
Beyond the Basics: An In-Depth Review of the Secondary Features of Proxy Access Bylaws

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INTRODUCTION

U.S. companies' adoption of proxy access bylaws—which give qualifying shareholders the right to nominate director candidates on the company's proxy ballot—in response to shareholder pressure has been the big corporate governance story of 2015 and 2016.

Presently, nearly 40 percent of S&P 500 companies provide a proxy access right; by summer 2017, the majority of the companies in the S&P 500 may provide proxy access, along with 15-20 percent of the S&P 400 index. As of June 30, 2016, 252 U.S. companies in the Russell 3000 have adopted some form of proxy access; only 16 of these companies had adopted proxy access before 2015.

While much of the discussion around proxy access centers on its growing currency across corporate America, less attention has been paid to the variety and nuances of individual proxy access bylaws, which set important boundaries around the right.

Consensus Reached on Basic Proxy Access Features

The basic features of proxy access bylaws are largely consistent—they generally enable a shareholder or a group of up to 20 shareholders who have held 3 percent of the company's stock for 3 years to nominate up to 20 percent of the board. This so-called 3/3/20/20 structure, which is similar in some respects to the standard the SEC set forth when it promulgated Rule 14a-11 mandating proxy access in 2010,¹ has taken hold as the most widely adopted model. Only 16 companies that adopted proxy access bylaws in 2015 and 2016 have more restrictive basic features.

Bylaw Focus Shifts to the Finer Points of Proxy Access

With a greater degree of conformity on the basic attributes, the focus is shifting to the bylaws' secondary features, such as the treatment of loaned shares, nominees' conflicts of interest, and re-nomination restrictions. An understanding of how these features can shape the right is critical for companies considering adopting a right, shareholders evaluating the reasonableness of companies' actions, regulators monitoring shareholder proposals, and journalists covering all of these developments.

These secondary features are on the verge of receiving more scrutiny than they ever have, in light of a decision in July by the SEC's Division of Corporation Finance to allow a shareholder proposal seeking to modify secondary features of H&R Block's existing proxy access bylaw on the ballot at its upcoming

¹ Rule 14a-11, which was ultimately vacated by the U.S. Court of Appeals for the D.C. Circuit in 2011, would have enabled shareholders who had held 3 percent of a company's stock for 3 years to nominate up to 25 percent of the board, with no grouping restrictions. See SEC Final Rule 14a-11: Facilitating Shareholder Director Nominations, adopted Nov. 10, 2010.

<https://www.sec.gov/rules/final/2010/33-9136.pdf>

shareholder meeting (see inset). It's an important precedent that has ramifications for similar proposals at other companies, such as one recently submitted to Microsoft, and if the H&R Block proposal is successful at the ballot, expect to see a proliferation of these proposals.

In this report, after briefly detailing the prevalence of the bylaws' basic features, we'll group the sixteen secondary features summarized in Table 1 on the next page into five categories—nuances of the basic features, managing potential conflicts of interest, the interplay between proxy access and proxy contests, the aftermath of a nomination, and general considerations—before surveying the landscape of these provisions.

Finally, we provide some thoughts on what these bylaws mean for companies and shareholders. There have not been any proxy access nominations yet at U.S. companies, and the number of proxy access nominations may remain quite low for some time: the shareholders most likely to meet the ownership requirements are the least likely to use the right. Smaller activist owners will attempt to enlist larger institutions to form nominating groups, especially at companies where concerns about responsiveness or engagement are present. However, even if proxy access remains lightly used, the real value of these bylaws for shareholders lies in the negotiating leverage they provide.

The H&R Block Proposal

H&R Block adopted a proxy access bylaw in June 2015. In March 2016, James McRitchie and Myra Young filed a shareholder proposal to strengthen four provisions of H&R Block's bylaw, including two secondary features—counting loaned shares as owned and eliminating restrictions on the re-nomination of proxy access nominees.

The company filed for no-action relief from the SEC's Division of Corporation Finance, arguing that it could exclude the proposal from its ballot because it had "substantially implemented" the proposal by having adopted a proxy access bylaw.

But on July 21, in an unexpected decision, the SEC staff sided with the proponents and allowed the proposal to make the ballot. The company then included the proposal in its proxy statement filed July 26 for its shareholder meeting on September 8.

Table 1: Prevalence of various secondary features in proxy access bylaws

Secondary Feature	Category	Number	Percent
The company restricts or disqualifies nominees who are officers or directors of competitors	Potential conflicts of interest	215	85.3%
The company restricts or prohibits proxy access and proxy contests at the same meeting	Interplay with proxy contests	191	75.8%
The proxy access nomination deadline is different from the advance notice deadline	Interplay with proxy contests	181	71.8%
The company restricts the resubmission of failed nominees	Aftermath of a nomination	179	71.0%
The max number of proxy access candidates may be reduced by elected nominees	Aftermath of a nomination	178	70.6%
The company has a post-meeting holding requirement	Nuances of the basic features	88	34.9%
The allowed period for recalling loaned shares is shorter than 5 days or is not specified	Nuances of the basic features	84	33.3%
The board has broad authority to interpret the proxy access bylaw provisions	General considerations	70	27.8%
The max number of proxy access candidates may be reduced by advance notice nominees	Interplay with proxy contests	48	19.0%
Loaned shares do not count as owned	Nuances of the basic features	37	14.7%
The company prohibits voting commitments	Potential conflicts of interest	36	14.3%
The company prohibits third-party compensation in connection with directorship	Potential conflicts of interest	35	13.9%
Funds within the same mutual fund family do not count as one shareholder	Nuances of the basic features	27	10.7%
Shareholders are disqualified from nominating future candidates if their nominee is elected	Aftermath of a nomination	26	10.3%
The bylaw does not expressly allow for a 500-word shareholder supporting statement	General considerations	8	3.2%
The company prohibits third-party compensation in connection with candidacy	Potential conflicts of interest	2	0.8%

Source: SEC filings.

