FAQ: Majority Voting for Directors

What is majority voting for directors?
CII considers companies to have majority voting when they require nominees to receive more "for" votes than "against" votes to be elected (or re-elected) to the board. Majority voting helps make board members responsive to the people they represent.

There is no standard definition of majority voting across the market. A company's definition of majority voting does not necessarily include permitting shareholders to vote against nominees, and it almost never includes relinquishing the board's authority to indefinitely retain majority-opposed directors.

There are just two ways to elect directors: by a plurality of votes cast and by a majority of votes cast. Policies and provisions determining what happens after the vote significantly affect how those vote requirements impact board composition. CII therefore discusses in this FAQ four discrete iterations of director election regimes:

- strict plurality
- "plurality plus" board-rejectable resignation
- majority voting with board-rejectable resignation
- consequential majority voting

Which approach do most companies take?
Although nearly 90 percent of S&P 500 companies use majority voting in some form, just 29 percent of Russell 2000 companies use a majority vote standard in uncontested elections, according to FactSet. Most mid-cap and small-cap companies elect directors (when there is no contest for seats) by plurality vote. Most overseas markets use a majority vote standard in some form. Only a handful of U.S. companies, such as Microsoft, provide for consequential majority voting.

What is plurality voting?
With plurality voting, the nominees who receive the most "for" votes are elected to the board until all board seats are filled. In an uncontested election, where the number of nominees and available board seats are equal, every nominee is elected upon receiving just one "for" vote.

A plurality standard is the best approach to contested elections and is appropriate for the small number of U.S. companies that permit cumulative voting. But a plurality standard is not appropriate for uncontested elections with no cumulative voting.

Almost all companies with plurality voting give shareholders an option on the ballot to "withhold" their vote. Withholding a vote allows shareholders to communicate their dissatisfaction with a given nominee, but it has no legal effect on the outcome of the election. Withholding a vote is fundamentally equivalent to an abstention, although as a practical matter, many interpret it as a non-binding "against." CII is concerned that some investors may believe incorrectly that a "withhold" option has legal significance different from an abstention.

Plurality voting in uncontested elections makes directors more accountable to each other than to the shareholders they represent. It's a "rubber stamp" process that entrenches boards and, in rare instances, elects directors who lack the confidence of shareholders representing a majority.

What is "plurality plus?"
In response to growing investor concerns about the lack of accountability inherent in plurality voting, since 2004 some companies have modified their plurality standard, either through non-binding policies or bylaw amendments, to require that a majority-opposed director (for whom "withhold" votes withheld exceed "for" votes) must tender her resignation to the board. However, at "plurality plus" companies, a nominee who fails to receive majority support is legally elected for another term, subject to board acceptance of the individual's resignation. Boards in the large majority of cases have rejected resignations in this situation.

CII views plurality plus as a step in the right direction, but not the best way to elect uncontested directors. Plurality plus preserves board control regardless of the voting results. CII encourages plurality companies to skip "plurality plus" and adopt consequential majority voting.

What is majority voting with board-rejectable resignation?
With majority voting, uncontested nominees must receive more "for" votes than "against" votes to be elected. Importantly, this standard properly denies majority-opposed nominees the honor of being legally elected to the board. However, almost all companies with majority voting couple that standard with a resignation requirement for defeated directors. Under the terms of the requirement, the board retains ultimate control over whether the individual departs from the board or stays.

This is the form of majority voting found at most S&P 500 companies. Given its widespread prevalence, CII currently accepts this form of majority voting if the company already has it in place, and the board has a good-faith commitment to replace unelected directors within a reasonable period of time. Yet the core problem persists; uncontested director elections remain functionally symbolic. CII therefore recognizes consequential majority voting as best practice.

Shareholders have other non-binding mechanisms to express their collective views, including shareholder proposals and non-binding "say-on-pay" votes. Director voting, the basis for board legitimacy, should be binding. Plurality-plus and majority vote standards that permit the board to reject a resignation or immediately reappoint the rejected director leave the actual decision on a board member's continued service in the hands of the board. In the rare cases in which directors are rejected in uncontested votes, it is not clear that the board, which tends to be put on the defensive by votes against any of its members, should be trusted to make this decision, except for a reasonable holdover period to arrange for board change.

