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Proxy Advisory Firms Clarify Voting Policies on Proxy Access and Unilateral Bylaw Amendments

On the heels of SEC Chair White's direction to the Division of Corporation Finance to review its position on proxy proposal conflicts under Exchange Act Rule 14a-8(i)(9), both Institutional Shareholder Services ("ISS") and Glass Lewis have issued clarifying policies on proxy access, entering the fray of what is becoming the hottest debate this proxy season. The publication of ISS's updated policy in particular means that market forces may have outpaced the SEC's review process. In order to avoid risking a withhold or no-vote recommendation from ISS against their directors, many companies will be faced with the choice of (i) including any shareholder-submitted proxy access proposal in their proxy materials (either alone or alongside a management proposal) (ii) excluding the shareholder submitted proposal on the basis of a court ruling or no-action relief from the Division of Corporation Finance on a basis other than Rule 14a-8(i)(9) (conflict with management proposal) or (iii) obtaining withdrawal of the proposal by the shareholder proponent.

Proxy Access

Glass Lewis estimates that approximately 100 companies will receive proxy access shareholder proposals in 2015, with the majority being submitted by the New York City Comptroller as part of the New York City pension funds' "Boardroom Accountability Project". In mid-January 2015, SEC Chair Mary Jo White directed the Division of Corporation Finance to review its position on Exchange Act Rule 14a-8(i)(9), which allows a company to exclude a shareholder proposal from its proxy materials if it "conflicts" with the company's own proposal to be submitted to shareholders at the same meeting. Pending such review, Corporation Finance will express "no views" on the application of Rule 14a-8(i)(9), leaving companies in a quandary about what to do if they find themselves in the situation of having conflicting proxy proposals. (See our [previous Client Memorandum](#) on this development.)

While previously operating on a "case-by-case" approach to evaluating proxy access proposals, ISS has now adopted a more definitive position, stating that it will generally support management and shareholder proxy access proposals that have (i) a share ownership threshold of 3% or less, with minimal or no limits on the number of shareholders that can form a proposing group, (ii) a share ownership duration of three years or less for each shareholder in the proposing group and (iii) a cap on nominees of generally 25% of the board. Expectedly, ISS will now generally recommend against proposals that are more restrictive than the foregoing, while reviewing any other prescriptions for reasonableness.

ISS further stated that it will generally recommend a vote against one or more directors if a company chooses to exclude a properly submitted shareholder proposal from its proxy materials (regardless of whether there is a conflicting management proposal or not) except where (i) the proponent has voluntarily withdrawn its proposal, (ii) the company has received SEC no-action relief or (iii) the company has obtained a U.S. District Court ruling allowing exclusion. If, however, the company has taken unilateral steps to implement the proposal, ISS will take into account the extent to which the proposal is implemented and any material restrictions added to it.

While Glass Lewis also published its views on proxy access late last month, it continues to take what is essentially a case-by-case perspective. Glass Lewis stated that while significant, long-term shareholders should be able to nominate their own board representatives, the possible distraction and disruption to a company dictates that minimum ownership, holding period and shareholder nominee caps are reasonable. Unlike ISS, Glass Lewis did not specify what those thresholds should be, but provided general principles of analysis. When considering shareholder proposals, Glass Lewis will review such proposals to assess whether they are “overly prescriptive”, contain minimum ownership calculations that could be abused or would unduly or unnecessarily burden the company or the board.

Glass Lewis will review company responses to a proxy access shareholder proposal for reasonableness and proportionality. When considering management proxy access proposals, Glass Lewis will review the proposal to ensure that it does not present overly burdensome hurdles or other restrictions that would “fundamentally vitiate” the proxy access right. Further, for alternate management proxy access proposals, Glass Lewis will examine numerous factors, including whether the company proposal varies materially from the shareholder proposal with respect to ownership, holding period and nominee cap thresholds; the company’s performance and governance profile; the board’s independence, leadership, responsiveness to shareholders and oversight; the opportunities for shareholders to effect change (such as the ability to call a special meeting); and the company’s rationale for its alternate proposal. Finally, Glass Lewis may recommend against certain directors if the management’s proposal is materially different from the shareholder proposal without sufficient rationale.

Other Updates

In addition to the foregoing proxy access policy updates, ISS also clarified its prior released policy to recommend a vote against the board if it unilaterally adopts a bylaw or charter amendment that materially diminishes, or is materially adverse to, shareholder rights. Under this updated policy, ISS stated that the following bylaw amendments are generally not considered materially adverse (although each will be evaluated on a case-by-case basis):

- Advance notice bylaws that set customary and reasonable deadlines;
- Director qualification bylaws that require disclosure of third-party compensation arrangements; and

- Exclusive forum provisions (when the venue is the company's state of incorporation).

ISS has, however, also included a lengthier list of amendments that would be considered materially adverse, including the following:

- Authorized capital increases that do not meet ISS's Capital Structure Framework;
- Board classification to establish staggered director elections;
- Director qualification bylaws that disqualify shareholders' nominees or directors who could receive third-party compensation;
- Fee-shifting bylaws that require a suing shareholder to bear all costs of a legal action that is not 100 percent successful;
- Increasing the vote requirement for shareholders to amend the company's bylaws or charter;
- Removing a majority vote standard and substituting plurality voting;
- Removing or restricting the right of shareholders to call a special meeting (including raising thresholds or restricting agenda items); and
- Removing or materially restricting the shareholder's right to act in lieu of a meeting via written consent.

We note that ISS has issued other FAQs on its independent chair, equity plan scorecard and selected compensation policies. For all of these updated ISS policies, see <http://www.issgovernance.com/policy-gateway/2015-policy-information/>

For Glass Lewis's proxy access views, see <http://www.glasslewis.com/blog/glass-lewis-views-proxy-access-developments/>

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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