgrounds in governance to augment their capabilities.

PROXY SOLICITORS

The proxy solicitor is part tactical advisor, part administrator, and an indispensable team member. A very small number of proxy solicitation firms dominate the business of contested proxy solicitation. They understand institutional and hedge fund investors' personalities, voting inclinations and behaviors, they have close relationships with these investors and with the proxy advisory firms and they play a valuable role in assessing the odds of success and providing insight into what arguments are likely to carry weight with investors. Proxy solicitors also run:

- The solicitation process, including coaching the management team on how to present their case, setting up investor meetings, organizing the "get out the vote" effort—including overseeing an army of personnel tasked with soliciting the votes of smaller investors and organizing meetings and conference calls with proxy advisory firms.
- The back office function, including collecting and tabulating investor proxies, and liaising with Broadridge Financial Solutions (Broadridge) in order to provide daily vote tabulations to the client. Broadridge provides proxy processing services to street name holders and is the dominant firm in the space.

INVESTMENT BANKERS

Most companies of scale will engage an investment bank in connection with a proxy contest. Nowadays every major investment bank and leading boutique has a team that is versed in activist defense and proxy contests. That team complements the bank's regular client team and plays a critical role in the development of the campaign platform, strategy and tactics and in shaping the company's response to the dissident's platform, which may be skewed by cherry-picking particular data, time periods or peer groups. The banks may also have important senior level relationships with investors that can be beneficial in the solicitation process. In recent years, some of the banks have expanded their teams to include governance specialists, who have the pulse of the proxy voting function at major financial institutions.

KEY LEGAL CONSIDERATIONS

The solicitation of proxies is governed by Section 14 of the Exchange Act and Regulation 14A thereunder. Revisions made in 1999 to the Exchange Act rules essentially eliminated “gun jumping” issues in proxy contests. These amendments have been a boon to dissidents, as they allow dissidents broad latitude to agitate without undertaking the time and expense of drafting a proxy statement.

Key aspects of Regulation 14A include:

- The meaning of “solicitation” (see Solicitation Rules).
- The ability to engage in solicitation before furnishing a proxy statement (see Solicitation Prior to Furnishing the Proxy Statement).
- Exemption of certain communications from the proxy rules (see Important Exemptions).
- The content of the proxy statement and proxy card (see The Proxy Statement and Proxy Card).
- Filing requirements for written soliciting materials (see Distribution of Proxy Materials; E-Proxy).
- Disclosure and anti-fraud rules (see Disclosure and Anti-Fraud Rules).

SOLICITATION RULES

The most important concept under the rules is the meaning of “solicitation.” Pursuant to Rule 14a-1(l)(1), the terms “solicit” and “solicitation” include:

- Any request for a proxy whether or not accompanied by or included in a form of proxy.
- Any request to execute or not to execute, or to revoke, a proxy.
- The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.

The term “proxy” includes every proxy, consent or authorization (*Rule 14a-1(f)*). The SEC and the courts have broadly interpreted the term “reasonably calculated to result in the procurement, withholding or revocation of a proxy” to include communications prior to the commencement of a formal solicitation that appear to be designed to influence stockholders’ voting decisions. Accordingly, communications that form part of a continuous plan that culminates in a formal solicitation and have the purpose or effect of influencing investors will be viewed as proxy solicitation.

The term “solicitation” does not include “[a] communication by a security holder who does not otherwise engage in a [non-exempt] solicitation ... stating how the security holder intends to vote and the reasons therefor” (*Rule 14a-1(l)(2)(iv)*). The exemption in Rule 14a-1(l)(2)(iv) is most commonly used by investors who are not seeking to conduct a proxy fight to disclose publicly their opposition to a proposed corporate transaction requiring stockholder approval. This exemption can also be of significant value in an election contest, as an announcement by an influential investor of how it intends to vote may affect the views of proxy advisory firms or other investors. For this reason, the issuer or dissident may try to persuade one or more key holders to disclose publicly their voting intentions.

All written communications must be filed with the SEC on the date of first use, no later than 5:30 p.m. Eastern time. The term “written

communication” is interpreted broadly to include all communications that are disseminated to the general public in any form other than orally and includes material such as press releases, slides, postcards, emails, and internet postings. Dissidents routinely establish campaign websites nowadays where they post key campaign materials, which may include high-end video content. All of these materials, or transcripts in the case of recordable media, must be filed. Scripts, prepared Q&A sheets or similar materials prepared for personal use generally do not need to be filed unless they are given out to the media or otherwise distributed publicly. Similarly, if a document is widely distributed throughout the company or provided to the IR department or other personnel for repeated use, it should be filed.

Once a solicitation begins, the company should assume that essentially all public or investor relations and employee communications could be viewed as solicitation activities and should make the appropriate filings. Communications with customers and suppliers can also be viewed as solicitations depending on the circumstances. Therefore, the company should implement procedures to ensure appropriate vetting of communications with counsel to comply with the proxy rules.

SOLICITATION PRIOR TO FURNISHING THE PROXY STATEMENT

Rule 14a-12 permits parties to engage in solicitation activities before furnishing a proxy statement and without pre-clearance by the SEC, so long as each written communication includes both:

- The identity of the participants in the solicitation and a description of their interests (by security holdings or otherwise) in the subject matter of the solicitation or a prominent legend indicating where security holders can find the information.
- A prominent legend advising security holders to read the proxy statement when it is available because it contains important information and explaining how investors can obtain the proxy statement and other relevant documents free of charge from the SEC’s website or from the participant.

In addition, a definitive proxy statement must be sent or given to security holders before or at the same time forms of proxy are furnished to or requested from security holders.

Any soliciting material published, sent or given to security holders in accordance with Rule 14a-12(a) must be filed with the SEC on the date of first use under cover of Schedule 14A (*Rule 14a-12(b)*).