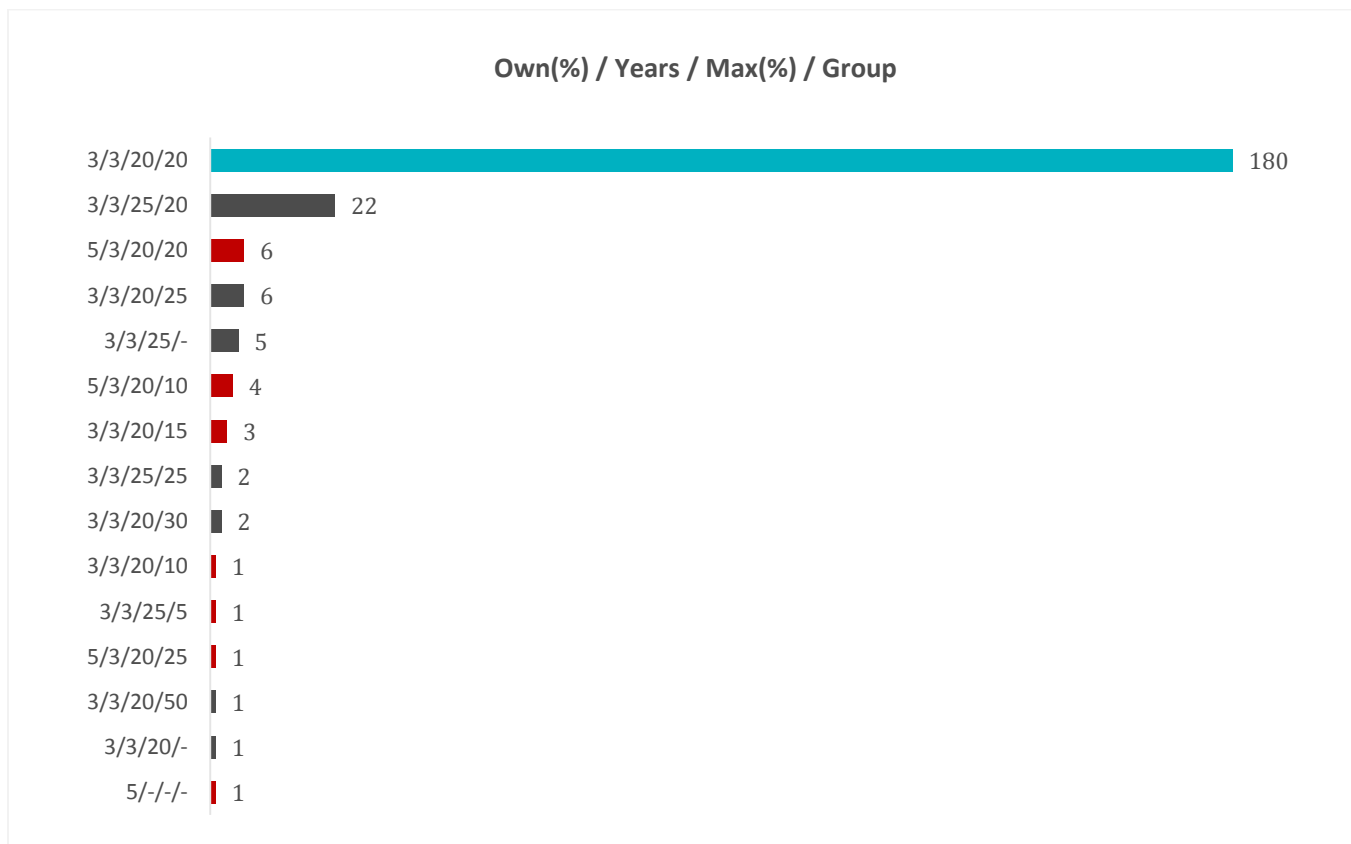
BASIC BYLAW FEATURES

The 3/3/20/20 structure appearing in most proxy access bylaws contrasts with what most shareholder proposals seek, which is to allow shareholders owning three percent of company shares for at least three years to nominate up to 25 percent of the board, with no limit on the number shareholders that could aggregate their shares to meet the ownership thresholds—known as 3/3/25.

Fourteen companies adopted proxy access bylaws prior to 2015, two companies adopted proxy access policies prior to 2015, 119 companies adopted proxy access bylaws in 2015, and 117 adopted proxy access bylaws in 2016, as of June 30.

For the 236 companies that adopted proxy access bylaws in 2015 and 2016, the following chart shows the prevalence of each variation of the basic features. Most companies—76 percent—have adopted 3/3/20/20; only five companies have adopted 3/3/25, as requested by shareholders.

Figure 1: Prevalence of the basic proxy access features in bylaws adopted in 2015 and 2016



Source: ISS QuickScore and SEC filings. Data as of June 30, 2016. Entries in green represent basic features that are more shareholder-friendly than the 3/3/20/20 norm; entries in red represent more restrictive basic features.

Prior to 2015, only four of the 16 companies that adopted proxy access used 3/3/20/20 or something less restrictive. Below is a chart of the pre-2015 adopters and their basic proxy access features, with more restrictive features in bold.

Table 2: Companies that adopted proxy access prior to 2015

Company Name	Adopted Date	Own(%)	Years	Max(%)	Max(#)	Group
Covanta Holding Corporation	3/15/2004	20%	-	-	1	1
EMCORE Corporation	8/7/2008	20%	-	-	1	-
American Railcar Industries, Inc.	6/30/2009	5%	2	-	-	-
LSB Industries, Inc.	2/18/2010	5%	1	25%	-	-
Hooper Holmes, Inc.	6/1/2010	5%	1	33%	-	-
KSW, Inc. (now private)	1/5/2012	5%	1	-	1	1
The Western Union Company	3/11/2013	3%	3	20%	-	-
Hewlett-Packard Company	11/26/2013	3%	3	20%	-	20
Panhandle Oil and Gas Inc.	12/11/2013	5%	1	-	1	1
Nabors Industries Ltd.*	4/14/2014	5%	3	-	1	1
Verizon Communications Inc.	5/1/2014	3%	3	20%	-	20
Enterprise Financial Services Corp*	5/22/2014	3%	3	25%	-	1
CenturyLink, Inc.	6/2/2014	3%	3	20%	-	10
Chesapeake Energy Corporation	6/19/2014	3%	3	25%	-	-
Darden Restaurants, Inc.	11/11/2014	3%	3	25%	-	10
Kilroy Realty Corporation	12/11/2014	5%	3	25%	-	10

*These companies have proxy access policies, not bylaws.

Source: ISS QuickScore and SEC filings.

