

## New Proxy Advisor Policy Affects IPO Company Director Elections

August 2, 2016

We recently published a survey of corporate governance practices adopted by companies in their IPOs. Our survey concluded that IPO companies continue to adopt charter provisions such as a classified board or dual class stock that can be viewed as having an anti-takeover impact, without any noticeable impact on valuation or marketing.

While we continue to believe that such provisions are appropriate in many instances, companies preparing for an IPO should be aware of the consequences for director elections of a recent policy change implemented by Institutional Shareholder Services (ISS), the influential proxy advisory firm. For newly public companies, ISS now will generally recommend “vote against” or “withhold” for directors of a company that, prior to or in connection with its IPO, adopted bylaw or charter provisions that ISS considers adverse to shareholders’ rights. These include common anti-takeover protections, such as a classified board, supermajority thresholds to amend the charter or bylaws, limitations on shareholders’ right to amend the charter or bylaws and dual-class shares. The policy was announced in November 2015, so the recently completed 2016 annual meeting season was the first time that the policy was applied to newly public companies.

We examined a sample of large companies that went public in 2015 and held their first public company annual meetings in 2016. In each case, ISS recommended against the directors that were on the board at the time of the IPO if the company had adopted anti-takeover provisions such as those listed above. What was the impact of the negative recommendation? The actual voting results varied widely depending on the nature of the companies’ shareholder base. Those with significant insider, venture capital or private equity shareholder bases saw minimal impact, while others’ directors received anywhere from 10% to 20% negative votes.

Should IPO companies care? Many IPO companies may not even be aware of the proxy advisory firms or their voting recommendations. The recommendations are not made public and generally are available only to investors who subscribe. They do, however, often have a significant impact on institutional investors’ votes.

Companies with concentrated shareholder bases such as those mentioned above may not care in the short term. However, ISS may continue recommending against directors every year until the provisions are put up for vote or removed, which could bring this into focus for companies as their friendly shareholders sell down. Companies with directors who sit on other public company boards and are concerned about the reputational impact of a “vote against” recommendation may also be more attuned to this topic. And, as was true even before the new policy was adopted, companies that are being spun out of other large public companies at IPO may be required by their parents to adhere to corporate governance “best practices,” rather than adopt the anti-takeover provisions that ISS and many institutional investors have been criticizing IPO companies (and their advisors) for adopting.

An IPO company that nonetheless wants to have such protections but mitigate the potential for adverse director recommendations can put its anti-takeover provisions to a vote within three years of the IPO (per the ISS policy). IPO companies should strongly consider putting these measures to a vote quickly, when their pre-IPO shareholders still hold a large position and will presumably be supportive.

ISS is not the only corporate governance watchdog taking action in this area. T. Rowe Price, not only a large shareholder but also an influential shareholder on corporate governance matters, has recently

adopted a policy of voting against directors sitting on the nominating and governance committees of companies with dual-class shares. While most companies with dual-class share structures have a majority of their votes held by a controlling shareholder (and therefore their directors are assured of re-election), this nevertheless brings into focus the fact that not only proxy advisory firms and pension funds, but also some mainstream mutual funds, are beginning to use director elections to advance a corporate governance agenda.

We expect that law firms and investment banks will continue to recommend use of classified boards and dual-class structures to their IPO clients where appropriate, but would recommend that IPO clients pay more attention to management and director education on this topic and consider submitting such provisions to a post-IPO shareholder vote.

---

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

<b>Alan F. Denenberg</b>	<b>650 752 2004</b>	<a href="mailto:alan.denenberg@davispolk.com">alan.denenberg@davispolk.com</a>
<b>Joseph A. Hall</b>	<b>212 450 4565</b>	<a href="mailto:joseph.hall@davispolk.com">joseph.hall@davispolk.com</a>
<b>Sophia Hudson</b>	<b>212 450 4762</b>	<a href="mailto:sophia.hudson@davispolk.com">sophia.hudson@davispolk.com</a>
<b>Michael Kaplan</b>	<b>212 450 4111</b>	<a href="mailto:michael.kaplan@davispolk.com">michael.kaplan@davispolk.com</a>
<b>Richard J. Sandler</b>	<b>212 450 4224</b>	<a href="mailto:richard.sandler@davispolk.com">richard.sandler@davispolk.com</a>
<b>Sarah K. Solum</b>	<b>650 752 2011</b>	<a href="mailto:sarah.solum@davispolk.com">sarah.solum@davispolk.com</a>
<b>Richard D. Truesdell, Jr.</b>	<b>212 450 4674</b>	<a href="mailto:richard.truesdell@davispolk.com">richard.truesdell@davispolk.com</a>
<b>Ning Chiu</b>	<b>212 450 4908</b>	<a href="mailto:ning.chiu@davispolk.com">ning.chiu@davispolk.com</a>