In summary, the only prerequisites for engaging in solicitation activity prior to the filing or distribution of a proxy statement are:

- **Include the required legends** on any written soliciting materials.
- **Do not deliver a form of proxy or request a proxy** until a definitive proxy statement is furnished.
- **File written soliciting material on the date of first use** (no later than 5:30 p.m. Eastern time).

Use of Social Media

With the advent of social media, the SEC has addressed how legending requirements can be satisfied for solicitations using social media prior to the delivery of a proxy statement. Where the medium permits inclusion of the legend in full, it must be included. However, the SEC staff will not object to the use of an active hyperlink to

satisfy the legending requirements for electronic communications distributed through a social media platform, such as Twitter, that has technological limitations on the number of characters or amount of text that may be included in the communication, if both:

- Including the legend in its entirety would cause the communication to exceed the character or text limit.
- The communication contains an active hyperlink to the required legend and prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink.

(See Question 164.02, SEC Compliance & Disclosure Interpretations: Securities Act Rules; for more, see Practice Note, Social Media Compliance with Securities and Disclosure Laws: Social Media Communications and Proxy Solicitations ([6-523-5948](#))).

IMPORTANT EXEMPTIONS

Rule 14a-2 sets out a number of exemptions from the proxy rules. Notably, Rule 14a-2(b) exempts from the proxy rules, other than the anti-fraud requirements of Rule 14a-9:

- Solicitations by certain persons not seeking proxy authority.
- Solicitations of ten or fewer stockholders (see Rule of Ten).
- The conduct of an electronic shareholder forum under the provisions of Rule 14a-17 by a person not seeking or requesting a proxy, provided that the solicitation is made more than 60 days prior to the date announced by a registrant for its next annual or special meeting of shareholders (see Electronic Shareholder Forums).

Solicitations by Persons Not Seeking Proxy Authority

Any solicitation by or on behalf of a person who does not seek power to act as proxy and does not furnish or request a proxy is exempt from the proxy rules (*Rule 14a-2(b)(1)*).

Categories of persons who cannot rely on this exemption include:

- The issuer, its affiliates, and their respective officers and directors.
- Any nominee for election.
- Any person being compensated by a person unable to rely on the exemption.
- Any Schedule 13D filer who has not disclaimed a control intent.
- Any person with a substantial interest in the subject matter of the solicitation not shared pro rata with other holders.

Rule 14a-2(b) can be used by stockholders to encourage other holders to support one or other of the parties to the contest with minimal regulatory constraints. It can also be used in “withhold the vote” campaigns against the election of one or more directors or against a corporate transaction such as a merger. Note that a decision to conduct an exempt solicitation under Rule 14a-2(b)(1) is irrevocable. While it is permissible for a party to abandon a non-exempt solicitation and subsequently initiate an exempt solicitation under Rule 14a-2(b)(1), the reverse is prohibited.

Persons that rely on Rule 14a-2(b)(1) and own shares (within the class being solicited) with a market value of more than \$5 million must also file any written soliciting materials with the SEC within three days after the date of first use under cover of a Notice of Exempt Solicitation.

Rule of Ten

The exclusion for solicitations on behalf of a person other than the issuer of not more than ten persons can be useful to a dissident. In cases in which the ownership of the issuer is particularly concentrated, it may be possible for an insurgent to obtain the requisite support of stockholders without making any filings under the proxy rules and, more importantly, without giving the issuer advance notice and the opportunity to solicit in opposition. This presumes, however, that the issuer is not otherwise aware of the soliciting party’s activities as a result of other disclosure requirements, such as those under Section 13(d) of the Exchange Act, its stock surveillance program, or market rumors, and that the issuer’s by-laws do not otherwise require advance notice to the issuer. It will be a rare case where the issuer has no inkling of the soliciting party’s activities.

Reliance on the “Rule of Ten” requires that the soliciting party refrain from any widespread solicitation activity, such as issuing a press release or appearing in the media, and limit all activities that may constitute “solicitation” to private outreach to no more than ten persons in total. The exclusion has occasionally been used effectively in an activist campaign. For example, in 2007 a group of investors that included Oppenheimer Funds and D.E. Shaw relied on the Rule of Ten to obtain voting agreements to replace the board of Take-Two Interactive Software.

Legal authority on how to count the ten “persons” is sparse. One case on point is *Crouch v. Prior*, 905 F. Supp. 248 (D.V.I. 1995), where the court, while noting the relative lack of precedent cases, found that a dissident stockholder had solicited more than ten persons. In *Crouch*, the court counted as one “person” each person holding voting rights to the shares, even if each voting entity represented more than one legal owner of shares, and did not count the separate legal owners against the ten-person limit. Thus, an individual with sole voting control over multiple shareholders was treated as one person. On the other hand, the court treated two members of the same family of investment funds, each of which was a record holder, as two separate persons, and treated both the dissident’s spouse and the dissident’s securities counsel, who was trustee of the dissident’s family trust, as persons solicited by the dissident.

Publicly available SEC staff interpretations provide the following, limited guidance:

- A solicited person holding shares in several nominee accounts will be deemed one “person” for purposes of Rule 14a-2(b)(2) (see Question 122.01, SEC Compliance & Disclosure Interpretations: Proxy Rules and Schedules 14A/14C).
- Providing a form of proxy to a person in response to that person’s unsolicited call based on a Schedule 13D filing and news reports is not counted against the ten-person limit (see Question 122.02, SEC Compliance & Disclosure Interpretations: Proxy Rules and Schedules 14A/14C).
- An insurgent intending to engage in a solicitation of no more than ten persons under Rule 14a-2(b)(2) should remain mindful that its filing of a Schedule 13D—depending on the content of the document and other relevant facts and circumstances—may constitute a more widespread “general” solicitation and preclude reliance upon Rule 14a-2(b)(2) (see Question 122.03,

SEC Compliance & Disclosure Interpretations: Proxy Rules and Schedules 14A/14C).