SECONDARY BYLAW FEATURES

We examined all 252 companies that allowed proxy access as of June 30, 2016, to determine the prevalence of a number of important restrictions.² The provisions we examined fall into five categories:

- 1) nuances around the basic requirements, such as the treatment of loaned shares and the presence of post-meeting ownership requirements;
- 2) a nominee's potential conflicts of interest, like voting and compensation arrangements with third parties;
- 3) the interplay between proxy access and advance notice, especially regarding when the use of one precludes the use of the other;
- 4) the aftermath of a proxy access nomination, including restrictions on the re-nomination of failed proxy access candidates; and
- 5) general considerations, like the extent of the board's authority to interpret the other provisions of the proxy access bylaw.

GROUP 1: Nuances of the Basic Features

Allowing for loaned shares to count as “owned”

Investors have paid close attention to whether proxy access bylaws expressly provide for shares owned by an investor and loaned to another investor to count as “owned” for purposes of meeting the ownership and duration thresholds. The instructions to the vacated Rule 14a-11 expressly provided that loaned shares would be considered continuously owned if the nominating stockholder had the right to recall the loaned shares. In arriving at this decision, the SEC said that it realized that share lending is a common practice and “loaning securities to a third party is not inconsistent with a long-term investment in a company.”

Many of the first adopters of proxy access did not include language expressly providing for loaned shares to count as owned. Starting in 2015, as companies began to engage more with shareholders around the drafting of these bylaws, the issue of loaned shares came to the fore as a shareholder concern. In response to this concern, 215 bylaws (85 percent of those adopted by June 30, 2016) now expressly provide for loaned shares to count as owned.

² We included the two companies that have adopted proxy access policies, rather than bylaws—Nabors Industries Ltd. and Enterprise Financial Services Corp—and one company that is no longer publicly traded—KSW, Inc.

Table 3: Allowing for loaned shares to count as “owned”

Do Loaned Shares Count as Owned?	Number	Percent
Yes	215	85.3%
Silent	37	14.7%

Source: SEC filings.

The number of days allotted for the recall of loaned shares

The SEC specified in its vacated rule that loaned shares must be recalled by a shareholder upon being notified that any of the nominees will be included in the company’s proxy materials; most companies have specified a number of days in which loaned shares must be recalled.

Only 23 of the 215 companies that count loaned shares as owned did not specify when loaned shares must be recalled. 130 companies specify that loaned shares must be recalled within five days, 59 say that loaned shares must be recalled within three days, and one company sets forth a 10-day recall period. Two additional companies said that loaned shares must be recalled “prior to the end of the period in question.”

Table 4: The number of days required to recall loaned shares

What Is the Recall Period for Loaned Shares That Count as Owned?	Number	Percent
5 days	130	60.5%
3 days	59	27.4%
Not specified	23	10.7%
Prior to the end of the period in question	2	0.9%
10 days	1	0.5%

Source: SEC filings. This table examines only the 215 companies that count loaned shares as owned.

The imposition of post-meeting shareholding requirements for nominating shareholders

One provision to which many shareholders have objected is the requirement that nominating shareholders disclose an intention to continuously hold their shares for at least one year after the annual meeting if their nominee is elected. 86 bylaws (34 percent) provide that shareholders must disclose their intentions to hold

shares after the meeting for at least one year after the annual meeting if their nominee is elected, and two have a post-meeting holding requirement with no time period specified. Investors critical of such a holding period argue their investment objectives could change after the nomination deadline.

Table 5: Post-meeting shareholding requirements for nominating shareholders

Does the Company Have a Post-Meeting Holding Requirement?	Number	Percent
No	164	65.1%
Yes, must disclose intentions to hold shares for one year after the annual meeting	86	34.1%
Yes, must disclose intentions to hold shares after the annual meeting	2	0.8%

Source: SEC filings.

Counting individual funds within a fund family as separate shareholders for purposes of an aggregation limit

A central question early in the proxy access debate was exactly what the definition of a shareholder should be. Because most investors hold shares in funds rather than at the institutional level, some companies have taken the approach that each fund within a family should count as a separate shareholder.

An effect of this approach is that, where a maximum of twenty shareholders can group together to reach the three-percent ownership threshold to nominate a proxy access candidate, that three percent would have to be owned not by twenty institutions but by twenty funds—a much harder test to satisfy. And at the few companies that do not permit grouping, one fund would have to hold three percent itself. As a result, there has been significant shareholder pressure to ensure that proxy access bylaws provide that multiple funds within a family combine to count as one shareholder.

Today, 215 bylaws—the vast majority—expressly provide that individual funds within the same family will count as one shareholder for purposes of satisfying the ownership and duration thresholds. 27 companies are silent on the matter, and the question is not applicable to 10 companies because those companies do not have a limit on the number of shareholders who may aggregate their shares as a group. Most of the companies that are silent on this provision adopted proxy access bylaws prior to the 2015 proxy season.

Table 6: Counting individual funds within a mutual fund family as separate shareholders

Do Funds Within the Same Mutual Fund Family Count as One Shareholder?	Number	Percent
Yes	215	85.3%
Silent	27	10.7%
Not applicable (no limit on aggregation)	10	4.0%

Source: SEC filings.

GROUP 2: Provisions Addressing a Nominee’s Potential Conflicts of Interest

Restrictions on third-party compensation in connection with a proxy access nominee’s candidacy

Because direct compensation for a board nominee can raise concerns about conflicts of interest if elected, a number of bylaws deal with the question of whether proxy access nominees receive compensation from third parties (including but not limited to the nominating shareholder) in connection with their candidacy. There are two variations of this provision. In one, the company expressly prohibits third-party compensation in connection with a nominee’s candidacy. In another, the company prohibits third-party compensation in connection with a nominee’s candidacy if it isn’t disclosed to the company.

Most of the adopted bylaws have no restrictions on compensation in connection with candidacy. Ninety-one companies (36 percent) require disclosure of any such arrangements. Only two companies prohibit third-party compensation in connection with candidacy, a stance which often meets with ire from shareholders and proxy advisors.

Table 7: Restrictions on third-party compensation of proxy access nominees

Third-Party Compensation in Connection with Candidacy	Number	Percent
No restrictions on compensation for candidacy	159	63.1%
Disclosure required	91	36.1%
Prohibited	2	0.8%

Source: SEC filings.

