

ISS Raises the Stakes on Shareholder Proposal Votes: Will Recommend Against Electing Boards that Fail to Respond to Majority-Supported Shareholder Proposals in 2013

November 19, 2012

Institutional Shareholder Services ("ISS") has made it much more difficult for boards to disregard advisory votes on shareholder proposals. In the proxy advisory firm's 2013 updates to its influential proxy voting guidelines released on November 16, 2012, ISS announced that, beginning in 2014, it would recommend a vote "against" or "withhold" from directors (except new nominees) if the board failed to act on a shareholder proposal that received the support of a *majority of votes cast* during the 2013 proxy season or subsequent years.^[1] Previously, and for the 2013 transition season, ISS's policy is to recommend a negative board vote if the board fails to act on a shareholder proposal that either received the support of a *majority of the shares outstanding* the previous year, or that received the support of a majority of shares cast in the last year and one of the two previous years.

In October 2012, ISS had proposed adopting the new board responsiveness policy for 2013 director elections.^[2] But it appears that ISS has been persuaded by commentators who criticized a 2013 implementation of the policy change that would have, in effect, retroactively penalized board inaction regarding 2012 shareholder proposal votes. Had the policy been adopted as proposed, the policy change, according to ISS, would have increased the number of companies facing a negative vote recommendation in 2013 by 24.

ISS attributes its change in policy to what it calls an evolving marketplace in the matter of board responsiveness to majority-supported shareholder proposals, in both institutional investors' expectations, and in the practices of issuers. ISS asserts that 86% of the investors that participated in its 2012-2013 policy survey "expect that the board should implement a shareholder proposal that receives support from a majority of shares cast in the previous year." At the same time, ISS observed an increasing willingness of companies to conform to majority-supported shareholder proposals. It reported that 50% of the proposals that received only one year of a majority of votes cast in 2012 were implemented, as compared to 37% in 2009.

Although it is difficult to establish a strictly causal relationship between proxy advisors' recommendations and voting outcomes, according to a 2012 study commissioned by the Investor Responsibility Research Center Institute, academic researchers have found strong correlations between proxy advisors' recommendations and shareholder voting outcomes.[\[3\]](#)

2012 Voting Results that Could Have Exerted Much Greater Pressure on Boards

The Conference Board's "Proxy Voting Fact Sheet,"[\[4\]](#) which examines shareholder proposals made during the first six months of 2012, indicates that of 719 shareholder proposals filed during that period with the Russell 3000 companies, the largest proportion of those proposals related to corporate governance—352 proposals. Even after eliminating the proposals that were withdrawn or appropriately excluded by issuers under SEC Rule 14a-8, approximately two-thirds of the 352 proposals (232) were voted on.

The results of those shareholder votes on governance proposals illustrate the potential impact of the ISS policy change on board responsiveness. On average, only 37.6% of the shares outstanding were voted in favor of the proposals, well under ISS' old standard that triggered a negative director vote recommendation only if a majority of the outstanding shares were voted for a proposal the prior year. However, the average "for" vote among all votes actually cast on shareholder governance proposals was 49.2%, a hair's breadth away from a majority vote that would put pressure on those boards to implement the related proposals.

How Can Boards Prepare for 2013 Shareholder Proposals?

In view of ISS' policy change, which goes a long way toward making mandatory those shareholder votes that are technically advisory, boards may wish to consider:

- engaging with shareholders whose proposals appear not to fully account for important countervailing considerations,
- mounting a campaign to actively oppose, rather than simply recommend against, shareholder proposals that are ill-advised, or
- as appropriate, launching an alternative proposal for a vote of shareholders.

Assuming a shareholder proposal qualifies for inclusion in a company's proxy statement (i.e., it may not be excluded on any of the grounds specified in SEC Rule 14a-8), companies have the opportunity, long before the matter is actually submitted to a vote of shareholders, to persuade the proponent to withdraw its proposal. Proposals that relate to corporate social responsibility, in particular, lend themselves to productive dialogue in which companies and proponent shareholders jointly seek out paths for successfully mediating social and corporate objectives. Often, proposals are withdrawn on the basis of (a) mitigating corporate considerations that the proponent was not fully aware of prior to such dialogue, or (b) a program crafted by the issuer that meets most, if not all, of the shareholder proponent's objectives.

Barring a productive dialogue with a proponent that leads to a proposal's withdrawal, boards can choose either to campaign against the proposal or preempt it, as permitted under SEC Rule 14a-8(i)(9), by putting its own proposal to a shareholder vote.

Whatever response or sequential responses a board chooses to avail itself of – advance preparation, in most cases, led by the board's corporate governance committee – should contribute substantially to a more balanced and effective process.

[1] <http://www.issgovernance.com/files/2013USPolicyUpdates.pdf>

[2] <http://www.issgovernance.com>

[3] Robyn Bew and Richard Fields. "Voting Decisions at US Mutual Funds: How Investors Really Use Proxy Advisers."

[4] <http://www.conference-board.org/publications/publicationdetail.cfm?publicationid=2275>

- **Robert A. Cantone**