Proxy contests for board representation or control have increased in frequency as activist strategies have become an established feature of the investment and governance landscape. In recent years, dissident stockholders have been consistently successful in using proxy contests to achieve strategic or governance changes. US public companies and their advisors therefore need to understand the dynamics of the proxy contest process, risk mitigation strategies and how to maximize their chances of prevailing.

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.

Over the past ten years there has been an 87% increase in frequency of proxy contests. On average, 60 proxy contests were initiated at US public companies each year for the period 2001–2005 and 112 for the period 2006–2010 (Proxy Fight Trend Analysis, SharkRepellent). Today the most common types of proxy contests are those seeking board representation or control by activist stockholders seeking short-term profits. The proxy contest serves as a tool to drive change, including:

- Adding directors who are sympathetic to the activist’s goals or bring fresh perspectives to the board, orchestrating a change in executive management and 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.

In recent years, dissidents who initiated a proxy contest have gained one or more board seats by running a successful campaign or settling before the vote in more than 50% of contests at listed companies. Besides traditional proxy contests, investors today have other tools available to express dissatisfaction and drive change, including “withhold the vote” campaigns. Assuming the current litigation challenge to the SEC’s new proxy access rule, Securities Exchange Act Rule 14a-11, is ultimately dismissed, another important mechanism will be available for dissidents to contest elections of directors (see Box, A Note on Proxy Access).

Given the increased frequency of proxy contests and other forms of dissident stockholder campaigns, it is important for general counsels and securities lawyers to develop a familiarity with the dynamics of a proxy contest, including:

- Investor relations environment.
- Importance of advance preparation.
- Timing and strategic considerations.
- Key legal considerations.
- Methods of fighting a proxy campaign.
- Settlement options.

This article is based on a Practice Note available on practicallaw.com. For this continuously maintained resource, search Proxy Contests on our website.
INVESTOR RELATIONS
ENVIRONMENT

Proxy contests are, in essence, like political election campaigns. It is important to understand prevailing voter, or stockholder, sentiment. Developments since the late 1990s have made proxy contests much more challenging for companies, including:

- 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.
- The near disappearance of the individual investor (who historically has been pro-management).
- The growing influence of proxy advisory firms, such as Institutional Shareholder Services (ISS).
- The decline of structural takeover defenses.
- The internet, which offers a plethora of tools to encourage investor dissatisfaction.
- Changes in federal regulation of proxy solicitation, which have dramatically reduced the compliance burdens and costs associated with communications by and among stockholders.

Simply put, the environment favors dissidents.

ADVANCE PREPARATION

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 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.

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 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 were in process for some time and have no causal connection with the dissident’s activities. In addition, enhancing communication with stockholders can increase stockholder support for management’s strategy and reduce their susceptibility to value creation arguments a dissident might raise (see Box, Self-assessments).

TIMING AND STRATEGIC CONSIDERATIONS

TIMING

Proxy contests typically 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 or by stockholder action by written consent, it is often more difficult to use those avenues for a proxy contest because they may be subject to higher vote requirements or procedural complexities.

Most public companies have advance notice provisions in their by-laws relating to stockholder nominations for directors and stockholder proposals. Advance notice nomination provisions establish a “window” during which nominations 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. 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 is foreclosed from proposing nominees.

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

- Accumulating a significant ownership stake (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 is expecting its notice of nominations.

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.

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 or five 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 below Settlement).

**STRATEGY**

Generally, there will be at least two weeks (and 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 before it starts a public fight with the dissident, which may include making changes to the annual meeting calendar, to the extent that this is to the company’s advantage. 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.
- The company prefers to negotiate with the dissident before mailing its proxy statement.

Because shares will trade in the market between the announcement of the meeting date and the meeting itself, setting a record date close to the annual meeting will reduce the “empty voting” problem associated with transfers of shares between the record and meeting dates. However, this may not always be to the company’s advantage and the company’s advisors should be consulted to determine the appropriate strategy.