Restrictions on third-party compensation in connection with directorships

Similar to restricting third-party compensation in connection with candidacy, many companies restrict third-party compensation in connection with directorship. These provisions would restrict elected nominees from receiving compensation from a hedge fund, for example, for serving as a director at the company—since the director is supposed to serve the interests of all shareholders, not one.

While 181 companies (72 percent) provide that elected nominees may receive third-party compensation in connection with directorship as long as it is disclosed to the company, 35 companies expressly prohibit any third-party compensation in connection with directorship. While many observers agree that active directors should not receive such compensation, some institutional investors believe they should be able to determine on a case-by-case basis whether such compensation would conflict with a director’s ability to represent all shareholders.

Table 8: Restrictions on third-party compensation in connection with directorship

Third-Party Compensation in Connection with Directorship	Number	Percent
Disclosure required	181	71.8%
No restrictions	36	14.3%
Prohibited	35	13.9%

Source: SEC filings.

Restrictions on voting commitments for proxy access nominees

It may come as a surprise that most companies allow individuals who have entered into voting agreements with third parties, which would require them to vote a certain way on issues if elected to the board, to be proxy access nominees as long as those agreements are disclosed to the company. However, 36 companies have adopted bylaws that prohibit proxy access nominees from entering into such voting arrangements. Investors that want to be able to determine for themselves whether these voting commitments would interfere with their ability to represent all shareholders may take issue with this prohibition.

Table 9: Restrictions on voting commitments for proxy access nominees

Treatment of Voting Commitments	Number	Percent
Disclosure required	149	59.1%
No restriction	67	26.6%
Voting commitments prohibited	36	14.3%

Source: SEC filings.

Restrictions on nominees who are officers or directors of competitors

Restrictions on the nomination of candidates who are, or have been, directors or officers of a competitor have been prevalent and contentious. Some companies restrict these nominations by saying that the board may reject the nomination of a competitor. Other companies are more emphatic and disqualify competitors from being nominated by stating that no vote on their nomination shall occur. The definition of “competitor” can vary, but the most common formulation refers to section 8 of the Clayton Antitrust Act, which governs interlocking directorships.³

The most common variation of this provision gives the board discretion to reject nominees who are, or have been, officers or directors of a competitor within the past three years. The second most common variation is an outright disqualification of such nominees. Only 37 companies do not have any restrictions on the nomination of officers or directors of a competitor.

Many investors believe that restricting or disqualifying such nominees would weed out potential candidates who may have relevant industry experience, and that they—not the company—should determine whether such affiliations would conflict with the nominee’s role as a director. In addition, these provisions generally don’t stipulate what would happen if a competitor merges or delists during the lookback period.

³ Section 8 of the Act states: “No person shall, at the same time, serve as a director or officer in any two corporations...that are...competitors such that the elimination of competition by agreement between them would constitute a violation of the antitrust laws.” Companies’ reliance on this statute in proxy access bylaws necessarily introduces some discretion into the determination of whether another company is a “competitor.”

Table 10: Restrictions on nominees who are officers or directors of competitors

Restrictions on Nominees Who Have Been Officers/Directors of Competitors	Number	Percent
Restricted if an officer/director of a competitor within the past 3 years	135	53.6%
Disqualified if an officer/director of a competitor within the past 3 years	71	28.2%
No restrictions	37	14.7%
Restricted if an officer/director of a competitor within past year	3	1.2%
Disqualified if currently an officer/director of a competitor	3	1.2%
Restricted if currently an officer/director of a competitor	1	0.4%
Restricted with no time specified	1	0.4%
Restricted if an officer/director of a competitor within the past 2 years	1	0.4%

Source: SEC filings.

GROUP 3: The Interplay Between Proxy Access and Advance Notice

Restrictions on the use of proxy access and advance notice (proxy contest) procedures for the same meeting

Advance notice is the process by which virtually any shareholder can initiate a proxy contest, in which the shareholder and the company nominate separate slates of directors, solicit shareholders’ votes on separate proxy cards, and file separate proxy statements in support of their slates. A proxy contest can feature a battle for just a few board seats (a “short slate” contest), or for majority control of the board (a “long slate” contest). Proxy contests provide flexibility, control, and low barriers to entry (*e.g.*, no long-term ownership requirement) that appeal to many prominent activists, and these features stand in contrast to the proxy access process, where only large long-term shareholders can nominate directors, and even then only up to 20-25 percent of the board.

Of the 252 proxy access bylaws adopted by June 30, 191 (76 percent) provide for either a restriction or prohibition on the use of proxy access and proxy contests in the same meeting. Those companies that restrict proxy access and proxy contests in the same meeting generally say that if any shareholder nominates an advance notice nominee, the board may exclude any proxy access nominees from the ballot. Those companies that prohibit proxy access and proxy contests in the same meeting generally say one of the following: 1) no vote on a proxy access nominee will occur if any shareholder intends to nominate an

advance notice nominee; or 2) proxy access will be unavailable if any shareholder intends to nominate advance notice nominees equal to or greater than a certain percentage of the board. Only 10 companies' bylaws contain that second type of prohibition, eight of which say that proxy access will be unavailable if any shareholder intends to nominate advance notice nominees equal to or greater than 50 percent of the board, and two of which say that proxy access will be unavailable if any shareholder intends to nominate advance notice nominees equal to or greater than 30 percent of board.

Table 11: Restrictions on the use of proxy access and proxy contest procedures for the same meeting

Restriction/prohibition of proxy access and proxy contests	Number	Percent
No restriction or prohibition	61	24.2%
Board has discretion to exclude access nominees if advance notice is used	134	53.2%
Access automatically unavailable if advance notice is used	47	18.7%
Access unavailable if a proxy contest seeks at least 50% of board seats	8	3.2%
Access unavailable if a proxy contest seeks at least 30% of board seats	2	0.8%

Source: SEC filings.

Although 61 companies do not restrict or prohibit the use of proxy contest nominees and proxy access nominees in the same meeting, 48 companies nonetheless state that the maximum number of candidates would be reduced by any advance notice nominees.

Table 12: The maximum number of candidates may be reduced by advance notice, or proxy contest, nominee

Maximum Number of Access Candidates Reduced by Advance Notice Nominees	Number	Percent
No	204	81.0%
Yes	48	19.0%

Source: SEC filings.

