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Jill E. Fisch
Perry Golkin Professor of Law
August 19, 2010

The Honorable Mary Schapiro, Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Concept Release on the U.S. Proxy System
File Number S7-14-1O

Dear Chairman Schapiro:

I am Perry Golkin Professor of Law and Co-Director of the Institute for Law and Economics at the University of Pennsylvania Law School. I have been teaching and writing in the areas of corporation law and securities regulation for twenty-two years. I write in response to your concept release requesting comments on the U.S. Proxy System.

Specifically Part V (A) of your release requests comment on the manner in which proxy advisory firms formulate their recommendations and the extent to which those recommendations influence shareholder voting, as well as the transparency of their operations. Professors Stephen Choi and Marcel Kahan of NYU Law School and I have conducted two empirical studies of the four major U.S. proxy advisory firms. The studies, which are published as *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649 (2009) (*Director Elections*) and *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010) (*The Power of Proxy Advisors*), are submitted together with this letter. *Director Elections* examines the criteria that proxy advisory firms use to formulate their recommendations in uncontested director elections. *The Power of Proxy Advisors* evaluates the extent to which the recommendations influence shareholder voting and considers various explanations for that influence.

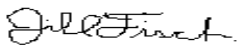
To summarize our findings briefly, we conclude in *Director Elections* that proxy advisory firms provide valuable information. Their recommendations appear to be based on the factors that should matter to investors – good governance, director attention, and performance. Withhold recommendations are made in response to identifiable issuer and director-specific problems including financial restatements, excessive executive compensation and lack of independence. We find a significant degree of heterogeneity among proxy advisors in the manner in which they formulate their recommendations and in the weight that they accord to various factors. We believe this heterogeneity is desirable in that it increases investor choice. We do have some concern, however, that although

proxy advisors explain the bases for their withhold recommendations, they do not reveal the relative importance of the different factors that they analyze, reducing the transparency of their approach.

In *The Power of Proxy Advisors*, we analyze the effect of proxy advisor recommendations on voting outcomes in uncontested direction elections. We find, in accordance with popular accounts, that Institutional Shareholder Services (ISS, n/k/a RiskMetrics) is by far the most influential of the four major firms, but that media reports overstate the extent of its influence by failing to control for the underlying firm and director-specific factors that influence voting outcomes. Controlling for these factors, we estimate that an ISS recommendation shifts 6-10% of shareholder votes and that a major component of this influence may stem from its role as information agent – aggregating information that investors consider important in making their voting decisions.

As our articles note, the potential influence of proxy advisory firms is likely to increase with the adoption of new initiatives regarding shareholder voting such as say on pay, majority voting, the elimination of broker voting and, potentially, proxy access. We are concerned about the potential influence exercised by private organizations that lack an economic stake in the companies they evaluate. In particular, we are troubled by the absence of mechanisms to hold proxy advisors accountable for their recommendations. We question whether investors have adequate incentives and information to allow market forces to monitor the quality of the information provided by proxy advisors. We note that federal regulation has fostered the growth of these firms by creating a need for institutional investors to document the rationality of their voting procedures. Although our study suggests that not all institutions blindly follow the ISS recommendations, they nonetheless rely heavily on proxy advisors in making their voting decisions. See also Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 324 (2008) (presenting data showing reliance by public pension funds on proxy advisors).

Sincerely,



Jill Fisch

SOUTHERN CALIFORNIA
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DIRECTOR ELECTIONS AND THE ROLE OF PROXY ADVISORS

STEPHEN J. CHOI, JILL E. FISCH &
MARCEL KAHAN

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DIRECTOR ELECTIONS AND THE ROLE OF PROXY ADVISORS

STEPHEN J. CHOI*
JILL E. FISCH†
MARCEL KAHAN‡

ABSTRACT

Using a dataset of proxy recommendations and voting results for uncontested director elections from 2005 and 2006 at Standard & Poor's 1500 companies, we examine how advisors make their recommendations. Of the four firms we study—Institutional Shareholder Services ("ISS"), PROXY Governance, Inc. ("PG"), Glass, Lewis & Company ("GL"), and Egan-Jones Proxy ("EJ")—ISS has the largest market share and is widely regarded as the most influential. We find that the four proxy advisory firms differ substantially from each other in their willingness to issue a withhold recommendation, in the factors that affect their recommendations, and in the relative weight of those factors. Specifically, ISS focuses on governance-related factors, PG on compensation-related factors, GL on audit/disclosure-related factors, and EJ on an eclectic mix of factors. To the extent these differences are understood, institutional investors can subscribe to those advisors whose recommendations best conform to the

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The authors thank Glass Lewis, PROXY Governance, and Egan-Jones for access to their voting recommendations and policies. We would also like to thank, for their helpful comments, Cindy Alexander, Martijn Cremers, Robert Daines, Un Kyung Park, Roberta Romano, Randall Thomas, and participants at faculty workshops at the New York University School of Law, Columbia Law School, Vanderbilt Law School, and Harvard Law School.

investors' assessments of value-maximizing corporate governance. But if these differences are not known, then proxy advisors may lack accountability for—and can pursue their own agenda in making—their voting recommendations, thereby impairing the effectiveness of the shareholder franchise.

I. INTRODUCTION

Proxy advisory firms provide services to investors in connection with shareholder voting. Proxy advisory services had their start in the mid-1980s, when Institutional Shareholder Services ("ISS"), now a business unit of RiskMetrics Group, was founded. More recently, several other firms—notably, PROXY Governance, Inc. ("PG"), Glass, Lewis & Company ("GL"), and Egan-Jones Proxy ("EJ")—have started to offer proxy advice. These firms, which typically operate on a subscription basis, research proxy issues, issue voting recommendations, and assist institutional investors in formulating voting guidelines.

