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Update on Power to Amend Bylaws: More Companies Waiting and Seeing

As companies begin filing their proxy statements for 2017, we continue to receive questions about whether Maryland companies should yield to the demands of Institutional Shareholder Services Inc. ("ISS") that they give up the exclusive power of the board – permitted by Maryland law – to amend the bylaws. ISS has announced in its voting policy updates for 2017 that it will recommend against incumbent members of a board's nominating and governance committee if shareholders do not have a concurrent right to amend the entire bylaws by a vote of no more than a bare majority of the votes entitled to be cast. We addressed this issue at length in earlier memos (ISS Releases 2017 Policy Changes: Focus on Bylaws Under Maryland Law and Proxy Statements under Maryland Law – 2017) and most recently and comprehensively in a later memo, (Addressing Board Exclusive Control of the Bylaws: Stop, Look and Wait). (While the latter was prepared for two recent conference calls of REIT general counsels, its focus is not limited to REITs.) If your board or governance committee is still considering this issue, we suggest reviewing these memos.

In addition to these memos, we have been making the following points to clients, many based on recent observations and discussions:

First, the trend we are seeing now appears to be running in favor of not taking action at this time but waiting and seeing how the issue develops later this proxy season and after. We believe that this approach is the most prudent course for now as it seems premature to take action before a consensus develops in the market on whether adoption of concurrent shareholder power to amend the bylaws is a good policy and, if so, any sensible conditions and limitations. Giving shareholders the concurrent power to make binding amendments to the bylaws is effectively a *one-way ratchet*. Once given, this power may be viewed as a right that may not be taken away from shareholders without their consent.

Second, we have been told that some dedicated REIT investors are not planning to follow ISS on the bylaws issue. Other major holders may follow.

Third, in assessing the percentages of REITs that have adopted concurrent shareholder power to amend the bylaws, we think it is appropriate to set the lodging REITs aside because much of the pressure on these companies has come from a lodging labor union that has repeatedly used its nominal shareholdings at many lodging companies to campaign for various corporate governance measures, most recently concurrent shareholder power to amend the bylaws. The union obviously has economic and other interests that differ from the interests of shareholders generally and, therefore, we believe that lodging companies are not appropriately comparable to other REITs (much less to non-REITs) generally.

Fourth, we have previously recommended discussing the issue with major shareholders and not limiting the discussion to just this one issue but, instead, including in the discussion a "full deck" of information about the company, its economic performance and its corporate governance. It continues to baffle us that ISS frequently recommends against one or more, and sometimes all, of the directors based on as few as one corporate governance measure undertaken (or not undertaken) by the board, *regardless of the company's economic performance* under the board's stewardship. Thus, while boards are considering this issue, we believe that the burden should be on proponents of giving shareholders the concurrent right to amend the bylaws to explain how taking this effectively irreversible step is in the "best interests" of the company. We have not seen any data supporting a correlation – much less a causal link – between concurrent shareholder power to amend the bylaws and economic performance by the company.

Fifth, if the members of the nominating and governance committee do not receive sufficient support from major shareholders and ISS, the board may change its position at any point, even before the annual meeting and votes are cast and counted, and agree to adopt concurrent shareholder power to amend the bylaws, perhaps with some negotiated terms. In addition, if nominating and governance committee members do not receive the requisite vote in an uncontested election, they will, under most current bylaws, typically hold over, offer to resign and (if their offers are not accepted) remain on the board, giving the board further time to assess the matter over the following months.

Finally, if the board decides not to adopt concurrent shareholder power to amend the bylaws at this time, it may want to issue a statement, perhaps in its proxy statement, that it has considered the matter carefully and that, as the issue and its ramifications are still developing, not all relevant information is known yet and, therefore, the board will continue to monitor and consider the issue over the coming several months, consult with major investors, take the advice of advisers and gather other information, including the decisions of boards and shareholders of other companies later this year. (*See* Public Storage Proxy Statement.)

As always, my colleagues and I are glad to discuss this matter with you further.

Jim Hanks