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ISS Updates Voting Policies for the 2011 Proxy Season

Institutional Shareholder Services, Inc. (ISS) recently published its 2011 Corporate Governance Policy Updates, indicating changes to how it will recommend its clients vote on various matters in the 2011 proxy season. Although the changes continue the trend of narrowing directors' discretion in areas traditionally within the board's authority, they are more incremental than fundamental this year, reflecting the degree to which power over corporate decision-making has already shifted in recent years from the boardroom towards shareholders, including activists and special interest groups. Companies will need to pay attention to these changes, given ISS' status as the *de facto* standard setter in the corporate governance area (a fact we have urged the SEC to consider in its "proxy plumbing" review).

The changes do not include a revision to ISS' position on independent board chair proposals. ISS had proposed tightening its policy on separation of chair and CEO positions by requiring companies to demonstrate both the presence of a "counterbalancing governance structure" (such as an independent lead director) *and* "compelling company-specific circumstances that challenge the efficacy of appointing an independent chair" to avoid an ISS recommendation in favor of a separation proposal. ISS ultimately rejected this change however, and will for now continue to focus on the presence of a "counterbalancing" structure and the absence of what ISS considers "problematic" performance, governance or management issues in determining how to recommend on proposals to separate the chair and CEO positions.

"Say When on Pay" & "Say on Golden Parachutes". ISS has adopted new policies that address the "say when on pay" and "say on golden parachutes" votes called for by the Dodd Frank Act. With respect to the frequency of say on pay, ISS will recommend *annual* advisory votes to maximize "accountability." With respect to say on golden parachutes, ISS will make recommendations on a case-by-case basis, taking into account the degree to which a company's arrangements feature any "problematic pay practices." For a company seeking to satisfy the golden parachute vote requirement by including specified golden parachute disclosure in an annual meeting proxy featuring a say on pay vote, ISS may give higher weight to the golden parachute arrangements in its say on pay analysis.

Problematic Pay Practices. ISS has revised (and shortened) its list of pay practices that may be sufficiently problematic individually to warrant a recommendation to vote against a company's say on pay proposal or, in specified circumstances, a director "withhold" vote recommendation. The revised list of "egregious" practices includes repricing underwater options without prior shareholder approval, "excessive" perks, and new or extended agreements that provide for change-in-control payments that are single trigger, exceed three times salary and bonus, or include an excise tax gross-up. Amending auto-renewing ("evergreen") agreements that contain problematic features may "receive particular scrutiny." Finally, ISS generally will no longer consider a company's commitment to eliminate "problematic" pay practices as a way of preventing or reversing a negative vote recommendation. This policy shift on commitments, which is effective immediately, is yet another example of the shrinking flexibility that companies will face in the upcoming proxy season.

Action by Written Consent. ISS will generally continue to support proposals to enable shareholders to act by written consent (which it describes as a "fundamental shareholder right"), but will vote case-by-case on consent proposals if, among other factors, the company's existing governance structure includes an "unfettered" right for 10% of the shareholders to call a special meeting (and no staggered board, plurality voting in director elections or rights plan that has not been approved by shareholders). The new 10% special meeting standard may be significant as it affords activists another tool to press for a "one-size-fits-all" lowest common denominator approach against companies that already have sensible thresholds of 20% or 25% to call a special meeting.

Action on Majority-Supported Shareholder Proposals. A board of directors will now face an across-the-board "withhold" or "against" vote if they do not act on a shareholder proposal that received the approval of either (i) a majority of the shares outstanding in the previous year or (ii) a majority of votes cast in the last year and in *one of the two previous years*. ISS' previous policy applied the "votes cast" standard only if the proposal had received such support in both of the two immediately preceding years. ISS explained the change by saying that the absence of a proposal from the ballot in an interim year should not preclude application of the "withhold" policy, but the policy as written is broader, and it is unclear if ISS would only apply it to situations where the proposal in question was absent from the ballot in the interim year.

Capital Structure. ISS will generally continue to assess proposals to increase a company's authorized number of shares of common or preferred stock on a case-by-case basis, but has revised its method for determining the "cap" on an allowable increase which, for the 2011 proxy season, will generally be 100 percent of existing authorized shares (with lower thresholds applied in certain circumstances). ISS has also toughened its policies with respect to reverse stock splits, particularly where authorized shares are not proportionately reduced.

Net Operating Loss ("NOL") Protections. In another example of "one-size-fits-all" policy-making, ISS will now recommend against protective charter or bylaw amendments or shareholder rights plans aimed at preserving a company's NOLs if the effective term of the amendment or rights plan would exceed the *shorter* of three years and the exhaustion of the NOL. Amendments or plans with shorter durations would be assessed on a case-by-case basis. The Delaware Supreme Court recently upheld a 4.99% rights plan to protect a company's NOLs.

Other Changes. ISS will now apply the US voting policies to the approximately 74 foreign-incorporated issuers that file regular SEC reports and are thus considered domestic issuers by the SEC and has tightened the standards for what ISS will consider an acceptable excuse for a director missing a quarter of board and committee meetings (including requiring that such explanations be publicly disclosed). ISS also flagged the linking of executive compensation to environmental and social criteria as a possible agenda item for the future (although no change is made this year) by noting that "the issue appears to be moving into the mainstream" and removing "policy language that did not reflect the evolving discourse."

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