Electronic Shareholder Forums

The 2008 amendments to the proxy rules also included revisions to encourage the use of electronic shareholder forums, which are essentially websites where information can be posted or exchanged to enhance communication among investors or between the issuer and investors. An exemption under Rule 14a-2(b)(6) permits management, or a third party, to use such a forum for solicitations made more than 60 days prior to the date announced for the next stockholders' meeting of the issuer or, if the announcement of the meeting date is made less than 60 days prior to the meeting date, not more than two days following the announcement. In effect, an electronic shareholder forum can be used to "test the waters" prior to a stockholders' meeting, without making any filings with the SEC.

THE PROXY STATEMENT AND PROXY CARD

In a proxy contest, each side must file its proxy statement and form of proxy in preliminary form with the SEC at least ten calendar days before distributing a definitive proxy statement and form of proxy to investors (*Rule 14a-6(a)*). The SEC generally attempts to provide comments within the ten-calendar-day period.

The proxy statement must contain the information specified in Schedule 14A. For a proxy contest in connection with the annual meeting, the company's proxy statement will largely mirror the regular annual meeting proxy statement, other than any discussion of the election contest itself and any supporting information the company chooses to include in its proxy statement. Because the SEC does not require pre-clearance of soliciting materials other than the proxy statement and form of proxy, the parties generally include limited discussion of their respective campaign platforms in the proxy statement. Instead, the parties disseminate "fight letters" to investors which lay out, often with considerable dramatic flair, their core arguments (see Platform and Strategy). The first fight letter is generally disseminated on the day the definitive proxy statement is filed.

Rule 14a-4 specifies requirements for the form of proxy card. The proxy card must set forth each matter to be acted upon clearly and impartially, and provide a specifically designated blank space for dating the proxy card. The proxy card must provide a means for the person solicited to specify approval, disapproval or abstention as to each matter to be acted upon, except that in the case of election of directors the proxy card must provide a means to withhold authority from each individual nominee, and may provide a means to vote for the nominees as a group so long as it provides a similar means to withhold authority for the nominees as a group.

If a dissident is seeking fewer than all board seats (known as a short slate), it can round out its slate by including nominees named in the company's proxy statement in its proxy card (*Rule 14a-4*).

The proxy card has important limitations. Generally, stockholders are faced with a mutually exclusive choice between executing the company's proxy card for some or all of its nominees or the dissident's proxy card for some or all of its nominees (plus the company's nominees used to round out the dissident's slate).

Although the proxy card limits the choices available to stockholders as a matter of federal law, sophisticated institutions understand that, as a matter of state law, they can submit a ballot at the meeting selecting from both the company's and the dissident's nominees. However, this can be logistically challenging and is quite rare in practice. The key point is that, with a binary choice between the issuer's and the dissident's proxy card, it greatly matters which proxy card stockholders execute and submit.

An important clarification of Rule 14a-4 was made in 2009. The SEC granted no-action requests by Carl Icahn and Eastbourne Capital, each of whom, unusually, was running its own proxy contest at Amylin Pharmaceuticals. The SEC permitted each dissident to round out its slate by including nominees of the other, not merely nominees of Amylin. (See Eastbourne Capital, L.L.C., SEC No-Action Letter (Mar. 30, 2009); Icahn Associates Corp., SEC No-Action Letter (Mar. 30, 2009).)

In the course of a proxy contest, investors may receive multiple proxy cards from each side, and may, intentionally or inadvertently, submit more than one proxy card. The latest dated proxy card revokes any prior proxy. For more information on what information is required in an annual meeting proxy statement and proxy card, see Practice Note, Proxy Statements ([4-381-1684](#)).

Universal Proxy Cards

In 2016, the SEC proposed amendments to the proxy rules to require parties in contested elections of directors to use a universal proxy card that would include the names of all nominees. The proposed rules stalled after the 2016 election, but the SEC has recently indicated it intends to reexamine the issue. Meanwhile, however, in June 2018 Sandridge Energy became the first company to voluntarily use a universal proxy card, in a proxy contest with Carl Icahn. The card allowed stockholders to vote for Sandridge's five nominees plus any two of three Icahn nominees (out of seven Icahn nominees) that Sandridge considered independent. It is generally assumed that the SEC concluded that Icahn's nomination notice included a consent of its nominees to be named in Sandridge's proxy, thus permitting Sandridge to use a universal proxy card. Absent such a consent—which is not contemplated by many current nomination by-laws—Sandridge could not have employed a universal proxy card under current law without the nominees' cooperation. In the event, while many investors applauded Sandridge's willingness to use a universal proxy card, the strategy did not change the outcome of the contest. Ultimately, Sandridge ceded control to Icahn in a settlement.

In connection with a proxy contest in 2018 by Starboard Value at Israeli registrant Mellanox Technologies, Mellanox called a special meeting seeking stockholder approval to use a universal proxy card at its subsequent annual meeting, at which Starboard was seeking to replace the Mellanox board. Stockholders approved the use of the universal proxy. Following the special meeting, Mellanox agreed to settle the proxy contest and gave Starboard two board seats.

These uses of a universal proxy card are a variant on a strategy used in a number of proxy contests, in which the issuer, recognizing that the dissident would likely win some seats, included in its proxy card fewer nominees than there were seats up for election. In each case, the objective was to get stockholders to vote on the issuer's card rather than the dissident's.

DISTRIBUTION OF PROXY MATERIALS; E-PROXY

Under Rule 14a-7, upon a written request by the dissident, the company is obligated to (at the company's option) either:

- Effect the mailing (or internet delivery) of the dissident's proxy materials within five business days.
- Provide to the dissident a list of record holders, non-objecting beneficial owners, and, if the company has elected to deliver proxy materials over the internet, the names of holders who have requested paper copies.

Because under state law (such as Section 220 of the DGCL) the dissident generally has the ability to obtain a stockholder list for the purposes of soliciting proxies, the election under Rule 14a-7 is not particularly significant.

