

Alert

SEC Disclosure and Corporate Governance

Heads Up for the 2016 Proxy Season

ISS Issues Long-Awaited Proxy Access FAQs: Identifies Problematic Provisions

Institutional Shareholder Services (ISS) has published revised [FAQs](#) for its U.S. Proxy Voting Policies and Procedures, including two new FAQs directly related to proxy access.

This Alert provides an update to our Alerts dated October 21, 2015 (available [here](#)) on Navigating Proxy Access and November 23, 2015 (available [here](#)) on ISS and Glass Lewis Updated Voting Policies.

Proxy Access Updates

- Since our October 21, 2015 alert, 54 more companies have adopted proxy access bylaw provisions. As expected, momentum continues to grow as companies have begun to receive proposals for the 2016 proxy season.
- ISS's new FAQs provide guidance on whether ISS is likely to recommend a vote against directors after the company has adopted a proxy access bylaw in response to a majority-supported shareholder proposal. ISS will examine whether:
 - The *major points of the shareholder proposal were implemented*.
 - Company-adopted provisions not contained in the shareholder proposal *unnecessarily restrict the use of a proxy access right*.
 - The bylaw contains material restrictions that are more stringent than those included in the shareholder proposal, including with respect to the following: (i) ownership thresholds above 3%; (ii) ownership duration longer than 3 years; (iii) aggregation limits below 20 shareholders; or (iv) a cap on nominees below 20% of the board.
 - The bylaw contains "especially" problematic provisions that ISS views as *effectively nullifying the proxy access right*, which are (i) aggregation limits that count individual funds within a mutual fund family as separate shareholders, and (ii) a requirement to hold company shares after the annual meeting.
 - The bylaw contains certain other "potentially" problematic provisions, especially when used in combination.
- ISS has not provided guidance on how it will evaluate a proxy access bylaw adopted in other contexts (*i.e.*, not in response to a majority-supported shareholder proposal), or how it will evaluate competing shareholder and management proposals.
- ISS's new FAQs also provide guidance as to how it would assess whether to recommend in favor of a proxy access nominee.

Board Responsiveness to a Majority-Supported Shareholder Proxy Access Proposal

Lack of responsiveness (as evaluated by ISS) by the board of directors to a majority-supported proxy access shareholder proposal could result in a negative voting recommendation by ISS against individual directors, nominating/governance committee members, or the entire board. The new FAQ provides the following guidance on ISS's assessment of a board's responsiveness:

- ISS will evaluate whether *the major points of the shareholder proposal were implemented* by the proxy access bylaw adopted by the company.
- ISS will examine other terms of the adopted bylaw that were not included in the shareholder proposal to assess whether they *unnecessarily restrict the use of a proxy access right*.
- ISS will review whether the adopted proxy access bylaw provision contains material restrictions that are more stringent than those included in the shareholder proposal, including with respect to the following:
 - Ownership thresholds above 3%
 - Ownership duration longer than 3 years
 - Aggregation limits below 20 shareholders
 - Cap on nominees below 20% of the board

During the 2015 proxy season, this 3% / 3-year / 20 shareholders / 20% of the board formulation was largely supported by shareholders. As expected, some proposals received thus far for the 2016 proxy season are more specific as to the proxy access formulation acceptable to the proponent. For example, proposals from active shareholder proponents James McRitchie and John Chevedden require:

- No limits on aggregation;
- Cap on nominees at 25% of the board; and
- That no additional restrictions should be applied to the proxy access nominations or renominations that are not also applied to other board nominees.¹

Much to the delight of many companies, the proposal submitted by the NYC Comptroller (the primary proponent of proxy access in 2015) for the 2016 proxy season mirrors the Comptroller's 2015 proposal and does not expressly prohibit limitations on aggregation.²

Spotlight on Aggregation Limits. Proxy access proponents have generally supported the Council on Institutional Investors (CII) view on proxy access "Best Practices,"³ including with respect to providing shareholders with unlimited ability to aggregate with other shareholders to meet proxy access requirements. Only 6 of the 107 companies that have adopted proxy access in 2015 thus far, provide for unlimited aggregation. Although companies may feel comforted by ISS's apparent support of an aggregation limit of 20 shareholders, the FAQ provides that in cases where a company's aggregation limit or the cap on nominees differs from what was specifically stated in the shareholder proposal, ISS may issue a negative vote recommendation when the company does not disclose its specific shareholder outreach efforts and engagement. It is unclear how ISS will view a proxy access bylaw adopted by a company containing an aggregation limit, when the majority supported shareholder proposal did not expressly prohibit a limitation (such as the proposal submitted by the NYC Comptroller).

