

AGENDA

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Can Renewed Calls for Universal Proxies Change Voting?

By Lindsay Frost December 18, 2017

Close and controversial high-profile proxy contests at Procter & Gamble and ADP have again raised questions about the proxy voting process in the U.S. Shareholders are continuing calls for the use of universal proxy ballots in contested director elections as regulators at the SEC mull the implementation of a universal proxy rule. Meanwhile, Congress sits on the Financial Choice Act — which would prohibit the SEC from ever implementing such a rule.

Governance experts encourage boards to talk to shareholders about improvements to the proxy voting process and prepare for the request of a universal proxy ballot in any future proxy contests at their company. Comment letters to the SEC continue to trickle in as companies and shareholders weigh the pros and cons of universal proxy ballots.

“The adoption of a universal proxy card, at the most basic level, will provide a solution to what is often regarded as a cumbersome voting process when trying to split your vote between issuer and activist,” writes **Michael Verrechia**, managing director of activism and contested situations at **Morrow Sodali**, in an e-mail.

Universal Proxies and Recent Contests

A universal proxy ballot allows for all director candidates in an election to be named on one ballot, giving shareholders an opportunity to mix and match dissident and incumbent candidates as opposed to choosing one slate of candidates versus the other. Most companies tend to reject the use of universal ballots, but shareholders continue to argue for their use.

A proxy contest between data company ADP and Pershing Square’s Bill Ackman last month saw the reemergence of the argument for a universal proxy. Pershing Square’s three nominees lost the contest, with each only receiving between 20% and 30% of the votes. Ackman, in September, requested that the company use a universal ballot for the contest, leaning on the SEC’s rarely used “bona fide nominee” rule, which allows for the dissident to name the management nominees on their ballot, but only with the nominees’ permission, which is rarely given and was not given by ADP.

ADP argued against the use of a universal ballot because the solicitation process had already commenced and shareholders, including its more than 300,000 retail investors, might be confused or disenfranchised. The company also said that it was not the time to try out a new process that has never been used at a large-cap company.

However, Ackman argued that the use of a universal proxy could have given him a better chance at winning a board seat. He noted ISS's recommendation of a withhold vote against the director that Ackman would have replaced.

"Had there been a universal proxy card, this [proxy advisory] firm would have simply recommended a vote for me and I would likely have been elected," Ackman wrote in a statement following the election. "It is incumbent upon all investors to insist that all companies use a universal proxy card in each director election to make sure that shareholders can easily select the directors they wish to represent them."

Another attention-grabbing proxy contest between large-cap consumer goods company P&G and Trian Fund Management's Nelson Peltz has caused governance experts to bring up universal ballots as a way to improve the time-consuming proxy voting system. After an initial vote that left him 6 million votes short, Peltz called for an independent recount, and as of late November, he was proclaimed the victor by a slim margin of 40,000 votes. Shareholders and governance experts question whether the universal proxy would have made a difference.

Most sources interviewed by *Agenda* said a universal proxy would have made a difference only if more dissident seats were being voted on. However, Jacob Williams, corporate governance manager at the Florida State Board of Administration, says a universal proxy would have given the investors more choices than the limited option of Peltz versus incumbent director Ernesto Zedillo.

"Having two slates, two voting cards for investors to choose from and two different cards for tabulators to tally, all reflect the complexity," writes Williams in an e-mail. "With a universal ballot, the Peltz appointment to the board would seem more certain."

Scott Hirst, a professor at Harvard Law School and author of a recent paper on universal proxies, argues that in contests similar to ADP's where shareholders withheld votes for directors instead of voting for another director on a different ballot, a universal proxy could have resulted in the election of the other nominee. For example, a proxy fight between Macellum Capital Management and Citi Trends in May resulted in the election of one dissident and one incumbent nominee. Hirst says more than 4 million votes were withheld from the Macellum nominees. If there had been a universal proxy, shareholders withholding their votes from Macellum nominees would likely have voted for incumbent nominees, and vice versa.

Shareholders Want a Fair Fight

Shareholders continue pressing for a universal proxy because it would place more emphasis on the quality of directors as opposed to who is nominating them, create equal opportunities for all nominees and give shareholders who cannot attend the annual meeting in person the same rights as those who can.

“Without a universal proxy in place, holders are left to make voting decisions between two competing proxy cards,” Verrechia says. “The holder’s shares are then counted on whichever card is voted, and in some cases there can be unintended consequences of voting one card versus the other.”

Hirst argues in his paper that “unilateral voting” disenfranchises shareholder voters and leads to distorted outcomes. His analysis says that 11% of proxy contests between 2001 and 2016 had distorted outcomes. He also argues that allowing for a universal ballot would improve outcomes for management.

For example, Williams says that in a 2008 contest between CSX and The Children’s Fund and 3G Capital, the availability of a universal proxy allowed the fund to split their vote, which reportedly became the swing vote allowing management to win.

“If the CSX vote had been all or nothing, then the SBA likely would have voted the entire dissident slate, which would have possibly eroded more of CSX’s incumbent board of directors than it did,” Williams says. “CSX realized this possibility, so it created a universal ballot that included all nominees and permitted shareowners to vote for any nominee they wished as long as only a total of 12 nominees were selected. This procedure allowed the SBA to exercise its entire vote by voting for the dissident and incumbent candidates that it desired to elect.”

Shareholders also say that the universal proxy would have little impact on director elections, so companies should allow it as an option. The Council of Institutional Investors argues that contested elections are “exceedingly rare” in the U.S., with only 12 short-slate and three full-slate contested director elections at Russell 3000 companies in 2017. Using data from ISS, they claim the universal ballot would impact fewer than 1% of director elections. The CII and other experts also say a universal proxy would make the proxy voting process more democratic.

“The universal proxy would reduce the gamesmanship and help shift the focus to a comparison of individual director qualifications,” Williams says. “Ideally, the adoption of universal proxy balloting by the SEC would allow investors to allocate support so distinctly in every proxy contest.”

Companies Wary on Use

According to comment letters to the SEC and public statements by companies, the most common argument against universal proxies was that the ballots would confuse shareholders. Other

arguments include that universal proxies could create more proxy contests at significantly higher costs to companies and their shareholders, exacerbate short-termism, increase over-voting, and create more defective ballots.

In a comment letter, the Chamber of Commerce's Center for Capital Markets Effectiveness wrote, "The Proposing Release suffers from a number of fatal flaws because it would increase the frequency and ease of proxy fights for dissident shareholders, favor activist investors over rank-and-file shareholders and other corporate constituencies, hamstring boards of directors and encourage balkanization of the board, conflict with common advance notice bylaw provisions, further empower proxy advisory firms ... and violate issuers' (and dissidents') First Amendment rights."

The Society for Corporate Governance argued in its comment letter that "mixed boards" might negatively impact a board's effectiveness.

The commission has received 39 comment letters on the universal proxy rule. In July, the SEC moved the universal proxy off its short-term agenda and onto its long-term agenda, indicating it won't be dealt with any time soon.

Hirst says the SEC should consider setting a universal proxy as the "default" and give companies the choice to opt out of the rule if investors approve. Or, he says, the SEC can make universal proxies voluntary instead of mandatory, as the current rule is written.