In 2007, the proxy rules were amended to provide for delivery of annual reports and proxy materials over the internet, thereby both streamlining the proxy process and reducing printing and mailing costs. To utilize e-proxy, the company must mail to security holders a notice of internet availability of proxy materials no later than 40 calendar days prior to the meeting date (*Rule 14a-16(a)*). If the company elects to use e-proxy, all of its proxy materials must be available on a website free of charge on or before the time the notice is sent, and all additional soliciting material must be available on the website on the day first sent to security holders or made public (*Rule 14a-16(b)*). The dissident has a choice to use e-proxy or paper delivery of materials and, if using e-proxy, must send its notice of internet availability of proxy materials by the later of 40 calendar days before the meeting or the date it files its definitive proxy statement as long as that filing occurs within ten days of the company's filing of its definitive proxy statement (*Rule 14a-16(l)*).

It is not necessarily to the company's advantage to use e-proxy in a proxy contest because it has been shown to lead to lower turnout of retail-held shares at stockholder meetings. In cases in which the company chooses to use e-proxy, a separate paper mailing to retail holders, or other additional solicitation efforts, may be important to maximize turnout by retail holders. The company should consult with its proxy solicitor to determine the most effective approach in its particular situation.

DISCLOSURE AND ANTI-FRAUD RULES

Rule 14a-9 prohibits making false and misleading statements of material fact in connection with any solicitation of proxies subject to Regulation 14A. The rule expressly states that the fact that proxy materials have been filed with or examined by the SEC does not constitute a finding that the materials are not false or misleading. The Supreme Court has held that a private right of action exists to remedy violations of Rule 14a-9 (see *J.I. Case v. Borak*, 377 U.S. 426, 431-432 (1964)). The standard for materiality under Rule 14a-9 was clarified by the Supreme Court in *TSC Industries v. Northway*:

"An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote...[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

(See *TSC Industries v. Northway*, 426 U.S. 438, 449 (1976).)

A showing of scienter is not required in an action under Rule 14a-9. The range of potential remedies for violations of the Rule includes injunctive relief (which may include enjoining a party from soliciting proxies, enjoining the vote, or requiring a new vote) and damages awards.

The SEC generally limits its role in proxy contests to:

- Reviewing materials for exaggerated or inflammatory statements.
- Requiring support for factual assertions and correction of statements expressed as fact which are matters of opinion rather than fact.

If a party believes the proxy materials of the other party violate Rule 14a-9, it can submit to the SEC a so-called "bed bug letter" highlighting deficiencies in the proxy materials. The SEC may require the other party to revise its materials to reflect issues raised in a bed bug letter. However, the SEC's general policy is to leave contentious matters to be addressed through litigation.

There is also an established body of case law in Delaware on the adequacy of disclosure in proxy statements, and the Delaware courts have shown themselves sensitive to the importance of full and fair disclosure in connection with elections of fiduciaries of the company. Whether considering litigation for federal or state law claims, however, in practice litigation is seldom a show-stopper in a proxy contest. Except for the most egregious rule violations, the typical remedy is corrective disclosure. Since stockholders today are generally skeptical of the value of proxy litigation, a decision to litigate should be made only after a thorough analysis of the benefits and risks involved. The decision to litigate should be based on one principal criterion: whether it increases the chances for success in the proxy contest.

HEIGHTENED SCRUTINY UNDER DELAWARE LAW

In Delaware, actions taken by a company that impact the exercise of the stockholder franchise may be subject to scrutiny under the heightened *Blasius* standard of review (see *Blasius Corp. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988)). In *Blasius*, the Delaware Chancery Court held that any action which has the "primary purpose" of impeding the exercise of the stockholder franchise must have a compelling justification (see Practice Note, Fiduciary Duties of the Board of Directors: Interference with Stockholder Vote (6-382-1267)). Applying this standard, the Delaware Supreme Court invalidated an expansion by Liquid Audio of its board of directors from five to seven members in the face of an effort by MM Co. to obtain two seats on the board (see *MM Co., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003)). In that case, the Delaware Supreme Court found that the primary purpose of the action was to diminish the influence of MM's nominees and that there was no compelling justification for the board's action.

As discussed below, stockholder Third Point LLC asserted *Blasius* claims in challenging the actions of the board of Sotheby's, Inc. in adopting a rights plan, and subsequently declining to waive the 10% flip-in threshold under the rights plan, in response to an accumulation by activist investors and an activist campaign and proxy contest by Third Point. Although Third Point was unsuccessful in enjoining the Sotheby's rights plan, the case underscores that governance and defensive actions in the context of a proxy fight at a Delaware corporation may be challenged under *Blasius*, making it critical to build a careful record regarding the board's motivations.

USE OF STOCKHOLDER RIGHTS PLANS IN PROXY CONTEST SITUATIONS

When an activist surfaces, issuers and their advisers frequently debate the merits of adopting a rights plan or, in the case of those rare companies that have an existing plan, amending the rights plan, to increase the issuer's leverage in dealing with the activist. Between 2014 and 2018, roughly 50 companies adopted a rights plan in the context of an activist situation (of which some were rights plans designed to preserve net operating loss carryforwards). Some rights plans adopted nowadays include "acting in concert" language (which has not yet been tested in the courts) that expands the definition of "beneficial ownership" to encompass activities that would not trigger 13D group status with a view to inhibiting various "wolf pack" activities. For an overview of rights plans, see Practice Note, *Poison Pills: Defending Against Takeovers/Stockholder Activism and Protecting NOLs* (3-386-0340). For more information on Section 13(d) groups, see Practice Note, *Filing Schedule 13D and 13G Reports: Box, Filings Involving More than One Reporting Person* (1-501-2832).