What is consequential majority voting?
Consequential majority voting requires an uncontested nominee to receive more "for" votes than "against" votes in order to be elected and establishes a reasonable point at which an unelected director may no longer serve on the board. It is the only approach that places ultimate authority in the hands of the company's owners. In this regard, it is the only approach with "teeth."

Some investors oppose this approach because in certain situations, shareholders oppose directors based on a policy matter, and in the view of these investors it is acceptable for the individual to continue on the board if the policy matter is resolved or meaningfully addressed. In some cases, this even extends to the director's behavior. For example, some incumbent directors are rejected due to poor attendance at board meetings, and shareholders can be amenable to their continued service with a pledge by the individual to improve attendance.

For sample bylaw language providing for consequential majority voting, please refer to Appendix 1, which provides both a Delaware-compliant example and a Model Business Corporation Act (MBCA) version.

Does a majority standard (whether traditional or "consequential") create the potential for an abrupt board vacancy upon a director's defeat?
In order to be workable, any majority vote requirement must be coupled with some form of "holdover" provision ensuring reasonable accommodation for a smooth transition in the event of a director's defeat. The purpose of a holdover provision is twofold: to safeguard against a hasty recruitment process for a suitable replacement, and to maintain compliance with the company's governing documents, contractual agreements, exchange listing standards and regulatory requirements throughout the transition period. Holdover provisions typically allow 90 days for the transition, and CII believes a window of up to 180 days is reasonable in certain circumstances.

Is consequential majority voting permissible under state law?
Yes. Section 141 of Delaware General Corporation Law provides that each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation. A 2006 amendment to Section 141 clarified that "a resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events [including failure to obtain a majority of votes cast]. A resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable."

Although many Delaware companies since 2006 have amended their bylaws to adopt a majority vote standard and a resignation requirement for directors who fail to obtain a majority of votes cast, these bylaws generally preserve the board's discretion to reject the resignation letter and keep the director on the board indefinitely.

Consequential majority voting is also permitted under the MBCA. In states where corporate law is based on the MBCA, mandatory departure of an unelected director can be tied to a fixed number of days following the election, unlike in Delaware where departure must be tied to a resignation.

Is there evidence that shareholders care about this issue?
Yes. According to FactSet, the 89 management proposals from 2013- 2016 for a majority vote standard received average support of 98 percent of shares voted (and 79 percent of shares outstanding). In each year since 2007, average support for shareholder proposals requesting majority voting exceeded 50 percent. Since that year, average annual support has grown from 50.4 percent of votes cast "for" and "against" to 73 percent in 2016. Most of these shareholder proposals were opposed by management.

Would there be significant director turnover if every company had to replace majority-opposed directors?
No. A tiny fraction of uncontested director elections result in failure to obtain majority support. In 2016, just 47 uncontested directors in the entire Russell 3000 did not receive majority support. These failures affected only 28 companies, or less than 1 percent of the index.

Is there any evidence that having majority voting in place makes a difference in actual director turnover when directors fail to obtain majority support?
Yes. Based on uncontested elections from 2013-2016 in which at least one director did not receive majority support, the vote requirement matters. Overall, a rejected uncontested director left the board 25 percent of the time. At "plurality plus" companies, the departure rate was nearly the same—24 percent, as of the close of 2016.

By contrast, at companies with majority voting, seven of nine directors who lost elections in the same period permanently left the board. The numbers involved are small but encouraging. Of course, any majority-opposed director at a company with consequential majority voting would have a 100 percent departure rate for unelected directors.

More details can be found on CII's website. These findings are generally consistent with a 2012 study by the IRRC Institute and GMI Ratings, which found that "companies with majority standards are more likely than others to remove directors who receive minority support."

