

US Policy - Director Elections - Poison Pills

Background and Overview

There has been a long evolution in the history of poison pills (shareholder rights plans) in the US since their origins in the 1980's, and ISS' policies have evolved accordingly. Once a ubiquitous takeover defense that companies renewed automatically every 10 years, pills more commonly now take two forms: a 3 year-pill approved by shareholders, or a short-term pill (term of 1 year or less) adopted in response to unusual purchases of stock or an unsolicited takeover bid. Most companies do not have an active pill, but some may keep one "on the shelf" to adopt if the latter situation were to occur.

ISS' current policy on director elections where the company adopted or renewed a pill that was not approved by shareholders has several focuses:

1. If the pill has a "deadhand" or "slowhand" feature. These features make it difficult to redeem a pill if a majority of the board does not consist of continuing directors or their nominees. Once quite common, ISS is now only tracking five such pills among publicly-traded companies. ISS recommends in these cases against the full slate of directors every year.
2. For long-term pills (term >1 year): Adverse recommendations depend on whether the board is annually-elected or classified. ISS recommends against all nominees every year if the board is classified, but, if the board is annually elected, only once every 3 years. Companies who had newly adopted a pill could be exempt from adverse vote recommendations by making a commitment to put the pill to a binding shareholder vote at the next year's AGM.
3. The policy above was put into place Nov 19, 2009. Boards that adopted pills adopted prior to that date were grandfathered from the policy and do not receive adverse vote recommendations.
4. Lastly, the adoption (not the renewal) of a short-term pill is considered on a case-by-case basis and generally does not cause an against recommendation on the board if there was a compelling rationale for its adoption and the company has a generally good governance track record.

Key Changes under Consideration

ISS is proposing to update the policies outlined above, and recommend against all board nominees, every year, at companies who maintain a long-term poison pill that has not been approved by shareholders. Therefore annually-elected boards would receive adverse recommendations on an annual basis, rather than every 3 years. Commitments to put a long-term pill to a vote the following year would no longer be considered a mitigating factor. The boards with the 10-year pills currently grandfathered from 2009 would no longer be exempt and would receive against recommendations. With the proposed removal of grandfathering, there will also be no need to have an explicit policy regarding deadhand or slowhand features, as the few remaining deadhand/slowhand pills are not approved by shareholders and would be covered under the proposed policy.

Short-term pill adoptions would continue to be assessed on a case-by-case basis, but the proposed policy update would focus more on the rationale for their adoption than on the company's governance and track record. Renewals or extensions though, as with the current policy, will not receive the case-by-case assessment.

Intent and Impact

The intent of this proposed policy update is to simplify ISS' approach to poison pills, and strengthen the principle that poison pills should be approved by shareholders.

ISS' vote recommendations under the proposed policy would be impacted as follows:

- About 90 companies with 10-year pills adopted or renewed in 2008 and 2009 would receive adverse vote recommendations on their boards; and
- About 50 companies with annually elected boards who adopted/renewed pills since 2009 would receive adverse vote recommendations every year, rather than once every 3 years.

Request for Comment

While we appreciate any comments on this topic, ISS is specifically seeking feedback on the following:

- Should ISS continue to grandfather the directors whose boards adopted 10-year pills in 2008 and 2009 given that they will expire under their terms over the next few years?
- Regarding short-term pills (1-year term or less), is the rationale for adoption (e.g. an unsolicited takeover offer) the most important factor for consideration when voting on directors who adopted the pill? If not, please specify other factors.
- Should one factor for the consideration of short-term pill adoptions be a commitment that any renewals or extensions of the pill will be put to a shareholder vote?