**SELF-ASSESSMENTS**

Companies should conduct periodic self-assessments focusing on:

- **Financial and stock price performance**
  - One-, three- and five-year performance review, with particular focus on performance relative to peers
- **Available value creation strategies**
  - Recapitalization
  - Divestitures/business separations
  - Sale of the company
  - Acquisitions
  - Operational improvements
  - Capital allocation
- **Corporate governance**
  - Board and committee leadership, composition and effectiveness
  - Compensation
  - Related party transactions
  - Other “red flag” issues, such as accounting restatements, FCPA issues, code of ethics violations or other compliance issues
  - Responsiveness to stockholders (transparency of communications, handling of stockholder proposals, withhold votes)
- **Structural defenses**
  - Board structure — annual versus classified
  - Ability to call special meeting/act by consent
  - Advance notice provisions
  - Poison pill
- **Stockholder base and relationships with key holders**
  - Presence of significant supportive investors
  - Mix of long-term versus short-term holders
  - Hedge fund ownership
  - Insider ownership
  - Known activists or “wolf pack” investors
  - Investor turnover

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. 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’ recommendation, or on the views of key stockholders, must be taken into
ASSEMBLING THE TEAM

Each side in a proxy contest needs a team, including a variety of professional advisors. Companies that have engaged in advance preparation may have a team already in place. Generally, the team consists of:

- Senior executives, directors and nominees.
- Head of investor relations of the company.
- Outside legal counsel.
- Financial public relations firms.
- Proxy solicitors.
- 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 and the dissident’s nominees may also need to participate actively in the contest. These individuals may need to attend investor meetings and meetings with proxy advisory firms such as ISS. In addition, directors (and nominees) may act as important advocates with specific stockholders by virtue of their participation on other corporate boards or executive teams.

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 and so-called “fight” letters (see below Platform and Strategy), 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.

PROXY SOLICITORS

The proxy solicitor plays a critical role as tactical advisor and administrator. The leading firms understand the investors’ voting inclinations and behaviors, have constructive relationships with key investors and the proxy advisory firms and play a valuable role in assessing the odds of success and which arguments are likely to carry weight with investors. They also run the solicitation process, which requires substantial organization and manpower.

INVESTMENT BANKERS

Many companies will also engage an investment banker in connection with a proxy contest. The investment bankers can contribute greatly to the development of the campaign platform, strategy and tactics and to shaping the company’s response to the dissident’s data, which may be skewed by cherry picking particular measures, time periods or peer groups. They too may have important senior level relationships with investors that can be beneficial in the solicitation process.

For more information on assembling a team, search Proxy Contests on our website.

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 the following:

(i) Any request for a proxy whether or not accompanied by or included in a form of proxy;
(ii) Any request to execute or not to execute, or to revoke, a proxy; or
(iii) 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 account before deciding to make significant changes in the annual meeting schedule.

KEY LEGAL CONSIDERATIONS

The solicitation of proxies is governed by Section 14 of the Securities Exchange Act of 1934, as amended (Exchange Act) and Regulation 14A under the Exchange Act. Revisions to the rules in 1999 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.”
- The ability to engage in solicitation before furnishing a proxy statement.
- Exemption of certain communications from the proxy rules.
- The content of the proxy statement and proxy card.
- Filing requirements for written soliciting materials.
- Disclosure and anti-fraud rules.

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.

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that appear to be designed to influence stockholders’ voting decisions.

However, the term “solicitation” does not include “[a] communication by a security holder who does not otherwise engage in a solicitation...stating how the security holder intends to vote and the reasons therefor” (Rule 14a-1(l)(iv)). Having influential investors publicly announce their voting intentions, as permitted by the rule, can be of significant value.

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, e-mails and internet postings.

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 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:

(i) 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; and

(ii) 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)).

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 (the “Rule of Ten”).

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)).

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 a party 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.

Persons that rely on Rule 14a-2(b) 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

Any solicitation other than on behalf of the company where the total number of persons solicited is not more than ten is exempt from the proxy rules (other than the anti-fraud requirements). At companies with extremely concentrated share ownership,
it may be possible to obtain the votes or consents needed to prevail in a contest without soliciting more than ten holders.

**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 below 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, designed to ensure that the proxy card itself is an impartial document. 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).

But 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 belogistically challenging and is quite rare in practice.

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.

One potential appeal of the new proxy access rule, Rule 14a-11, to dissidents and investors, is that in a Rule 14a-11 campaign the company will be required to provide on its proxy card a means to vote for each company and proxy access nominee, enabling investors to vote for any combination of company and dissident nominees (see Box, A Note on Proxy Access).

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.

**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 standard for materiality under Rule 14a-9 was clarified by the US Supreme Court in TSC Industries v. Northway:

An omitted fact is material if there is a substantial likelihood that a reasonable stockholder would have considered 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 (1976).)
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, the SEC’s general policy is to leave those 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. However, in practice litigation for federal or state law claims 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 based on one principal criterion: whether it increases the chances for success in the proxy contest.

