Bylaw Response To ‘Placeholder Slate’ Tactic Is Unproven

By **Richard Grossman, Robert Saunders, Rodd Schreiber, David Clark and Rachel Cohn**

Richard Grossman

Robert Saunders

Rodd Schreiber

In the past year, more than 50 publicly traded companies, including 19 on the Standard & Poor’s 500 index, have amended their bylaws to address the potential for a so-called “placeholder slate” of directors. The bylaw amendments began to appear in response to a tactic used last year to end-run typical advance notice bylaws for director nominations. However, neither the bylaw amendments nor the placeholder-slate tactic has been tested in court, leaving their ultimate fate undetermined even as the adoption of these amendments appears to be growing.

In the summer of 2016, activist hedge fund Corvex Management LP announced its intent to oust all 10 members of the board of The Williams Companies Inc. The move was part of a two-year battle for influence over Williams, during which Corvex’s founder, Keith Meister, and five other Williams directors resigned over strategic disputes with management, culminating in a failed $33 billion merger that would have created the nation’s largest natural gas transporter.

Because the dispute came to a head shortly before Williams’ advance notice deadline for director nominations, Corvex needed more time to identify a full slate of new and independent director candidates. Its approach to sidestep the deadline was novel: Corvex would nominate, prior to the advance notice deadline, 10 of its employees for election to the Williams board at the upcoming annual meeting. These employees would serve as placeholders until Corvex could identify more suitable directors, which it would disclose to Williams’ stockholders in advance of the election. Once elected and seated, the placeholder directors would immediately appoint Corvex’s true nominees to the board and then resign.

The strategy ultimately went untested. Corvex stood down following a series of new director appointments by Williams that Corvex deemed satisfactory.

Although no investor has attempted the Corvex tactic since, at least not publicly, companies took notice, with many drafting amendments designed to prevent such a maneuver. By our count, in the past year, 54 companies have amended their bylaws in the wake of the threatened Corvex-Williams proxy fight, including Williams itself. Our survey of

the market shows:

- With minor variations, the language used in the amended bylaws is mostly standard: A director nominee must provide a written representation that he or she "intends to serve" as a director.

- The majority of the amendments (45) specify that the individual must intend to remain a director for the "full" or "entire" term, and two companies add that the director must intend to serve until a successor is elected and/or deemed qualified.

- Seventeen companies explicitly state that the nominee must "currently" intend to serve a full term (i.e., at the time of nomination); the remaining bylaws do not specify a particular time frame during which the intention must exist.

- One company's bylaws take the intend-to-serve requirement a step further by requiring that it be "genuine."

- Only a minority of companies make clear that the qualification applies to all directors and not just stockholder nominees.

Like the placeholder-slate tactic itself, these responsive amendments are untested. To date, we are not aware of any legal challenge or significant stockholder opposition to these amendments, though they may ultimately be subject to legal challenge or stockholder pressure.

The Delaware General Corporation Law provides that "[t]he certificate of incorporation or bylaws may prescribe other qualifications for directors" so long as the qualifications are not "inconsistent with" the law and, in the case of bylaw provisions, the certificate of incorporation. Delaware case law further proscribes director qualifications that are "unreasonably vague." Beyond that, however, the courts offer little guidance on permissible (or impermissible) qualifications, other than the generally applicable principles that bylaw and charter provisions must be applied equitably and in a reasonable manner, and utilized for legitimate corporate purposes.

To that end, case law would suggest that director qualifications that apply equally to all director nominees — both stockholder and company nominees — are the more defensible form of qualification. Despite some uncertainty on the permissible parameters, qualification provisions are today commonplace. Qualifications most often seen are those dealing with compliance with U.S. Securities and Exchange Commission and stock exchange rules, compliance with company policies, criminal history and, for regulated companies, citizenship of directors.

Institutional Shareholder Services (ISS) has not issued specific guidance on the intend-to-serve qualification. In its "2015 Benchmark U.S. Proxy Voting Policies," ISS stated that if "a unilaterally adopted amendment is deemed materially adverse to shareholder rights, ISS will recommend a vote against the board." According to ISS guidelines in its "Director Qualification/Compensation Bylaw FAQs," published in 2014, the "adoption of restrictive director qualification bylaws without shareholder approval may be considered a material failure of governance because the ability to elect directors is a fundamental shareholder right. Bylaws that preclude shareholders from voting on otherwise qualified candidates unnecessarily infringe on this core franchise right." In contrast, ISS looks favorably on qualifications that "provide greater transparency for shareholders, and allow for better-informed voting decisions." To date, however, ISS has not adjusted its corporate governance scorecard for these types of bylaw amendments, nor has it commented publicly on them.

Under the default standard of the Delaware General Corporation Law, the vote of a majority of the directors then in office is required to fill a director vacancy. Most Delaware companies have not altered this default standard. In addition, many Delaware companies have adopted bylaws that allow the board of directors, by a majority vote, to increase the size of the board and fill the resulting vacancies. Therefore, to successfully implement the Corvex tactic, an activist would in most cases need to win at least a majority of the board seats (i.e., a control slate). Otherwise, the newly seated placeholder directors would not be able to control the appointment of their planned successors.

Against this backdrop, corporate boards may wish to carefully consider the adoption of additional director qualifications in response to the Corvex placeholder-slate tactic. Boards will need to weigh the utility of an intend-to-serve qualification in light of potential legal uncertainty and stockholder reaction, especially if this clause continues to become more prevalent.

Richard J. Grossman, Robert S. Saunders and Rodd M. Schreiber are partners at Skadden Arps Slate Meagher & Flom LLP. David R. Clark and Rachel E. Cohn are associates at the firm.