Why do so few companies have consequential majority voting?
Many boards view themselves as best qualified to make final decisions about the fate of majority-opposed directors, discounting shareholder views. Skeptics of consequential majority voting may argue that requiring an unelected director to leave the board could cause the company to be out of compliance with contracts, listing standards or corporate governing documents. (In fact, consequential majority voting provides a grace period to maintain compliance.) Skeptics may also claim that consequential majority voting empowers "special interests." (This argument strikes CII as weak on its face, as holders of a majority of shares voting – the threshold for failure of a nominee under consequential majority vote standard – should not be considered a "special interest" in the context of a widely held public company with one-share, one-vote.)

Additionally, statutory and regulatory history bends toward plurality voting. Most states have corporate codes establishing plurality voting as the default standard, and companies are inclined to follow the default. Although some states have made majority voting the default, no state requires majority voting in uncontested director elections. CII petitioned the Delaware State Bar Association and the American Bar Association (ABA) to embrace majority voting, first as a default, then as a universal standard for publicly-traded companies. The Delaware bar and the ABA declined to support the proposals. The major U.S. stock exchanges do not require listed companies to elect directors by majority vote, despite CII requests to amend listing standards subject to SEC approval. (Correspondence with the Delaware bar, the ABA and the exchanges can be found here.)

Isn't the threat of a proxy fight from activist shareholders sufficient to hold boards accountable to shareholders, without any need for shareholders to have an option to vote against directors in routine, uncontested elections?

No. Even in uncontested situations, the election of directors should be more than an empty formality. Director elections are the basis for legitimacy of boards of directors in their exercise of power over property they do not own.

It is true that proxy fights for board seats are a critical accountability mechanism, but such fights entail substantial cost, are often disruptive and in some cases can focus on financial engineering for the benefit of short-term shareholders. Directors should be accountable to all shareholders on a more routine basis. In addition to the traditional proxy fight, many companies now permit large long-term holders to use "proxy access" to nominate a small minority of directors. However, we believe that voting rights should be meaningful without a requirement for a dissident nomination process and escalation to a proxy fight, even including a tool like proxy access that empowers only long-term shareholders. Moreover, proxy access has not been mandated market-wide.

Does the SEC regulate how companies describe their voting standards in SEC filings?
Yes. While state law and companies' governing documents define the voting standard, the SEC regulates the contents of proxy statements and proxy cards.

But investors should be aware that some plurality-vote companies provide confusing descriptions of their vote standard in their SEC filings. In particular, some:

- Use terminology such as "majority voting" and "majority vote standard" in proxy statements, when in fact they are referring to the support threshold at which a director is required to submit a resignation letter for board consideration
- Provide an "against" choice on the proxy card, potentially leading shareholders to believe such votes have an impact on the outcome of the election, when in fact they do not
- Avoid using the word "plurality" in the description of the vote requirement, for example by stating that majority voting applies unless certain external documents provide otherwise

CII raised concerns in 2015 with the SEC about companies' use of confusing vote terminology. The SEC on Oct. 26, 2016, proposed certain reforms (see p. 83). The most beneficial of these, in CII's view, is the proposed requirement that plurality-vote companies disclose the effect of a "withhold" vote. This would make it crystal clear to investors that uncontested plurality elections guarantee victory for all nominees. However, the SEC proposal would not require the handful of plurality companies that provide an "against" choice to similarly disclose that voting "against" has no impact on the election's outcome. The SEC proposal would require companies with majority voting to provide "against" and "abstain" options, and bar them from providing a "withhold" choice.

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The **Council of Institutional Investors (CII)** is a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Member funds include major long-term shareholders with a duty to protect the retirement savings of millions of workers and their families. CII's associate members include a range of asset managers with more than $20 trillion in assets under management. CII has advocated for majority voting since 2005.