Different nomination deadlines for proxy access nominees and advance notice nominees

Most companies maintain different nomination deadlines for proxy access nominees and advance notice nominees. The basis for this disconnect may lie in the SEC’s vacated Rule 14a-11, which specified that proxy access nominations be delivered to companies “no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary of the date that the company mailed its proxy materials for the prior year’s annual meeting.”⁴

Most companies have incorporated this 120-150 day concept into their proxy access bylaws. By contrast, many companies set forth a 90-120 day window for advance notice nominees, in part due to pressure from shareholders and proxy advisors to allow more time for proxy contests to develop—or settle.

Of the 181 companies that have different nomination windows for the two processes, 125 chart the course described above. Of the 71 companies that have the same window for proxy access and advance notice nominees, 26 use 120-150 day windows for both, and 25 use 90-120.

Table 13: The nomination deadline for proxy access nominees differs from that for advance notice nominees

Nomination Deadline Different from Advance Notice Deadline	Number	Percent
Proxy access is 120-150, advance notice is 90-120	125	49.6%
Both are 120-150	26	10.3%
Both are 90-120	25	9.9%
Proxy access is 120-150, advance notice is 60-90	11	4.4%
Other misaligned	45	17.9%
Other aligned	20	7.9%

Source: SEC filings.

⁴ See SEC Final Rule 14a-11: Facilitating Shareholder Director Nominations, adopted Nov. 10, 2010.
<https://www.sec.gov/rules/final/2010/33-9136.pdf>

GROUP 4: The Aftermath of a Proxy Access Nomination

“Penalty box” #1: Prohibitions on the resubmission of failed nominees in subsequent years

Most bylaws—179 as of June 30—feature a “penalty box” provision that sidelines a shareholder nominee that fails to receive a certain level of support. 116 companies (47 percent) have a prohibition of two years on the resubmission of the nominee if that nominee receives less than 25 percent support. By contrast, 73 companies place no restriction on the re-nomination of failed proxy access candidates.

Table 14: Prohibitions on the resubmission of failed nominees in subsequent years

Prohibitions on Resubmission of Failed Nominees	Number	Percent
No restrictions on failed nominees	73	29.0%
2 years if nominee receives < 25% support	116	46.0%
If nominee receives < 25% support at one of two preceding meetings	26	10.3%
2 years if nominee receives < 10% support	11	4.4%
2 years if nominee receives < 20% support	8	3.2%
If nominee receives < 20% support at one of two preceding meetings	6	2.4%
If nominee receives < 15% support at one of two preceding meetings	4	1.6%
If nominee receives < 25% support at one of three preceding meetings	3	1.2%
If nominee receives < 10% support at one of two preceding meetings	2	0.8%
3 years if nominee receives < 25% support	1	0.4%
3 years if nominee receives < 33% support	1	0.4%
1 year if nominee receives < 50% support	1	0.4%

Source: SEC filings.

“Penalty box” #2: Restrictions on nominating shareholders’ re-use of the proxy access right

Along the same lines as restrictions on the re-nomination of particular candidates, a small number of companies preclude a nominating shareholder from re-using the proxy access right under certain

circumstances; 26 companies (10 percent) have some type of this restriction in their bylaws. Of these companies, 18 provide that a nominator shall be disqualified from nominating candidates for two years if its candidate is elected to the board; two companies extend this moratorium to three years. Other variations have arisen as well, as detailed in the table below.

Table 15: Does a proxy access nomination preclude the nominating shareholder from using proxy access again?

Eligible Shareholder Disqualified from Nominating Future Candidates	Number	Percent
No	226	89.7%
2 years if nominee is elected	18	7.1%
3 years if nominee is elected	2	0.8%
If nominee receives < 10% support at one of two preceding meetings	2	0.8%
3 years if nominee receives < 33% support	1	0.4%
If nominee receives < 25% support at one of two preceding meetings	1	0.4%
Indefinitely as long as shareholder nominees comprise 20% of board	1	0.4%
For the later of 1 year or the date the elected nominee is no longer on the board	1	0.4%

Source: SEC filings.

The impact of elected shareholder nominees on the maximum number of proxy access nominees in subsequent years

In order to avoid having repeated proxy access nominations result in a change in the majority of board seats, which can often trigger change-in-control severance payments to executives along with other effects, most proxy access bylaws provide that the maximum number of proxy access nominees allowed will be reduced by elected directors who were previously proxy access nominees.

Only 74 of the 252 companies with proxy access as of June 30 do not reduce the maximum number of candidates by the number of elected directors who were previously proxy access nominees or advance notice nominees. Of the 178 companies (70 percent) that provide for this reduction, the most common formulation is to reduce the maximum number of candidates by any director who was a proxy access nominee in the last two years (79 companies). Another 26 companies provide for a reduction in the maximum number of candidates by any director who was a proxy access nominee in the last three years. There are a number of variations on these provisions, and many companies use more than one variation.

Since virtually all companies provide that the maximum number of nominees shall be reduced by nominees who are withdrawn or whom the board decides to nominate, we excluded those provisions from this analysis.

Table 16: An elected shareholder nominee may count towards the maximum number of proxy access nominees

Maximum Reduced by Elected Shareholder Nominees	Number	Percent
No reduction of maximum nominees by elected directors	74	29.4%
By any director who was a proxy access nominee in the last 2 years	79	31.3%
By any director who was a proxy access nominee in the last 3 years	26	10.3%
By any director who was elected pursuant to an agreement with the board or who was a proxy access nominee in the last 2 years	22	8.7%
By any director who was elected pursuant to an agreement with the board in the last 2 years or who was a proxy access nominee in the last 2 years	20	7.9%
By any director who was elected pursuant to an agreement with the board or who was a proxy access nominee in the last 2 years and who is not seeking reelection	8	3.2%
By any director who was a proxy access nominee in the last year	4	1.6%
By any director who was elected pursuant to an agreement with the board or who was a proxy access nominee in the last 3 years	4	1.6%
By any director who was a proxy access nominee and who hasn't served for a 3 year term	2	0.8%
By any director who was a proxy access nominee or an advance notice nominee	2	0.8%
By any director who was a proxy access nominee or an advance notice nominee in the last 2 years	2	0.8%
Other formulations	9	3.6%

Source: SEC filings.