Since a rights plan operates to cap the activist's "beneficial ownership" of common stock (generally including derivative instruments whether settled in stock or cash), an activist will often conduct its accumulation rapidly and with stealth, using derivatives to build a large economic stake before it becomes subject to 13D filing or HSR clearance obligations and before the issuer is aware of facts that could cause it to adopt a rights plan. A successful stealth accumulation can, of course, substantially reduce the utility of the rights plan.

Compared to the thousands of activist campaigns in the past several years, 50 instances of adopting a rights plan as a response strategy is a very small number. The comparative rarity of this strategy reflects, in the first instance, a marked change in boards of directors' sensitivity to the benefits and detriments of deploying takeover defenses. Boards must balance the (sometimes marginal) benefit of capping the activist's accumulation against the potential negative reactions of other investors. Where the activist has entered the stock at a low trading price, the activist's presence in the market may be supporting the stock and providing liquidity to other investors—and the board may not want to undermine that market support. There may also be a natural cap on the activist's ownership stake due to its financial capacity or legal considerations (such as state takeover statutes, charter provisions, or Section 16 reporting requirements) that reduces the importance of a rights plan. (For more information on Section 16 reporting, see Practice Note, *Section 16 Reporting: Why, How and When to Do It* (2-386-1726)). Moreover, a typical rights plan with a 15% trigger will not necessarily have a significant effect on the activist.

In the activism context, the most significant recent Delaware decision concerning rights plans arose in the 2013-2014 activist campaign at Sotheby's (*Third Point LLC v. Ruprecht, et al.*, 2014 WL 1922029 (Del. Ch. May 2, 2014)). Following accumulations by multiple activists and interactions with two of the activists, Sotheby's adopted a rights plan with a 10% trigger for 13D filers and a 20% trigger for passive, 13G filers. At the time Sotheby's adopted its rights plan, three well-known activists—Marcato Capital, Third Point, and Trian Fund Management—were in the stock, with collective ownership of approximately 19% of the shares. Although each activist was subject to the 10% trigger, so long as the three activists were not acting in concert, the rights plan would not preclude them each individually acquiring or holding up to 10% of the stock. Third Point

later challenged the Sotheby's board's decision to adopt the rights plan and its subsequent decision not to grant Third Point a waiver to increase the ownership cap from 10% to 20%. Third Point's challenge included claims that the board's actions were:

- Not a reasonable response to a cognizable threat under *Unocal* (see Practice Note, *Defending Against Hostile Takeovers: Enhanced Scrutiny* (9-386-7206)).
- Invalid under the *Blasius* standard because they were taken for the primary purpose of interfering with the exercise of the stockholder franchise.

Denying Third Point's motion for a preliminary injunction, the Court found that the record developed by Sotheby's and its advisers provided sufficient evidence that Third Point posed a threat to Sotheby's at the time the rights plan was adopted and did not support Third Point's contention that the board adopted the rights plan for the primary purpose of interfering with the stockholder franchise. In the Court's view, whether the board's determination that there was an objectively reasonable and legally cognizable threat to Sotheby's when Third Point made its waiver request was a much closer question. Since Third Point was seeking only the right to acquire up to 20% of the shares, Third Point did not present a risk of acquiring "creeping control" of Sotheby's. Ultimately, however, the Court concluded that the available evidence indicated that Sotheby's may have had legitimate concerns that enabling Third Point to obtain 20% as opposed to 10% ownership in the company could result in Third Point exercising "negative control" over Sotheby's (taking into account the significant holdings of other hedge funds).

The Court also discussed, but did not rule upon, the bifurcated 10% active/20% passive investor trigger under the rights plan. However, the Court's comments displayed some skepticism about this feature. For a detailed summary of the *Sotheby's* decision, see Legal Update, *Third Point v. Ruprecht: Creeping Control and Negative Control Upheld as Defenses for Two-Tier Poison Pill* (4-567-6928).

FIGHTING THE CAMPAIGN

When faced with the prospect of a proxy contest, a company needs to understand the situation dynamics and the strategic options available to it. The principal issues to consider include:

- The composition of the stockholder base and their likely voting inclinations (see *The Stockholder Base*).
- How to develop an effective platform and strategy (see *Platform and Strategy*).
- The impact of ISS and other proxy advisory firms (see *Proxy Advisory Firms*).
- The solicitation process (see *The Solicitation Process*).
- Tactical maneuvers, including conduct of the annual meeting (see *The Meeting; Tactical Maneuvers*).

THE STOCKHOLDER BASE

It is crucial for the company to understand its stockholder base when formulating its strategy. Typically, there is a diverse group of investors, including:

- Index funds.
- Actively managed mutual funds.

- Wealth management companies.
- Quant funds.
- Pension funds.
- Hedge funds.
- Corporate insiders.
- Retail (“Mom and Pop”) investors.

Management and investor relations personnel generally have substantial familiarity with most of the company’s key investors and, in the case of actively managed funds, the portfolio managers who manage these investments. In a proxy contest, however, a proxy department or proxy committee may control the institution’s voting decisions and the portfolio manager’s views may not necessarily prevail. In addition, almost all large institutions are influenced by the recommendations of proxy advisory firms, and in some cases (such as some index and quant funds) automatically follow their proxy advisory firm’s recommendation. Finally, most institutions vote very late in the process, in the last few days prior to the vote (and as late as the day of the meeting), which leads to anxiety even where the participants in the solicitation are confident as to how stockholders will vote. With the increasing role of index funds in the securities markets, these funds are pivotal in many proxy contests.

Most proxy contests occur at micro, small and mid-cap companies. Hedge funds may own 10% to 30% of the shares of these companies, depending on the industry sector. This is significant because hedge funds commonly support dissidents in proxy contests. If there is a substantial hedge fund presence in the stock and it is not counterbalanced by a number of loyal, long-term investors or by substantial insider holdings, the company may face significant obstacles to winning the contest.