-January 2017

Appendix 1: Sample bylaw language for consequential majority voting

Sample bylaw language compliant in Delaware[1]

If, as of the record date for a meeting of stockholders for which directors are to be elected, the number of nominees for election of directors equals the number of directors to be elected (an "Uncontested Election"), each director shall be elected by the vote of the majority of the votes cast with respect to that director's election at such meeting of stockholders, provided a quorum is present. For the purpose of an Uncontested Election, a majority of votes cast means that the number of votes "for" a director's election must exceed fifty percent (50%) of the votes cast with respect to that director's election. Votes "against" a director's election will count as votes cast, but "abstentions" and "broker non-votes" will not count as votes cast with respect to that director's election.

If, as of the record date for a meeting of stockholders for which directors are to be elected, the number of nominees for election of directors exceeds the number of directors to be elected, the nominees receiving a plurality of the votes cast by holders of shares entitled to vote in the election at a meeting at which a quorum is present shall be elected.

In order for any person to become a member of the Board of Directors, such person must agree to submit upon appointment or first election to the Board of Directors an irrevocable resignation, which resignation shall provide that it shall become effective, in the event of a stockholder vote in an Uncontested Election in which that person does not receive a majority of the votes cast with respect to that person's election as a director, at the earlier of (i) the selection of a replacement director by the Board of Directors, or (ii) 90 [or 180] days after certification of such stockholder vote. Acceptance by the Board of Directors is not a condition to the effectiveness of the irrevocable resignation.

Any director may resign at any time upon notice given in writing or by electronic transmission to the Chairman of the Board or to the Secretary. A resignation is effective when delivered unless the resignation specifies (i) a later effective date or (ii) an effective date determined upon the happening of an event or events (including but not limited to a failure to receive more than fifty percent (50%) of the votes cast in an election).

[1] Following consultation with multiple Delaware securities law experts, CII believes this sample language complies with Delaware General Corporation Law as currently interpreted. There can be no accounting for future litigation in this area, however. Any company exploring revisions to its vote requirement should seek counsel on bylaw language, including counsel on how to address extraordinary circumstances such as multiple failed elections potentially triggering change-in-control provisions under material contracts and debt covenants.

Sample bylaw language compliant with the Model Business Corporation Act

Companies incorporated in states that generally follow the Model Business Corporation Act may consider the consequential majority voting bylaw at Microsoft[2], which is incorporated in Washington, an MBCA state:

2.2 Election – Term of Office. At each annual shareholders' meeting the shareholders shall elect the directors to hold office until the next annual meeting of the shareholders and until their respective successors are elected and qualified. If the directors shall not have been elected at any annual meeting, they may be elected at a special meeting of shareholders called for that purpose in the manner provided by these Bylaws.

Except as provided in Section 2.10 and in this paragraph, each director shall be elected by the vote of the majority of the votes cast. A majority of votes cast means that the number of shares cast "for" a director's election exceeds the number of votes cast "against" that director. The following shall not be votes cast: (a) a share whose ballot is marked as withheld; (b) a share otherwise present at the meeting but for which there is an abstention; and (c) a share otherwise present at the meeting for which a shareholder gives no authority or direction. In a contested election, the directors shall be elected by the vote of a plurality of the votes cast.

A contested election is one in which (a) on the last day for delivery of a notice under Section 1.13(a), a shareholder has complied with the requirements of Section 1.13 regarding one or more nominees, or on the last day for delivery of a notice under Section 1.14(g), an Eligible Shareholder has complied with the requirements of Section 1.14 regarding one or more nominees; and (b) prior to the date that notice of the meeting is given, the Board has not made a determination that none of the candidacies of the shareholder or Eligible Shareholder's nominees creates a bona fide election contest. For purposes of these Bylaws, it is assumed that on the last day for delivery of a notice under Section 1.13(a) or Section 1.14(g), there is a candidate nominated by the Board for each of the director positions to be voted on at the meeting. The following procedures apply in a non-contested election. A nominee who does not receive a majority vote shall not be elected. Except as otherwise provided in this paragraph, an incumbent director not elected because he or she does not receive a majority vote shall continue to serve as a holdover director until the earliest of (a) 90 days after the date on which an inspector determines the voting results as to that director pursuant to RCW 23B.07.290; (b) the date on which the Board appoints an individual to fill the office held by such director, which appointment shall constitute the filling of a vacancy by the Board pursuant to Section 2.10; or (c) the date of the director's resignation. Any vacancy resulting from the non-election of a director under this Section 2.2 may be filled by the Board as provided in Section 2.10. The Governance and Nominating Committee will consider promptly whether to fill the office of a nominee failing to receive a majority vote and make a recommendation to the Board about filling the office. The Board will act on the Governance and Nominating Committee's recommendation and within ninety (90) days after the certification of the shareholder vote will disclose publicly its decision. Except as provided in the next sentence, no director who failed to receive a majority vote for election will participate in the Governance and Nominating Committee recommendation or Board