GROUP 5: General Considerations

Whether the board has broad authority to interpret the proxy access bylaw provisions

A particularly contentious restriction has been a provision that gives the board broad authority to interpret the company’s proxy access bylaw. While it seems like boilerplate at first glance, these provisions may be construed as giving the board the flexibility to make any determination it deems warranted, including ruling on the eligibility of nominators and nominees on the basis of factors not enumerated in the bylaw.

Although this is not a majority practice, 70 companies (28 percent) have opted to provide this authority to the board.

Table 17: The board has broad authority to interpret the proxy access bylaw provisions

Board Has Broad Authority to Interpret Provisions	Number	Percent
No	182	72.2%
Yes	70	27.8%

Source: SEC filings.

Space allotted for the nominating shareholder’s supporting statement in the proxy

Almost all companies with proxy access bylaws expressly provide for nominators to include a supporting statement for their nominees in the proxy. Of those, 244 provide for a maximum of 500 words in a supporting statement. This is consistent with the vacated SEC Rule 14a-11, which provided for the same number of words, and is equal to the mandated allowance for shareholder proposals filed under Rule 14a-8.

Seven bylaws are silent on whether a nominating shareholder may provide a statement in support of a nominee, and what length that supporting statement could be. One company—The Western Union Company, which adopted proxy access in March 2013—provides for a maximum of only 250 words.

Table 18: Space allotted for the nominating shareholder’s supporting statement

Space Allowed for Nominator's Supporting Statement	Number	Percent
500 words	244	96.8%
Not disclosed	7	2.8%
250 words	1	0.4%

Source: SEC filings.

SHAREHOLDER AND ISS REACTIONS TO THE ADOPTED BYLAWS

None of the companies that adopted proxy access bylaws in response to a majority-supported shareholder proposal in 2015 implemented basic features that were more restrictive than 3/3/20/20. Most of these companies incorporated a number of restrictive secondary features in their proxy access bylaws, but outside of a small handful of instances, shareholders generally did not hold directors accountable for doing so.

Institutional Shareholder Services issued negative recommendations in 2016 against certain directors at three companies—CBL & Associates Properties, Inc., Cloud Peak Energy Inc., and Cheniere Energy, Inc.—whose proxy access bylaws were deemed not adequately responsive to the successful shareholder proposals at their 2015 shareholder meetings. These companies adopted 3/3/20/20 as their basic features, but restrictive secondary features combined with poor disclosure of engagement on the topic and supermajority vote requirements to amend the bylaws led to the negative recommendations.

After ISS published its recommendation on Cloud Peak, the company amended its bylaws to remove all of the restrictive secondary provisions in its bylaws. ISS subsequently reversed its recommendation and supported the governance committee members’ re-election. Both directors on the ballot received the support of 96 percent of shareholders.

CBL & Associates and Cheniere Energy did not amend their bylaws. At CBL & Associates, the lead independent director and the chair of the Governance Committee received the support of only about 75 percent of votes cast. The four members of Cheniere Energy’s Governance & Nominating Committee fared better, receiving 88-91 percent support, due in part to a more concentrated ownership base.

GAUGING THE LIKELY IMPACT OF THE CAMPAIGN FOR ACCESS

Undeniably, proxy access has joined board refreshment and director performance evaluations as today's fastest-moving governance trends.

But high-speed doesn't always mean high-impact. Does proxy access represent a sea change in the way shareholders elect directors, or is the impact more modest? And what should boards be prepared to do?

Strong Shareholder Pressure Now, But Will It Last?

More than half of shareholder proposals voted in the last two years received majority shareholder support. That alone gives proponents the incentive to continue to seek proxy access at more companies.

At some point, however, shareholder movements tend to subside. An illustrative example is the Shareholder Rights Project, which from 2011 to 2014 assisted shareholder proponents in prompting large-cap companies to declassify their boards. The group says it played a role in the declassification of 121 boards—or about two-thirds of the S&P 500 companies that had classified boards in early 2012—before winding down operations after the 2014 proxy season.

An important difference, of course, between the Shareholder Rights Project and today's proxy access proponents is that the latter have not unified against a defined target group of companies. And because proxy access proponents haven't defined an end-goal to their efforts, expect proxy access to continue to be the most commonly filed shareholder proposal over the next couple of proxy seasons. As the H&R Block proposal that we highlighted at the beginning of this paper suggests, we're likely to see a mix of proposals urging companies to adopt proxy access for the first time and proposals seeking shareholder-friendly amendments to existing access bylaws.

How, When, and by Whom Will Proxy Access Be Used?

Dozens of companies provided for proxy access by late 2015, but no shareholder used proxy access at a U.S. company during the 2016 proxy season. It's entirely possible that proxy access could follow in the footsteps of the shareholder rights to call special meetings and to act by written consent: rights that have become commonplace in companies' bylaws, but which shareholders hardly ever exercise.

But if proxy access is to meet a different fate, which investors are most likely to use it?

Big asset managers? Unlikely. Most mainstream institutions would shy away from taking the lead on a proxy access nomination; however, some may well join a nominating group in the right situation. For

instance, Vanguard has indicated that it could consider joining a nominating group where severe concerns around a board's responsiveness or engagement are present.

Activist hedge funds? Probably not. Many activist funds have expressed a preference for the proxy contest format over proxy access, because of the flexibility and control that process provides.

This leaves large asset owners as the likely driving force in nominating proxy access candidates. Of course, only a few of the asset owners that could be categorized as activists hold large enough stakes in companies to be able to nominate candidates themselves: although state or national pension systems like CalPERS or Norges Bank, or labor union pension funds like UAW, could unilaterally nominate proxy access candidates at a small number of companies, expect to see these investors solicit asset managers to join their cause where exceptional board accountability concerns arise.

Proxy Access May Be Most Successful When It Isn't Used

In the end, boards are most likely to feel the impact of proxy access away from the ballot. Although a variety of motives have driven the actions of the proxy access proponents, institutional support for these proposals has derived in part from an awareness of the negotiating leverage that the proxy access right may provide them.

Investors will undoubtedly use the threat of a proxy access nomination when seeking a board seat or other concession from the company. The board's job, then, will be to assess the potency of that threat—and as in so many other areas of corporate governance these days, the board's most effectual course of action involves proactive shareholder outreach, not only with portfolio managers, but also with the in-house governance units of its shareholders.