Conversely, there have been few proxy contests at larger companies. Among firms with an equity market capitalization in excess of \$10 billion, there have been roughly 15 contests between 2014 and 2018. Of those contests, only five actually went to a vote:

- ADP/Pershing Square (won by management).
- DuPont/Trian (won by management).
- General Motors/Greenlight Capital (won by management).
- Procter & Gamble/Trian (won by Trian by about 43,000 votes).
- Wynn Resorts/Elaine Wynn (won by management).

At the end of 2018, one pending large-cap proxy contest (Campbell Soup/Third Point) appeared likely to be won by management due to support from Campbell’s founding Dorrance family.

Given the dominant position of ISS among proxy advisory firms, maximizing the likelihood of getting the support of ISS is important, especially in contests at smaller issuers (see Box, Example Ownership Profile). However, in some contests that may not be a realistic outcome. In that case, the company needs to develop an effective strategy to minimize the impact of a negative recommendation from ISS, and to work proactively with investors (well in advance of the issuance of ISS’s report), to persuade them to attach lesser weight to ISS’s recommendations.

PLATFORM AND STRATEGY

Before the campaign begins, each side should already have a preliminary view of its chances of success and have formulated a strategy to maximize the likelihood of a favorable outcome. There are typically three possible outcomes if the contest goes to a vote: win for the company, win for the dissident, or a split decision in which one or more but less than all dissident nominees are elected. Therefore, the primary strategy for either side may not necessarily be to gain total victory, but may instead be to achieve a split.

The strategy for either side may be purely an investor relations and public relations strategy that is focused on convincing investors and proxy advisory firms of:

- The merits of the party’s business plan and/or value creation ideas.
- Demonstrating strong, or improving, financial or operational metrics (or the contrary, in the case of the dissident).
- A showing of good governance practices.
- The quality and effectiveness of its nominees.
- Weaknesses in the other party’s platform and slate of nominees.

Before starting on the campaign trail, the company should have a detailed list of its upcoming business announcements. The company’s goal, to the extent feasible and consistent with accurate disclosure, is to have a steady stream of favorable announcements (such as financial results, new product introductions, new customer wins and progress against publicly disclosed operational goals) throughout the campaign.

In the course of the fight, each party will disseminate a series of fight letters, typically two to four printed pages in length, the first setting forth the party’s principal arguments and subsequent letters emphasizing specific themes that the party believes are most effective. As the contest evolves and the parties receive feedback from investors, it may become apparent that certain messages resonate strongly with investors while others do not.

In addition to fight letters, each party’s soliciting materials will include investor presentations, press releases, and internet postings. The parties may also conduct media interviews, orchestrate favorable editorials or articles by third parties, and encourage other investors to speak out in support. State pension funds and unions have been the investors most willing to publicize their voting intentions in a proxy contest, particularly in support of dissidents, although institutional investors occasionally are willing to publicize their votes.

However, a strictly investor relations and public relations campaign may not be a sufficient strategy, particularly for a company with a record of performance challenges confronted by a credible, well-funded dissident. Additional actions may be necessary to win investors’ support. In this regard, the company typically has more tools available than the dissident, and has the opportunity to negotiate with key investors (regarding board composition, issues of corporate planning or strategy) to secure their vote. Examples include:

- Governance enhancements.
- Unilateral changes in the board of directors or management.
- Conceding one or more board seats to the dissident by nominating fewer candidates than there are seats.

- Implementing items of the dissident's agenda, including corporate actions advocated by the dissident, such as:
 - changes to the company's business plan;
 - undertaking a review of strategic alternatives;
 - announcing a plan to return capital to investors; or
 - divesting assets.

It is worthwhile to make an assessment early on regarding the actions needed to win over investors. These actions may take significant time and, if undertaken belatedly, may be ineffective.

PROXY ADVISORY FIRMS

Almost all institutional investors use a proxy advisory firm (and in some cases, multiple firms) that provides governance services, conducts proxy research, and issues vote recommendations to its subscribers. ISS is the dominant proxy advisory firm, with Glass Lewis having the second largest market share, followed by Egan Jones. The proxy advisor's recommendation varies from influential to decisive: ISS recommendations are correlated with the outcome of a proxy contest a majority of the time (although its recommendations carry less weight in proxy contests at the largest issuers) and ISS supports one or more dissident nominees in a significant majority of contests. In a proxy contest, every vote (and every vote recommendation) counts, so the parties must make every effort to secure the recommendations of as many proxy advisory firms as possible, and should seek to maximize favorable publicity, or minimize unfavorable publicity, when the proxy advisory firms publish their recommendations. For a proxy advisor's perspective on the role of proxy advisors and the engagement processes, see Practice Note, *Developing Relationships with Proxy Advisory Firms* ([8-517-2134](#)).

ISS has well-established guidelines and procedures and will meet with each side about two weeks before the vote. Conducting an in-person meeting with ISS is preferable for any contest of reasonable scale. The participants for the company should generally be one or more key directors (the Chairman or Lead Director and perhaps the head of the Nominating and Governance Committee, or another director who is an effective advocate for the company), the CEO and the CFO. They are usually accompanied by the proxy solicitor and perhaps one of the other outside advisors. For the dissident, the team will usually be the dissident's senior personnel, possibly one or more nominees, the proxy solicitor, and perhaps another outside advisor. Each side should furnish a detailed presentation of its campaign platform to ISS in advance.

In contests for board representation, ISS asks two key questions:

- **Has the dissident demonstrated that change is warranted?** In evaluating whether change is warranted, ISS reviews financial performance and stock price performance compared to a peer group (generally over five years), as well as governance considerations. Financial and stock price performance measures generally predominate in ISS's analysis. Long-term performance generally matters more than short-term performance. Because many activist targets are companies with a record of underperformance, it may be difficult to have confidence that the company can prevail on this prong of the ISS analysis, unless there are clear signs of a turnaround.
- **If change is warranted, are the dissident nominees more likely to effect that change than the management nominees?** The statistics

show that ISS tends to recommend at least some of the dissident slate if it determines that change is warranted and the proxy contest is being fought by a reasonably credible financial activist.

