

November 20, 2015

**ISS Releases 2016 Policy Updates:**  
**Focuses on Board Changes to Bylaws and Charters;**  
**Defers Action on Proxy Access**

Institutional Shareholder Services Inc. (“ISS”) today released its 2016 Benchmark Policy Update (the “Update”). The Update revises ISS’s Proxy Voting Guidelines, and will generally apply to ISS’s recommendations at stockholder meetings held on or after February 1, 2016. The Update incorporates, to some extent, the results of its annual Policy Survey (the “Survey”) and its annual Policy Consultation (the “Consultation”), which were addressed in our previous client memos. Although we disagree with some of ISS’s proxy voting policies, we continue to commend ISS for soliciting the views of market participants each year. As always, we urge each company to review (a) the voting policies of each of its major shareholders and (b) the extent to which each of these shareholders relies on ISS, as this information will assist the company in determining the potential impact of ISS’s recommendations and in guiding any company outreach to shareholders. Below is a summary of the most significant changes that may affect Maryland public companies.

**Unilateral Charter and Bylaw Amendments:** Last year, ISS introduced a policy of recommending against directors if a board unilaterally amends the charter or bylaws to, in ISS’s view, “materially diminish shareholder rights.” The Survey and Consultation explored the possibility of expanding this policy to recommend against directors (a) for multiple annual meetings and (b) for actions taken prior to or in connection with a company’s IPO. As a result, the Update states that any unilateral charter or bylaw amendment that classifies the board, establishes supermajority voting requirements or reduces shareholders’ rights to amend the bylaws will generally be met with adverse vote recommendations for director nominees (except for non-incumbent nominees, who will be evaluated case by case) until the amendment is either “reversed or submitted to a binding shareholder vote.” This policy raises the prospect of negative ISS recommendations for the same directors across multiple years for one action.

In our view, penalizing directors for more than one annual meeting further exacerbates ISS’s already disproportionate reaction to these singular corporate decisions. We continue to be amazed that ISS would recommend against directors for adopting just one bylaw amendment that ISS does not like, even though those same directors may have guided the company to sound, even outstanding, economic performance. This change is particularly important to Maryland public companies as the boards of these companies generally have the right to unilaterally classify the board, amend the bylaws and take other actions in the companies’ best interests.

ISS, in its Consultation, mentioned The Macerich Company, a Maryland corporation, as an example of a company that earlier this year committed to declassify after receiving pressure from the investment community. However, ISS misses the point: Macerich was able to successfully protect itself from an undervalued, unsolicited takeover offer by unilaterally classifying its board in the first place, giving it valuable leverage and time to negotiate, which it did. Yet, ISS is continuing to use its outsized influence to dissuade companies from availing themselves of reasonable and limited protections.

In addition, ISS will now generally recommend against director nominees (except for non-incumbent nominees, who will be evaluated case by case) at newly-public companies if, prior to or in connection with an IPO, the board adopts bylaw or charter provisions “adverse to shareholder rights.” ISS does not list which specific bylaw or charter provisions are subject to this new policy. ISS says it will

evaluate director nominees case by case in subsequent years until the adverse provisions are “reversed or submitted to a vote of public shareholders.”

This result is particularly egregious because, prior to the IPO, a company’s corporate governance profile is clearly disclosed to all potential purchasers, who then have the opportunity to evaluate a company’s corporate governance profile before making their investment decision. Contrary to what ISS may think that shareholders want, there may be investors who buy the stock *because of* those provisions that offend ISS. Furthermore, pre-IPO companies have ample opportunities to negotiate with underwriters representing the interests of prospective investors to arrive at prudent corporate governance policies for that company. In a society that purports to value pluralism and in an economy that purports to value choice, we do not believe that ISS should attempt to substitute its own “we know what’s best for you” vision of corporate governance at all public companies from day one.

Externally Managed Entities: ISS will now recommend against the Say-On-Pay proposal at externally-managed entities “when insufficient compensation disclosure precludes a reasonable assessment of pay programs and practices applicable to . . . executives.” As is well known, ISS’s recommendations on Say-On-Pay proposals are very influential; indeed, our most recent experience has been that, absent other issues, institutional holders tend to link their votes on director re-election to their views on the company’s executive compensation. A potential recommendation against a Say-On-Pay proposal by ISS will almost certainly motivate externally managed entities, including many investment companies and real estate investment trusts formed under Maryland law, to increase their compensation disclosure in their proxy statements.

Overboarding: ISS currently recommends against individuals who serve on more than six public company boards. Beginning with annual meetings held on or after February 1, 2017, ISS will recommend against directors who sit on more than five public company boards. For CEOs who serve at more than two outside boards, ISS continues its policy of recommending against those outside directorships.

Other Minor Changes: The Update states that ISS will consider any unique, company-specific factors that are relevant when evaluating director nominees who were submitted via proxy access; details of this framework will be included in a FAQ document to be released by ISS in December 2015. Additionally, ISS made several clarification changes to its policies on shareholder proposals regarding animal welfare, pharmaceutical pricing and climate change—further suggesting a move by ISS into non-governance policies.

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As always, our colleagues and we are available at any time to discuss these or other matters of Maryland law.

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