APPENDIX: Companies That Have Adopted Proxy Access, by Adoption Date

Through June 30, 2016

Company Name	Bylaw Amended Date
Covanta Holding Corporation	3/15/2004
EMCORE Corporation	8/7/2008
American Railcar Industries, Inc.	6/30/2009
LSB Industries, Inc.	2/18/2010
Hooper Holmes, Inc.	6/1/2010
KSW, Inc. (now private)	1/5/2012
The Western Union Company	3/11/2013
Hewlett-Packard Company	11/26/2013
Panhandle Oil and Gas Inc.	12/11/2013
Nabors Industries Ltd.*	4/14/2014
Verizon Communications Inc.	5/1/2014
Enterprise Financial Services Corp*	5/22/2014
CenturyLink, Inc.	6/2/2014

Company Name	Bylaw Amended Date
Chesapeake Energy Corporation	6/19/2014
Darden Restaurants, Inc.	11/11/2014
Kilroy Realty Corporation	12/11/2014
Nielsen Holdings plc**	2/4/2015
General Electric Company	2/6/2015
HCP, Inc.	2/8/2015
Boston Properties, Inc.	2/24/2015
Arch Coal, Inc.	2/26/2015
Prudential Financial, Inc.	3/10/2015
Cabot Oil & Gas Corporation	3/11/2015
Bank of America Corporation	3/17/2015
New York Community Bancorp, Inc.	3/17/2015
Biogen Inc.	3/23/2015

Company Name	Bylaw Amended Date
FirstMerit Corporation	4/15/2015
Rite Aid Corporation	4/15/2015
United Therapeutics Corporation	4/29/2015
Big Lots, Inc.	5/28/2015
Monsanto Company	6/5/2015
H&R Block, Inc.	6/17/2015
SLM Corporation	6/25/2015
Whole Foods Market, Inc.	6/26/2015
Broadridge Financial Solutions, Inc.	7/2/2015
Regency Centers Corporation	7/15/2015
PayPal Holdings, Inc.	7/17/2015
Merck & Co., Inc.	7/22/2015
SBA Communications Corporation	7/28/2015
McKesson Corporation	7/29/2015
VEREIT, Inc.	8/5/2015

Company Name	Bylaw Amended Date
The Progressive Corporation	8/6/2015
Microsoft Corporation	8/7/2015
The Clorox Company	8/28/2015
Marathon Oil Corporation	9/1/2015
The Coca-Cola Company	9/2/2015
United Technologies Corporation	9/9/2015
Anadarko Petroleum Corporation	9/15/2015
Philip Morris International Inc.	9/16/2015
DTE Energy Company	9/17/2015
EOG Resources, Inc.	9/22/2015
YUM! Brands, Inc.	9/23/2015
Chevron Corporation	9/30/2015
Hasbro, Inc.	10/1/2015
Equity Residential	10/1/2015
Mondelez International, Inc.	10/1/2015

Company Name	Bylaw Amended Date
Capital One Financial Corporation	10/5/2015
CSX Corporation	10/7/2015
Occidental Petroleum Corporation	10/8/2015
ConocoPhillips	10/9/2015
The Bank of New York Mellon Corporation	10/13/2015
CF Industries Holdings, Inc.	10/14/2015
EQT Corporation	10/14/2015
Walgreens Boots Alliance, Inc.	10/14/2015
State Street Corporation	10/15/2015
TCF Financial Corporation	10/19/2015
American Electric Power Company, Inc.	10/20/2015
Cloud Peak Energy Inc.	10/20/2015
Noble Energy, Inc.	10/20/2015
Citigroup Inc.	10/22/2015
United Natural Foods, Inc.	10/23/2015

Company Name	Bylaw Amended Date
The Goldman Sachs Group, Inc.	10/23/2015
McDonald's Corporation	10/26/2015
Altria Group, Inc.	10/28/2015
Morgan Stanley	10/29/2015
VCA Inc.	10/29/2015
Kindred Healthcare, Inc.	10/29/2015
Visa Inc.	10/30/2015
Hewlett Packard Enterprise Company	10/31/2015
The Priceline Group Inc.	11/4/2015
Spectra Energy Corp	11/4/2015
Hess Corporation	11/4/2015
Archer-Daniels-Midland Company	11/5/2015
NVR, Inc.	11/6/2015
Southwestern Energy Company	11/9/2015
3M Company	11/10/2015

Company Name	Bylaw Amended Date
Aflac Incorporated	11/10/2015
Target Corporation	11/11/2015
Cimarex Energy Co.	11/11/2015
Kohl's Corporation	11/11/2015
Level 3 Communications, Inc.	11/12/2015
AvalonBay Communities, Inc.	11/12/2015
AmerisourceBergen Corporation	11/12/2015
Oshkosh Corporation	11/13/2015
American International Group, Inc.	11/16/2015
Windstream Holdings, Inc.	11/19/2015
The Allstate Corporation	11/19/2015
Union Pacific Corporation	11/19/2015
Pioneer Natural Resources Company	11/19/2015
The AES Corporation	11/25/2015
Staples, Inc.	12/1/2015

Company Name	Bylaw Amended Date
General Dynamics Corporation	12/2/2015
Ecolab Inc.	12/3/2015
The Dun & Bradstreet Corporation	12/3/2015
Northrop Grumman Corporation	12/4/2015
Corning Incorporated	12/7/2015
Qualcomm Inc.	12/7/2015
CarMax, Inc.	12/8/2015
Applied Materials, Inc.	12/8/2015
MetLife, Inc.	12/8/2015
Caterpillar Inc.	12/9/2015
Alaska Air Group, Inc.	12/9/2015
Cheniere Energy, Inc.	12/9/2015
T. Rowe Price Group, Inc	12/10/2015
Peabody Energy Corporation	12/10/2015
Edison International	12/10/2015