When the dissident is seeking board control, ISS requires of the dissident:

- A well-reasoned and detailed business plan (including the dissident's strategic initiatives).
- A transition plan that describes how the change in control of the company will be effected.
- The identification of a qualified and credible new management team.

ISS then compares that plan against the incumbents' plan and the dissident's proposed board and management team against the incumbent team to arrive at its vote recommendation.

When the dissident is seeking a minority position on the board (as in most proxy contests), the burden of proof on the dissident is lower. In those cases, ISS does not require a detailed plan or proof that the dissident's plan is preferable. Instead, it requires proof that change is preferable to the status quo and that the dissident slate will add value to board deliberations by considering the issues from a different viewpoint than the current board members.

Since most serious proxy contests are initiated by reasonably credible financial activists, and these activists frequently are able to attract credible independent nominees, it has become more difficult to attack the qualifications of dissident nominees. The dissident nominees also have the added advantage of not representing the status quo. In addition, if ISS supports the dissident, it favors having a representative of the dissident on the target company's board.

ISS does its own analyses, based on public data and submissions by the parties, in arriving at its recommendation. It also looks at third-party commentary, including analysts and industry experts. ISS also consults its clients who are key holders of the company's stock, and receives in-bound calls from other investors (more commonly those siding with the dissident) seeking to influence its recommendation. The practical reality is that ISS is a service provider and, in general, must be in step with its clients. If key clients are significant stockholders of the target company, their views on the contest necessarily will influence the ultimate recommendation.

While the other proxy advisory firms have less sway than ISS, Glass Lewis can still be an important voice. Glass Lewis formerly did not meet with the parties, but it has now adopted an engagement process in proxy contests similar to that of ISS. Glass Lewis is something of a contrarian and often reaches a different recommendation than ISS. The proxy solicitors will advise their clients regarding meetings or calls with other proxy advisory firms. These may not directly impact many votes, but can still make for favorable publicity.

THE SOLICITATION PROCESS

If a proxy contest cannot be avoided or settled, the parties must conduct a vigorous solicitation of investors. Beyond fight letters and press releases, in-person meetings and telephone calls are essential to garner investors' support. At companies with a highly diversified stockholder base, the solicitation process will be an intensive, multi-week schedule of in-person meetings and calls. The proxy

solicitor is invaluable in this process, as it coordinates road show presentations and conference calls with investors, telephone and e-mail solicitation of smaller investors, and meetings and conference calls with proxy advisory firms. It may be necessary for the parties to engage in extensive follow up with investors. In addition to members of management and staff of the proxy solicitor, a large number of employees may be needed to make calls to investors in order to get their shares voted.

For anyone who has not experienced a full-fledged proxy contest, it is difficult to imagine how time-consuming and intense the solicitation process can be. Much of the street vote comes in the final two to three days of the process. This leads to a nerve wracking process even if the outcome is not expected to be close and leaves limited time for the parties to react to adverse developments in the vote totals. Moreover, the process is far from transparent, because street name holders vote through Broadridge's proxy processing systems and Broadridge provides aggregated data to the parties. A sophisticated proxy solicitor can interpret the Broadridge data to reach conclusions about which holders have voted, but this is not apparent on the face of the data.

To the extent that a stockholder is voting through Broadridge or another intermediary, or is located outside the US, there may be significant logistical and timing issues involved in ensuring that the stockholder actually votes, or in getting that holder to reverse its vote. The problem of under- and over-voting of street name positions held through Broadridge (which frequently leads to investors voting a smaller or larger number of shares than anticipated by the proxy solicitor) was among the issues considered by the SEC in its review of "proxy plumbing" (see Concept Release on the U.S. Proxy System, Release No. 34-62495 (July 14, 2010) and Legal Update, SEC Issues Concept Release Seeking Public Comment on US Proxy System ([4-502-7993](#))). No major reforms resulted from that review, but proxy plumbing is again under discussion at the SEC and was an agenda item at an SEC roundtable in November 2018 (see Legal Update, SEC Chairman Announces SEC Staff Roundtable on the Proxy Process ([w-016-0575](#))).

In a closely fought contest, solicitation of investors may continue right up to and during the stockholders' meeting. Because an investor can change its vote at any time before the polls close, each side may be actively engaged in trying to secure last-minute proxies and getting investors to change their vote by executing a new proxy until the polls close.

THE MEETING; TACTICAL MANEUVERS

One of the advantages the company has is that it chooses the time and place of the meeting and runs the meeting. Ordinarily, the dissident negotiates an agreement with the company regarding meeting logistics, including number and location of seats, opportunity to present the dissident's proposals and address the meeting, and access to meeting rooms and telecommunications equipment.

The company will appoint inspectors of election for the meeting. The role of the inspectors is to:

- Ascertain the number of shares outstanding and whether a quorum is present.
- Determine the shares represented at the meeting and the validity of proxies and ballots.

- Tabulate all votes and ballots.
- Determine and retain a record of the disposition of challenges to any determination by the inspectors.
- Certify the number of shares represented at the meeting and their count of votes and ballots.

Each side's proxy solicitor will need to work closely with the inspectors of election to minimize issues regarding the submission of proxies.

The time and location of the meeting may be designed to make it logistically more difficult for the dissident to submit proxies. However, such maneuvers are subject to scrutiny under state law and, even if legally permissible, may be viewed skeptically by investors and proxy advisory firms. In addition, the company has substantial latitude to determine:

- When to open and close the polls.
- The order in which business is conducted.
- How much time to allow for discussion.

Companies should have alternative plans for the conduct of the meeting (that is, one plan if the outcome is clear and another if the outcome is close).

In a close contest, the conduct of the meeting will depend on whether the company is ahead or behind. If the company is ahead, it will run the meeting with the goal of closing the polls as rapidly as possible. If the company is behind, it may stall for time by starting the meeting behind schedule, making presentations and allowing remarks from the floor, or even leaving the polls open after the formal business of the meeting has been concluded.

