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ISS Releases 2017 Policy Survey: Focus on Maryland

Institutional Shareholder Services Inc. (“ISS”) last week released its annual Policy Survey. In keeping with its prior practice, ISS seeks responses from institutional shareholders, issuers, directors and other market constituents on a wide range of corporate governance matters. The Policy Survey is generally a good indicator of the areas in which ISS is considering a policy change for its voting recommendations in the forthcoming proxy season. While we often disagree with ISS’s policies, we applaud it for soliciting the views of market players. Below is a brief summary of three subjects on which ISS is seeking input for the 2017 proxy season that may be of particular interest to publicly traded Maryland-formed companies.

1. Amending the Charter to Adjust the Number of Authorized Shares. In 1995, the Maryland legislature authorized the declaration of trust of a Title 8 REIT to include a provision allowing the board of trustees to amend the declaration unilaterally to increase (or decrease, but never below the number issued) the number of authorized shares. In 1999, this power was extended to boards of directors of Maryland corporations. Since then, in our experience, the charters or declarations of the overwhelming majority of Maryland public companies (especially REITs) have included this power (the “Authorized Shares Provision”), and it has proven to be indispensable in enabling many share-based transactions to proceed without the delay of a shareholders meeting to obtain approval.

The Authorized Shares Provision, which we believe to be unique to Maryland, is especially useful for REITs, which must continually access capital markets. We see a close analogy here to charter provisions authorizing “blank check” stock. These provisions empower the board to authorize the issuance of shares with market-based terms in time-sensitive global capital markets and have been nearly universally adopted by public companies for many years. As shareholders already entrust the board to make good business decisions on the issuance of blank check stock—not to mention entrusting the board with the power to issue unlimited amounts of debt—it is consistent to permit the board to determine the amount of common equity that is right for the company. (Maryland-formed corporations registered as open-end investment companies under the Investment Company Act of 1940 rely on the a pre-1995 authorized shares provision for the conduct of their routine operations.) Common equity, preferred equity, secured and unsecured debt, leases and licenses are all part of the overall financing of a company, which should be well within the business judgment of the board, subject, as always, to the shareholders’ power to elect (and remove) directors. This is especially true now that a heavy majority of boards are no longer classified.

In the Policy Survey, ISS asks whether it should begin to “consider recommending against directors at Maryland REITs who have failed to opt-out of the provisions that give the board the ability to . . . increase the number of authorized shares without shareholder approval.” We are not aware of any recent shareholder proposals calling for a charter amendment to divest the board of the power to increase or decrease the number of authorized shares. By comparison, in the last two years alone, there have been over 175 proposals to include a proxy access provision in the bylaws

and over 50 proposals to mandate an independent chairman of the board. Yet, ISS does not propose recommending against directors at companies who do not affirmatively conform to those trends and, in its other publications, ISS has not previously addressed the Authorized Shares Provision. We suspect ISS is concerned that a company with an Authorized Shares Provision will misuse it by, for instance, increasing the number of authorized shares and then issuing the shares, either to a friendly party to defeat a takeover attempt that has broad shareholder support or for less than fair market value. We are unaware of any such misuse and ISS gives no recent examples. It seems to us misguided for ISS to interfere with a company's ability to access the capital markets on favorable terms (and thereby maximize shareholder value) because of the mere potential of misuse.

2. Amending the Bylaws to Withdraw Exclusive Board Power to Amend. Under Maryland law, the bylaws of a Maryland corporation (or Title 8 REIT) may provide that the board of directors (or board of trustees) has the sole power to amend the bylaws (the "Bylaw Provision"). The Policy Survey asks whether ISS should "consider recommending against directors at Maryland REITs who have failed to opt-out of the provisions that give the board the ability to amend the bylaws."

We are concerned about this question for several reasons. First, these provisions have been in the Maryland General Corporation Law (the "MGCL") for many years without any significant issues. Second, giving the shareholders the concurrent power to amend the bylaws may invite mischievous and harmful proposals, such as limiting the rights of directors and officers to indemnification and advance of expenses in the event of litigation. Third, much of the impetus for repealing bylaw provisions giving the board the exclusive right to amend the bylaws has come from a labor union with members in the hospitality and gaming sectors. This union typically owns only a nominal numbers of shares, often not much more than the minimum required to file a shareholder proposal under Rule 14a-8, and clearly has different economic interests from the interests of shareholders generally. Shareholders with typical economic interests simply have not been submitting these proposals. Fourth, as in the case of the Authorized Shares Provision, the shareholders retain the ultimate power to elect (or remove) directors and trustees. Finally, we do not consider these proposals to be accurate indicators of corporate governance trends, and therefore we question the wisdom of ISS relying on these provisions as the basis for a negative vote recommendation on directors.

3. Subtitle 8. ISS asks in the Policy Survey whether it should recommend against incumbent director nominees at Maryland corporations if the corporation has not affirmatively opted out of Subtitle 8 of Title 3 of the MGCL ("Subtitle 8").* We have often written about the operation of Subtitle 8, its benefits to Maryland companies and their shareholders and recent efforts to encourage opting out of Subtitle 8. See [Opting Out of "MUTA" Is Still a Bad Idea](#), [Green Street Takes a Wrong Turn](#) and [Board Classification in Maryland: Evaluating Section 3-803 of the MGCL](#). Because Subtitle 8 remains useful for Maryland companies and their shareholders,

* Subtitle 8 is sometimes mistakenly referred to as "MUTA," for "Maryland Unsolicited Takeovers Act." In fact, there is no act by that name. Subtitle 8 was enacted as one part of S.B. 169, now chapter 300 of the 1999 Laws of Maryland. S.B. 169 was titled "Unsolicited Takeovers" and included many provisions other than Subtitle 8.

we continue to urge boards of directors and trustees not to opt out of Subtitle 8 and thereby retain the undeniable leverage of Subtitle 8 in the event the board ever decides to negotiate with an unsolicited bidder for control. We recommend reviewing [Getting Nothing for Something](#), published by REIT Zone Publications in September 2014, detailing our reasons for not opting out of Subtitle 8, which remain as valid today as two years ago.

4. Conclusion. We are concerned by ISS's pressure on boards of directors and trustees, by threat of negative vote recommendations, to opt out of Subtitle 8 and to remove the Authorized Shares Provision and the Bylaw Provision. Subtitle 8, the Authorized Shares Provision and Bylaw Provision have been accepted by the market for years and we are not aware of any data correlating these provisions to negative economic performance.

The release of the Policy Survey is the first step in ISS's annual policy update process. The next steps for the 2017 proxy season are likely to occur as follows:

- Policy Survey Closes – August 29, 2016
- Policy Survey Results Released – Late September
- Proposed Updates to Proxy Voting Guidelines – October
- Open Comment Period for Proposed Guidelines – October
- Final Updates to Proxy Voting Guidelines Released – November

We urge interested companies to review the Policy Survey as it may affect them. We would be happy to review with you the Policy Survey and ISS's policies as they relate to your company's current corporate governance.

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As always, our colleagues and we are available to discuss these or other matters.

Jim Hanks
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