Problematic Provisions

The FAQ identifies two restrictions on proxy access that it views as “especially” problematic, because they are so restrictive as to *effectively nullify the proxy access right*:

- Counting individual funds within a mutual fund family as separate shareholders for purposes of an aggregation limit; and
- The imposition of post-meeting shareholding requirements for nominating shareholders.

We expect that ISS categorizing the imposition of a post-meeting shareholding requirement as an “especially” problematic provision will cause many companies that have already adopted a proxy access bylaw to revisit their bylaws. While proxy access bylaws adopted in 2015 generally did not include an aggregation limit on mutual fund families, more than half of the proxy access bylaws adopted in 2015 did include provisions that require nominating shareholders to provide a statement of intent to maintain ownership after the meeting.

Five “potentially” problematic provisions were also identified by ISS, especially when used in combination:

- Prohibitions on resubmission of failed nominees in subsequent years;
- Restrictions on third-party compensation of proxy access nominees;
- Restrictions on the use of proxy access and proxy contest procedures for the same meeting;
- How long and under what terms an elected shareholder nominee will count towards the maximum number of proxy access nominees; and
- When the right will be fully implemented and accessible to qualifying shareholders.

Every proxy access bylaw adopted in 2015 contains one or more of these provisions, with varying degrees of prevalence; however, it is not clear which individual or combination(s) of these provisions in a proxy access bylaw will be viewed by ISS as more problematic than others.

Evaluation of Proxy Access Nominees

As we discussed in our Alert on ISS’s 2016 Policy Updates (available [here](#)), ISS has added an analytical framework for evaluating proxy access nominees, which it had previously treated the same as proxy contest nominees. ISS has created “additional analytical latitude” for evaluating proxy access nominees, which it states was informed by related policies in international markets, such as the UK & Ireland, Europe, Japan and Australia. In evaluating whether to recommend in favor of a proxy access nominee, ISS will consider any relevant factors including, but not limited to: (i) nominee/nominator specific factors (*e.g.*, nominators’ rationale, critique of management/incumbent directors, and the nominees’ qualifications for directorship); (ii) company specific factors (*e.g.*, relative company performance, the board’s track record and responsiveness, independence of directors/nominees, governance profile, current board composition and the presence of any ongoing controversies); and (iii) election specific factors (*e.g.*, whether the number of nominees exceeds the number of available seats and the voting standards for director elections).

Other FAQs

Two additional sets of FAQs related to U.S. executive compensation policies (available [here](#)), and equity compensation plans (available [here](#)) were also issued by ISS on December 18, 2015.

What to Do Now:

- **For companies that received a majority supported proxy access shareholder proposal in 2015 and have (or not yet) adopted a proxy access bylaw in response:**
 - Review the ISS FAQ on board responsiveness. Understand that *how* the proxy access right is implemented will be scrutinized by ISS.
 - Evaluate whether your proxy access bylaw contains material restrictions that are more stringent than those included in the majority-supported proxy access shareholder proposal. ISS has provided guidance on four restrictions that it views as material. Understand that, at minimum, a bylaw that includes an ISS-deemed “especially” problematic provision will be viewed by ISS to *effectively nullify the proxy access right*.
 - Evaluate whether your proxy access bylaw includes any “potentially” problematic provisions, and carefully consider which of these provisions is most important to your company. Understand that there is a lack of clarity as to which one or combination of such provisions could be viewed as nonresponsive and possibly result in a negative recommendation in the election of your directors. While not specifically stated by ISS, proxy statement disclosure of shareholder engagement efforts relating to the adoption of specific provisions could support your board’s decision to adopt these provisions.
 - If a proxy access shareholder proposal received majority support in 2015, but you did not adopt a proxy access bylaw, be prepared to receive a negative recommendation from ISS in the election of directors.
- **For companies that have adopted a proxy access bylaw either voluntarily or in response to a negotiated and withdrawn shareholder proposal:**
 - The FAQ does not provide guidance on how ISS will evaluate a proxy access bylaw adopted in other contexts (*i.e.*, not in response to a majority supported shareholder proposal). Continue to stay informed and monitor proxy access developments.
 - Evaluate whether your proxy access bylaw contains any ISS-deemed “potentially” or “especially” problematic provisions to anticipate possible criticism from ISS and any future proxy access shareholder proposals.
- **For companies whose shareholder proposal deadlines have not passed and who have not yet received a proxy access proposal (or for companies where a proxy access proposal did not receive majority support):**
 - Wait-and-See Approach – Continue to stay informed, monitor proxy access developments, and engage with and understand the position of your key shareholders. Consider preparing a draft proxy access bylaw to keep “on the shelf.”
 - Proactive Approach– Consider whether to adopt a more “company-friendly” proxy access bylaw ahead of your 2016 annual meeting in order to decrease your vulnerability to receiving proxy access proposals on terms that are less favorable to you and to demonstrate a proactive commitment to corporate governance.
- **For companies that will have a competing management proposal on the agenda at their 2016 annual meeting:**
 - ISS has not addressed how it will evaluate a competing management and shareholder proposals. On the other hand, Glass Lewis has stated, in its updated 2016 Proxy Voting Policies, that it will consider the following factors when reviewing conflicting proposals: (i) nature of the underlying issue; (ii) benefit to shareholders by implementing the proposal; (iii) materiality of the differences between the terms of the conflicting proposals; (iv) appropriateness of the provisions considering your shareholder base, corporate structure and other relevant circumstances; and (v) the Company’s overall governance profile, specifically responsiveness to shareholders evidenced by response to previous shareholder proposals and adoption of progressive shareholder rights provisions.
 - Understand the positions of your key shareholders and engage with them to garner their support. This will be critical to defeating a proxy access shareholder proposal in favor of a management-supported proxy access bylaw.

ENDNOTES

¹ See, e.g., James McRitchie, Avoiding Proxy Access Lite: QUALCOMM Proposal (Sept. 23, 2015), available at <http://www.corpgov.net/2015/09/avoiding-proxy-access-lite-qualcomm-proposal/>.

² See Office of the Comptroller of New York City, Boardroom Accountability Project, available at <http://comptroller.nyc.gov/boardroomaccountability/bap-proxy-access-proposal/> for an example of the NYC Comptroller's 2015 proxy access proposal.

³ See Council of Institutional Investors, Proxy Access: Best Practices (August 2015), at 3-5, available at http://www.cii.org/files/publications/misc/08_05_15_Best%20Practices%20-%20Proxy%20Access.pdf.

* * *

If you have any questions on these matters, please do not hesitate to speak to your regular contact at Weil, Gotshal & Manges LLP or to any member of Weil's Public Company Advisory Group:

Howard B. Dicker	Bio Page	howard.dicker@weil.com	+1 212 310 8858
Catherine T. Dixon	Bio Page	cathy.dixon@weil.com	+1 202 682 7147
Lyuba Goltser	Bio Page	lyuba.goltser@weil.com	+1 212 310 8048
P.J. Himelfarb	Bio Page	pj.himelfarb@weil.com	+1 214 746 7811
Ellen J. Odoner	Bio Page	ellen.odoner@weil.com	+1 212 310 8438
Adé K. Heyliger	Bio Page	ade.heylinger@weil.com	+1 202 682 7095
Kaitlin Descovich	Bio Page	kaitlin.descovich@weil.com	+1 212 310 8103
Joanna Jia	Bio Page	joanna.jia@weil.com	+1 212 310 8089
Megan Pendleton	Bio Page	megan.pendleton@weil.com	+1 212 310 8874
Reid Powell	Bio Page	reid.powell@weil.com	+1 212 310 8831

We thank our colleague Joanna Jia for her contribution to this alert.

© 2015 Weil, Gotshal & Manges LLP. All rights reserved. Quotation with attribution is permitted. This publication provides general information and should not be used or taken as legal advice for specific situations that depend on the evaluation of precise factual circumstances. The views expressed in these articles reflect those of the authors and not necessarily the views of Weil, Gotshal & Manges LLP. If you would like to add a colleague to our mailing list, please [click here](#). If you need to change or remove your name from our mailing list, send an email to weil.alerts@weil.com.