

# Experts Challenge Starboard Bid to Revamp ISS



Starboard Value CEO Jeff Smith. Diane Bondareff/AP/Shutterstock/The Deal

---

**Jeff Smith's proposal for proxy advisers to evaluate board candidates regardless of a company's performance doesn't sit well with many in the activist community.**

---



**By Ronald Orol**

March 10, 2023 10:09 AM

For years proxy advisers **Institutional Shareholder Services Inc.** and Glass Lewis & Co. LLC have employed a two pronged approach to reviewing activist director contests.

First, the pair will review whether change at a company is truly necessary. ISS, for example, will review of a company's total shareholder returns, an economic comparison to peers, as well as positioning and strategy before reviewing candidates for corporate boards. Then — and only then — will they move to evaluate and make recommendations on incumbent and dissident director candidates.

These recommendations, only gained through the two step approach at ISS and Glass Lewis, carry huge influence among large institutional shareholders in contested board battles such as those launched by activists.

The approach, however, came under fire this week as **Jeff Smith** of **Starboard Value LP** suggested to a Council of Institutional Investors conference that the advisers should abandon their approach. He said the two should make changes to allow for more support for dissident nominees that are more qualified than incumbent directors in some situations even if they determine that change isn't necessary at a company.

“If there are super smart candidates that are proposed that are better than some weaker candidates, we [investors] should choose the best board,” Smith said. “Currently the proxy advisors aren't set up that way and they are holding on to their prior methodology which is ‘is change necessary.’”

Though the proposal caused a great deal of buzz in the activist community (**and at the conference**), such changes are unworkable and unlikely, experts said, given the complexities assessments of director candidates would add to their process. Changes would also be hard to digest for institutional investors, the main users of the advisers' recommendations.

The elimination of the initial economic first prong review, for instance, would put more pressure on ISS and Glass Lewis analysts to conduct a qualitative review of all candidates, said one banker. In many scenarios, the banker said, it's difficult to determine if new nominees would add much value over incumbent directors.

Adding to the complexities, the banker said, companies will bring in new board members after the activist launched its contest, making it much more difficult to determine whether the board still needs still to be refreshed.

“If you don’t have the two-pronged process, companies that are underperforming but have good directors may not get an ISS recommendation against incumbents or for activist candidates,” said **Waheed Hassan**, founder of **ZMH Advisors** and a former analyst in the ISS special situations group.

To focus exclusively on director candidates could lead to situations where severely underperforming companies with seemingly strong incumbent directors get a pass, he said.

A new system that ignores economic arguments in some cases to focus on governance alone would be also be difficult to implement.

“It creates a lot of gray areas and you would have to train all the analysts in the different approach,” Hassan said. “For instance, if the first prong suggests that management has done a good job, but at the same time, one of the activist nominee is much stronger than an incumbent director, what is the right recommendation to make?”

He added that If ISS supports the activist nominee, investors might ask, “why would you oppose an incumbent director who helped create shareholder value?”

A second banker, focused on activist defense said a change would raise the ire of institutional investors who have been happy with the two-stage approach the proxy advisers have been employing.

He noted that big investors, such as mutual fund managers, likely don't want the added responsibility of reviewing proxy adviser recommendations about directors at companies that are performing adequately, as they consider thousands of proxy votes annually.

## **The Case for Change**

Some observers agreed with Smith, at least partly, suggesting the proxy advisers' current approach to reviews could overlook situations with long-tenured and no-longer-qualified directors, for example.

“You don’t need to see how the company has performed in some cases,” said **ZMH Advisors'** Hassan. “If the activist has a better candidate, someone with more relevant expertise and skillset, and it is clear that the incumbent director doesn’t add value, then such a change should be supported without the need for the first prong of the ISS and Glass Lewis frameworks.”

It may be a real challenge for proxy advisers to abide by the existing process in the wake of universal proxy card **rules that took effect in** September, said **Legion Partners Asset Management LLC** co-founder Ted White.

Proxy advisers may need to rethink their rubric, and in particular consider what they view as necessary change. A proxy adviser, he said, could conclude that the company isn’t underperforming its peers, but need new directors.

“You could make the case that boards don’t do a great job overall on refreshing directors,” White said. “You could see a scenario where an activist [launches a campaign] that is much more oriented towards ‘the board needs to be in better shape for the company going forward’ without much of a focus on the business side, and a proxy adviser doesn’t recommend for the activist.”

White said that this kind of scenario wouldn’t work at a company with a stellar performance that beats peers handily, but it could impact a mid-performer that needs board changes.

“Could mutual funds signal to proxy advisers to dial back their policies? It could drive a major change in how boards consider board refreshment,” he said.

Overall, ISS' two-pronged approach has existed since the early 2000s and has survived at least three different leadership changes in its special situations group.

Starboard’s Smith, who didn't appear confident advisers would heed his advice, also told the conference that institutional investors need to be “more and more willing” to

support great candidates even if ISS and Glass Lewis might not, especially with the adoption of the universal proxy card.

“You now have a choice and you should understand the power you have with UPC to pick and choose whoever you want,” Smith said.

Smith received a rousing ovation for his comments, though it's unclear if such changes would be as widely hailed in the investor community at large.

ISS declined to comment and Glass Lewis didn't return a request for comment.

TAGS

FEATURES AND COMMENTARY

INSTITUTIONAL INVESTORS, ASSET MANAGERS AND CUSTODIANS

ACTIVISM

WASHINGTON, D.C.

\$ 1-10 BILLION

REGULATION

CORPORATE GOVERNANCE

ESG

NEW YORK

UNIQUE ANALYSIS

---

## COMPANIES MENTIONED

---

Apple Hospitality REIT Inc.	Box Inc.	CII Parent Inc.	Glass, Lewis & Co. LLC	
Green Dot Corp.	Humana Inc.	Humm Group Ltd.	Hunt Corp.	Huntsman Corp.
Huntsman Polyurethanes	ISS A/S	Institutional Shareholder Services Inc.		
Legion Partners Asset Management LLC	LivePerson Inc.	Mercury Computer Systems Inc.		
Mercury Systems Inc.	Seize The Deal LLC	Starboard Value LP	Union Planters Corp.	
ZMH Advisors				

---

## PEOPLE MENTIONED

---

Amina Hassan	Claire White	Jeff Smith	Louis Glass	Luke S Smith	Waheed Hassan
--------------	--------------	------------	-------------	--------------	---------------