Normally, a preliminary announcement of the results of the vote can be made at the meeting. In some cases, the vote will be too close to call; in any event, the vote is not final until a report of the inspectors of election is issued and any legal challenges are resolved. In the recent proxy contest by Trian Fund Management at Procter & Gamble, P&G declared itself the winner at the meeting but, after the vote tabulation was completed, Trian's nominee, Nelson Peltz, was ahead by a mere 43,000 votes and P&G elected not to further contest the vote count.

SETTLEMENT

For many management teams, conducting an extended proxy contest (with all of the attendant costs and distractions) while facing uncertain odds of success is not an attractive strategy. It can also be unappealing to the dissident for whom the costs of solicitation may materially impact the profitability of its investment. Even if the dissident prevails, it is not assured of getting its costs and expenses reimbursed, as this is generally in the discretion of the board. The benefits and risks of fighting a proxy contest must be evaluated taking into account the:

- Stockholder base.
- Credibility of the arguments of each side.
- Quality of the nominees.
- Costs of fighting and diversion of management resources.
- Possible settlement parameters.
- Tactical advantages of fighting versus negotiating a settlement.

Some companies believe it is in their best interests to fight, because they expect to win or to get a better result (losing fewer than all the seats being contested) by fighting, whether temporarily or to the finish. Further, not all dissidents are prepared to conduct a vigorous proxy contest to conclusion.

A settlement may involve a number of elements, including:

- Board representation (dissident nominees or other independent nominees).
- Committee representation.
- A commitment by the company regarding the size of the board.
- Withdrawal by the dissident of all proposals and nominations and agreement to vote for the company's nominees.
- A standstill agreement whereby the dissident agrees to limit its security holdings in the company and refrain from public or private agitation.
- Expense reimbursement.
- Other agreements by the company, such as formation of a special committee, engaging a financial advisor, or agreeing to pursue a specific corporate transaction.

Settlements can occur at all stages of a proxy contest, but a high percentage of settlements occur in the early stages. Data on settlements indicate that when an issuer settles early in the process, the settlement terms are generally less onerous. Both parties usually have a strong incentive to settle early, because the parties often do not get meaningful intelligence about the probable outcome of the vote until very late in process (after significant time and money has been spent). ISS issues its recommendation about ten days before the meeting and most institutions wait for the recommendations of ISS and other proxy advisors before going to their proxy committees to determine their votes. Even if a settlement is not achievable at the preliminary stage, the fact that settlement discussions took place may play to a party's advantage with investors, and discussions may be resumed later in the contest. Settlements may also occur between the start of the campaign and the issuance of the ISS recommendation (at which point one of the parties may feel it has significantly diminished incentive to settle) or, in a very close contest, at any time prior to the vote.

In a notable recent case, the Delaware Chancery Court found that the parties had reached a binding oral agreement to settle a proxy contest (*Sarissa Capital Domestic Fund LP v. Innoviva, Inc.*, 2017 WL 6209597 (Del. Ch. Dec. 8, 2017)). At the end of a conference call the day before the stockholders' meeting, the principals confirmed that they "had a deal." Neither side stated that the deal was contingent upon execution of a written settlement agreement, although a written agreement was in process. Before the settlement agreement was executed, a key stockholder voted in favor of Innoviva's slate. As a result, Innoviva was assured of winning the proxy contest, and it abandoned settlement discussions and held the meeting, with all of Innoviva's nominees being elected. Sarissa successfully sued under Section 225 of the DGCL to enforce the oral settlement agreement.

The decision to settle a proxy contest is not to be taken lightly. Multi-year activist campaigns are now common, many stocks nowadays attract multiple or successive activists, and most activist settlements are for a one-year term. Consequently, a settlement may represent only a period of breathing space for the issuer, not a final resolution.

Moreover, a settlement can lead to significant changes in board composition and dynamics that create dysfunction in the board room and undermine corporate performance. Activist directors generally have plenary access to corporate books and records, and may pursue investigations against management and/or litigation. On the other hand, boards can benefit from new perspectives and the substantial analytical resources that some activist investors offer can add value in the board room. Bringing an activist investor onto the board will require that investor to adhere to the issuer's trading policies and may reduce volatility in the stock. These are all factors an issuer should weigh in deciding the merits of a proxy contest versus a settlement. For more guidance on this issue, see Article, *Dealing with Activist Directors on the Board* ([w-008-5249](#)).

EXAMPLE OWNERSHIP PROFILE

A common share ownership profile for the target in a proxy contest initiated by an activist hedge fund might look as follows:

- Dissident 5-10%
- Other hedge funds 15-20%
- Institution A – 8%
- Institution B – 7%
- Institution C – 5%
- Other ISS subscribers 20-30%
- Other institutional investors 10%
- Insiders and employees 3-5%
- Individual holders and other 5-10%

In this example, the dissident can be assumed on day one of the election contest to have 20% to 30% of the vote by virtue of its direct ownership and the ownership positions of other hedge funds. In this scenario, the recommendation of ISS is pivotal, since if ISS recommends for the dissident and its subscribers follow its recommendation, the company will need virtually every other available vote, and may need to prevail on a number of investors who use ISS to override its recommendation, to win.

The author wishes to thank Annie Chen, an associate in Fried Frank's M&A and Private Equity Group, for her assistance in updating this resource.

ABOUT PRACTICAL LAW

Practical Law provides legal know-how that gives lawyers a better starting point. Our expert team of attorney editors creates and maintains thousands of up-to-date, practical resources across all major practice areas. We go beyond primary law and traditional legal research to give you the resources needed to practice more efficiently, improve client service and add more value.

If you are not currently a subscriber, we invite you to take a trial of our online services at [legalsolutions.com/practical-law](https://www.practical-law.com). For more information or to schedule training, call **1-800-733-2889** or e-mail referenceattorneys@tr.com.