### FIGHTING THE CAMPAIGN

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

- The composition of the stockholder base and their likely voting inclinations.
- How to develop an effective platform and strategy.
- The impact of ISS and other proxy advisory firms.
- The solicitation process.
- Tactical maneuvers, including conduct of the annual meeting.

### 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:

- Actively managed mutual funds.
- Wealth management companies.
- Index funds.
- 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 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

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**A NOTE ON PROXY ACCESS**

At the time of going to press, the SEC has agreed to stay Rule 14a-11 and related amendments to Rule 14a-8 pending resolution of a legal challenge by the Business Roundtable and the US Chamber of Commerce, but the rule ultimately is likely to take effect. The new rule expands both the time period and the range of circumstances in which companies will be vulnerable to an election contest at the annual meeting.

Under Rule 14a-11, nominating stockholders or groups who satisfy a 3%, three-year continuous ownership and holding period requirement will be permitted to submit nominations between 150 and 120 days prior to the anniversary date of the mailing of the previous year’s proxy statement, for up to 25% of the seats on the board of directors. Unions, state pension funds and governance activists, which currently account for a significant majority of stockholder proposals, are expected to form nominating groups to submit alternative nominees for director. Early indications are that institutional investors will generally be cautious about initiating proxy access campaigns.

Financial activists face certain hurdles in using proxy access. But it is difficult to envision them not using this new means of agitation in some situations, since it increases the time period during which the board is confronted with the threat of a contest and enables the activist to “test the waters” through its filings under Rule 14a-11 and discussions with potential nominating group members. In addition, activists will still retain flexibility to switch to a traditional proxy contest.

The proxy access mechanism eliminates some of the costs and burdens of a traditional proxy contest. However, serious efforts to change corporate boards via Rule 14a-11 will require a vigorous solicitation effort. Many of the practical and strategic considerations discussed above with regard to traditional proxy contests will apply equally to proxy access campaigns.

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For more information on the anti-fraud and disclosure rules applicable to proxy statements, search Proxy Statements on our website.
in some cases automatically follow their proxy advisory firm’s recommendation.

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.

Given the dominant position of ISS among proxy advisory firms, maximizing the likelihood of getting the support of ISS is important (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’ report), to persuade them to attach lesser weight to its 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.

The strategy 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.
- Strong, or improving, financial or operational metrics (or the contrary, in the case of the dissident).
- Good governance practices.
- The quality and effectiveness of its nominees.
- Weaknesses in the other party’s platform and slate of nominees.

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. In addition to fight letters, each party’s soliciting materials will include investor presentations and press releases. The parties may also conduct media interviews, orchestrate favorable editorials or articles by third parties and encourage other investors to speak out in support.

However, a strictly investor relations and public relations campaign may not be a sufficient strategy, particularly for a company with a record of under-performance confronted by a credible, well-funded dissident. Additional actions may be necessary to win investors’ support. 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 undertaking a strategic review or return of capital.

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**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:

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

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.
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 less effective.

**PROXY ADVISORY FIRMS**

Almost all institutional investors use a proxy advisory firm (and in some cases, multiple firms). The proxy advisor’s recommendation varies from influential to decisive. ISS is the dominant proxy advisory firm, with Glass Lewis having the second largest market share. 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. 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’ 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, if the proxy contest is 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 the majority of 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.

The statistics show that, in contests at companies with a market cap above $100 million, over a five-year period ISS has supported one or more dissident nominees more than 60% of the time. The statistics also show a strong correlation between ISS’ recommendations and proxy contest outcomes, with about two-thirds of contests being won by the party that obtained ISS’ recommendation.

**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.

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.

**TACTICAL MANEUVERS**

One of the advantages the company has is that it chooses the time and place of the meeting and runs the meeting. For example, 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 may even leave the polls open after the formal business of the meeting has been concluded.

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.

According to SharkRepellent’s Proxy Fight Trend Analysis, there has been a significant increase in the frequency of settlements over the past decade. From 2001–2004, on average about 22% of proxy contests were settled. Beginning in 2005, the frequency of settlements has increased, with an average of 37% of contests settled in years 2005–2010.

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. There is a strong incentive to settle early, because the parties often do not get meaningful intelligence about the 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.