Company Name	Bylaw Amended Date
PPG Industries, Inc.	12/10/2015
Honeywell International Inc.	12/11/2015
Ameren Corporation	12/11/2015
Abbott Laboratories	12/11/2015
Illinois Tool Works Inc.	12/11/2015
Kimberly-Clark Corporation	12/14/2015
Flowserve Corporation	12/14/2015
Pfizer Inc.	12/14/2015
The Boeing Company	12/14/2015
Public Service Enterprise Group Incorporated	12/15/2015
Sempra Energy	12/15/2015
International Flavors & Fragrances Inc.	12/15/2015
Dominion Resources, Inc.	12/17/2015
PPL Corporation	12/18/2015
Baxter International Inc.	12/18/2015

Company Name	Bylaw Amended Date
AT&T Inc.	12/18/2015
Wells Fargo & Company	12/18/2015
Apple Inc.	12/21/2015
Gilead Sciences, Inc.	12/23/2015
Duke Energy Corporation	1/4/2016
Alexion Pharmaceuticals, Inc.	1/8/2016
Corrections Corporation of America	1/8/2016
PepsiCo, Inc.	1/11/2016
MGM Resorts International	1/13/2016
Colgate-Palmolive Company	1/14/2016
U.S. Bancorp	1/19/2016
JPMorgan Chase & Co.	1/19/2016
CVS Health Corporation	1/21/2016
Intel Corporation	1/21/2016
Praxair, Inc.	1/26/2016

Company Name	Bylaw Amended Date
Dana Holding Corporation	1/26/2016
Devon Energy Corporation	1/26/2016
Brocade Communications Systems, Inc.	1/26/2016
Alliance Data Systems Corporation	1/26/2016
Apartment Investment and Management Company	1/26/2016
Johnson & Johnson	1/26/2016
S&P Global Inc.	1/27/2016
Cognizant Technology Solutions Corporation	1/28/2016
Time Warner Inc.	1/28/2016
Huntington Ingalls Industries, Inc.	1/28/2016
NiSource Inc.	1/29/2016
Crown Holdings, Inc.	1/29/2016
Science Applications International Corporation	2/2/2016
Murphy Oil Corporation	2/3/2016
Accenture plc	2/3/2016

Company Name	Bylaw Amended Date
Celanese Corporation	2/3/2016
Fidelity National Financial, Inc.	2/3/2016
CMS Energy Corporation	2/4/2016
Fluor Corporation	2/4/2016
UnitedHealth Group Incorporated	2/9/2016
Apache Corporation	2/9/2016
International Paper Company	2/9/2016
Sonoco Products Company	2/10/2016
Stericycle, Inc.	2/10/2016
BorgWarner Inc.	2/10/2016
CBL & Associates Properties, Inc.	2/11/2016
Dover Corporation	2/11/2016
Bristol-Myers Squibb Company	2/12/2016
The Children's Place, Inc.	2/12/2016
American Tower Corporation	2/12/2016

Company Name	Bylaw Amended Date
Amgen Inc.	2/15/2016
PG&E Corporation	2/17/2016
Xcel Energy Inc.	2/17/2016
United Continental Holdings, Inc.	2/18/2016
Eastman Chemical Company	2/18/2016
Anthem, Inc.	2/18/2016
Whiting Petroleum Corporation	2/18/2016
AbbVie Inc.	2/18/2016
Chemed Corporation	2/19/2016
Fiserv, Inc.	2/19/2016
Zoetis Inc.	2/19/2016
ITT Corporation	2/19/2016
Kellogg Company	2/19/2016
Ryder System, Inc.	2/22/2016
Domtar Corporation	2/23/2016

Company Name	Bylaw Amended Date
Amazon.com, Inc.	2/24/2016
Unum Group	2/24/2016
Marathon Petroleum Corporation	2/24/2016
Quest Diagnostics Incorporated	2/25/2016
Cerner Corporation	2/25/2016
Edwards Lifesciences Corporation	2/25/2016
Xylem Inc.	2/25/2016
Macy's, Inc.	2/26/2016
Range Resources Corporation	2/29/2016
Avon Products, Inc.	3/1/2016
Kansas City Southern	3/1/2016
The Mosaic Company	3/3/2016
The Home Depot, Inc.	3/3/2016
General Motors Company	3/4/2016
FedEx Corporation	3/7/2016

Company Name	Bylaw Amended Date
iRobot Corporation	3/7/2016
General Mills, Inc.	3/8/2016
Roper Technologies, Inc.	3/9/2016
American Airlines Group Inc.	3/9/2016
Express Scripts Holding Company	3/9/2016
National Fuel Gas Company	3/10/2016
Splunk Inc.	3/10/2016
Allison Transmission Holdings, Inc.	3/11/2016
Omnicom Group Inc.	3/14/2016
eBay Inc.	3/15/2016
CIT Group Inc.	3/15/2016
Reliance Steel & Aluminum Co.	3/16/2016
Monster Worldwide, Inc.	3/16/2016
salesforce.com, inc.	3/16/2016
Lowe's Companies, Inc.	3/18/2016

Company Name	Bylaw Amended Date
The Brink's Company	3/19/2016
Amphenol Corporation	3/21/2016
Raytheon Company	3/23/2016
SL Green Realty Corp.	3/23/2016
Yahoo! Inc.	3/25/2016
Equinix, Inc.	3/28/2016
The Procter & Gamble Company	4/8/2016
Leidos Holdings, Inc.	4/12/2016
NETGEAR, Inc.	4/19/2016
The Macerich Company	4/21/2016
Exelon Corporation	4/26/2016
Vertex Pharmaceuticals Incorporated	4/26/2016
Expeditors International of Washington, Inc.	5/3/2016
DCT Industrial Trust Inc.	5/4/2016
Intuit Inc.	5/5/2016

Company Name	Bylaw Amended Date
Republic Services, Inc.	5/6/2016
Intercontinental Exchange, Inc.	5/6/2016
UDR, Inc.	5/12/2016
Qorvo, Inc.	5/16/2016
Westmoreland Coal Company	5/17/2016
Electronic Arts Inc.	5/19/2016
Kate Spade & Company	5/19/2016
Brandywine Realty Trust	5/24/2016

Company Name	Bylaw Amended Date
The Wendy's Company	5/26/2016
Ingersoll-Rand plc	6/2/2016
Freeport-McMoRan Inc.	6/8/2016
Rockwell Automation, Inc.	6/8/2016
Visteon Corporation	6/9/2016
Oracle Corporation	6/15/2016
The Walt Disney Company	6/28/2016
Cardinal Health, Inc.	6/30/2016

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