[2] Microsoft's complete bylaws, filed with the SEC in an 8-K on July 5, 2016, are available at https://www.sec.gov/Archives/edgar/data/789019/000119312516641678/0001193125-16-641678-index.htm.

decision about filling his or her office. If no director receives a majority vote in an uncontested election, then the incumbent directors (a) will nominate a slate of directors and hold a special meeting for the purpose of electing those nominees as soon as practicable, and (b) may in the interim fill one or more offices with the same director(s) who will continue in office until their successors are elected.

Appendix 2: The continuum of regimes for uncontested director elections

	PLURALITY VOTING		MAJORITY VOTING	
	Strict Plurality (no resignation)	**Plurality Plus (rejectable resignation)**	**Majority Voting (rejectable resignation)**	**Consequential Majority Voting**
How do shareholders oppose[1] a nominee?	Withhold their vote	Withhold their vote	Vote against	Vote against
Who gets elected?	Nominees receiving the most for votes (i.e., all nominees)	Nominees receiving the most for votes (i.e., all nominees)	Nominees receiving more "for" votes than "against" votes	Nominees receiving more "for" votes than "against" votes
Must majority-opposed directors *immediately* depart from the board?	No. Majority-opposed directors are duly elected.	No. Majority-opposed directors are duly elected.	No. Unelected directors remain temporarily via holdover provision, though sometimes indefinitely.	No. Unelected directors remain only temporarily via holdover provision.
Must majority-opposed directors *eventually* depart from the board?	No	No. The "hard deadline" is the board's decision to accept or reject the resignation.	No. The "hard deadline" is the board's decision to accept or reject the resignation.	Yes. Unelected directors cannot serve beyond a grace period such as 90 or 180 days. (For DE companies, cutoff ties to irrevocable resignation; for MBCA companies, cutoff ties directly to calendar.)

[1] Shareholders who withhold their vote "oppose" a nominee only in unofficial capacity. Technically, every uncontested nominee in a plurality election receives 100% support and zero opposition because withholding a vote is the legal equivalent of an abstention.

	PLURALITY VOTING		MAJORITY VOTING	
	Strict Plurality (no resignation)	**Plurality Plus (rejectable resignation)**	**Majority Voting (rejectable resignation)**	**Consequential Majority Voting**
Argument in favor	Assures board continuity	Enables board continuity while instituting a process for board to consider removal of majority-opposed directors	Same as Plurality Plus, but also denies majority-opposed directors the distinction of legally being re-elected	The only approach with "teeth." Places ultimate authority in the hands of the company's owners by removing the possibility of unelected directors indefinitely remaining on board
Argument against	No accountability to shareholders and no formal process for board to consider removing a majority-opposed director.	Legal election of all nominees remains certain. Resignation requirement provides discretion to reject the letter, which routinely happens.	Board retains discretion to keep unelected directors, and sometimes does so (albeit less often than at "plurality plus" companies.)	Does not accommodate scenario of unelected directors "curing" or pledging to resolve issue(s) perceived as having caused the defeat
Currently most prevalent among	Smaller-cap companies	Smaller-cap companies	Larger-cap companies	Not prevalent at present; early examples include WA-incorporated Microsoft's MBCA-compliant version; first DE company TBD
CII position	Opposes	Opposes	Accepts at companies with MV already in place and good-faith commitment to replace unelected directors within reasonable period	Supports as best practice