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**Shareholder Direct Amendment of Bylaws in Maryland**

As preparation for the 2018 proxy season begins, Maryland public companies are continuing to consider whether and to what extent to extend to shareholders the power to directly amend any provision of the bylaws without board action. Under the new proxy voting policy of Institutional Shareholder Services Inc. ("ISS"), as adopted and applied for last proxy season and continued for 2018, ISS will withhold recommending the election of members of the nominating and governance committee of a board of a company that does not grant this direct-amendment power to holders of at least $2,000 worth of the company's shares for at least one year by a vote of no more than a majority of the votes entitled to be cast on the matter.

Thus, three main variables are implicated: (a) The percentage and length of ownership of shares by the proponent/s of the direct amendment; (b) the range of bylaw provisions that may be amended directly; and (c) the shareholder vote necessary to approve the direct bylaw amendment.

Share Ownership of Proponents. There is growing recognition by companies and major holders that the $2,000/one-year requirement of SEC Proxy Rule 14a-8, originally adopted on May 21, 1998 (when the Dow Jones Industrial Average was under 9,000) for shareholder precatory proposals, is no longer sufficient in 2018, certainly not for binding proposals to directly amend bylaws without prior board approval. Moreover, the now overwhelming market standard for share ownership to begin a proxy access process – three percent for three years – is a clear analogue for shareholder bylaw amendment proposals. Both (a) proxy access to nominate a director in the company's own proxy materials and (b) direct shareholder power to amend the bylaws are significant corporate governance actions that should not be initiated by holders of only a small number of shares who may have economic interests and agendas other than the company's and other shareholders', potentially costing the company an unnecessary expenditure of time, money and other resources. Already, in late 2017, AvalonBay Communities, Inc. (AVB), Equity Residential (EQR) and CoreCivic, Inc. (CXW) have adopted provisions permitting direct bylaw amendments to be proposed by a group of up to five shareholders owning a modest one percent of outstanding shares continuously for one year. Limited contact with some major REIT holders thus far indicates an understanding and acceptance of this compromise position.

Range of Bylaw Provisions Amendable by Shareholders ("Ringfencing"). Under ISS's policy, any and all provisions in the bylaws must be amendable by shareholders. Thus, shareholders could amend the bylaws to divest the board of the power to amend the bylaws. Fortunately, even ISS has acknowledged in our discussions that it would not be "comfortable" with such a proposal. There are other provisions of bylaws that a company may want to protect from direct shareholder amendment, including director and officer indemnification and expense advance. AVB, EQR and CXW have each "ringfenced" D&O indemnification and bylaw

amendment procedures. The board of each company should review its bylaws to identify provisions that it wants to protect. In doing so, however, a board should remember that there is likely a practical limit on the number and type of existing or new provisions that many stakeholders will think should be protected from direct amendment by shareholders.

Shareholder Vote Requirements to Approve Direct Bylaw Amendments. Under its new policy and practice last year, ISS will not accept a shareholder vote requirement to approve a properly presented direct bylaw amendment proposal of more than a majority of the votes entitled to be cast. This position is consistent with ISS's and many institutional holders' opposition to supermajority vote requirements. However, not all supermajority vote requirements are created equal. The traditional supermajority vote requirement – two-thirds of all the votes entitled to be cast on the matter – is the default statutory standard for major corporate transactions such as charter amendments, mergers, sales of all or substantially all of the assets and dissolution, all of which must first be approved by the board. A shareholder direct bylaw amendment, by definition, has *not* been approved by the board; in fact, it would probably be opposed by the board (otherwise, the board would have agreed to it). This difference in context is significant. It is reasonable to conclude that amending an important governing document like the bylaws should require the approval of more than holders of a bare (and very possibly transitory) majority of the votes entitled to be cast.

We recognize there are several alternatives for a company to consider, including (i) maintaining the board's exclusive power over bylaw amendments, (ii) accepting ISS's policy "as is," and (iii) adopting a compromise position, and that there are variables within each of them and pros and cons to each alternative. In making a decision, we generally recommend to boards (a) checking the voting policies of a company's current top shareholders, (b) discussing the issue with them and (c) soliciting their views, especially as more and more major holders are developing their own positions on governance issues rather than relying on ISS's largely undifferentiated policies. Some holders may oppose a particular governance policy or provision but recognize that the decision on voting for directors should turn on more factors – the company's economic performance, for example – than just one departure from one ISS position.

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As always, our colleagues and we are available at any time to discuss these or other matters of Maryland law, including assisting in developing the form and content of possible approaches to major holders.

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