Critics have expressed concerns about the influence that proxy advisors in general, and ISS in particular, can potentially exert over the shareholder voting process. Proxy advisors are depicted as powerful, yet unaccountable, institutions that can sway the outcome of corporate votes without any of their own money at stake. In addition to concerns about this extreme level of influence, commentators have identified potential conflicts of interest that might compromise the integrity of voting recommendations. These concerns are intensified by the limited transparency that proxy advisors provide about the processes by which their recommendations are determined. This lack of transparency has led the U.S. Chamber of Commerce to describe ISS's process for making proxy recommendations as a "black box."[1]

Because institutional investors now have the ability to choose among several different proxy advisors, the extent to which the advisors' policy determinations are transparent becomes an important factor in ascertaining the efficiency of the market for proxy advisory services. The efficiency of this market has the potential to affect critically the outcomes of corporate elections. Numerous developments, including recent calls for increased shareholder activism, regulatory reforms that increase institutional investor obligations to vote responsibly, attempts to expand shareholder voting rights (via proxy access and "say on pay" initiatives), and the move from

1. Rachel McTague, *Chamber Approaches RiskMetrics with Proposed Changes to Policy-Setting*, 40 Sec. Reg. & L. Rep. (BNA) 569, 589 (2008).

plurality to majority voting in director elections, all increase the potential importance of the shareholder franchise and thereby increase the potential effect of the proxy advisory firms that influence the manner in which shareholders vote. If institutional investors understand the basis for voting recommendations of the various proxy advisors, they can subscribe to and follow the recommendations of those advisors that best match their assessment of which votes maximize corporate value. On the other hand, if institutional investors lack such understanding and choose to follow a proxy advisor based on other criteria, then proxy advisors are indeed, as charged by their critics, powerful, unaccountable, badly incentivized, and able to pursue their own agenda in issuing voting recommendations.

In light of these concerns, understanding the role and influence of proxy advisors is critically important. Using a dataset of director elections at Standard & Poor's ("S&P") 1500 companies and proxy recommendations for 2005 and 2006, this Article examines the factors that affect the recommendations made by the four major proxy advisory firms—ISS, PG, GL, and EJ—in uncontested director elections. It is the first article to examine empirically the factors that affect these voting recommendations and the first article that compares the recommendations made by several proxy advisors.

The Article proceeds as follows: Part II describes the development of the market for proxy advisory services, the main proxy advisory firms, and the institutional context in which those firms operate. Part III describes our basic regression analysis in which we analyze the relationship between withhold recommendations and a variety of director-specific, firm, and market factors that might be expected to influence the likelihood of a withhold recommendation. Part IV presents an interaction analysis in which we examine the relationship between several key factors. Part V examines whether directors who receive nominations for multiple boards receive different recommendations compared with directors who sit on only one board. Part VI discusses how group-based and spillover effects might influence whether advisory firms issue withhold recommendations. Part VII considers the implications of our findings.

II. THE EVOLUTION OF PROXY ADVISORS AND THEIR SERVICES

ISS, the first proxy advisor, was founded in 1985 and began to provide

proxy advisory services to institutional investor clients in 1986.[2] ISS provides these services on a subscription basis. A subscription entitles the client to ISS's voting recommendations as well as a report detailing the underlying research and analysis upon which those recommendations are based.[3] Additionally, ISS offers assistance in developing the client's voting guidelines, providing issuer-specific research, and handling the mechanical process of voting the client's shares.[4] Clients may delegate to ISS the authority to vote their proxies, either in accordance with the client's own voting guidelines or in accordance with ISS recommendations.[5] ISS also evaluates issuer corporate governance and releases highly publicized corporate governance ratings in which issuers are scored based on their corporate governance structure and policies.[6]

For many years, ISS faced a competitor—Proxy Monitor—that offered similar services, including voting recommendations.[7] In 2001, however, the two companies effectively merged when Proxy Monitor acquired ISS.[8] The merger left ISS as the sole proxy advisor and created a monopoly.[9] Today, ISS remains the dominant proxy advisory firm. According to Robert Daines, Ian Gow, and David Larcker, "ISS claims over 1,700 institutional clients managing $26 trillion in assets, including 24 of the top 25 mutual funds, 25 of the top 25 asset managers and 17 of the

2. RiskMetrics Group, Company History, http://www.riskmetrics.com/history (last visited Apr. 20, 2009).

3. RISKMETRICS GROUP, PROXY RESEARCH SERVICES FOR INSTITUTIONAL INVESTORS WORLDWIDE 1–3 (2009), *available at* http://www.riskmetrics.com/sites/default/files/GS1-Proxy%20Research%20Services.pdf. ISS recommendations are frequently reported in the media. *See, e.g.*, John D. Stoll & Stephen Wisnefski, *ISS Recommends Lear Holders Reject Icahn Bid*, WALL ST. J., June 21, 2007, at A12 (reporting ISS's recommendation against Carl Icahn's proposed takeover of Lear).

4. RISKMETRICS GROUP, *supra* note 3, at 1–3.

5. *Id.* at 2. Some companies have made notable use of these proxy voting services. *See, e.g.*, Luisa Beltran, *ISS Could Kill HP-Compaq*, CNNMONEY, Mar. 4, 2002, http://money.cnn.com/2002/03/04/deals/iss_hp/index.htm (describing how Barclays Global Investors delegated to ISS the authority to vote its nearly sixty million Hewlett-Packard shares in the vote on the merger with Compaq Computer Corporation and how one Barclays spokesman stated "[w]e provided ISS the authority to vote the shares" and "[w]e have no influence on how they are going to vote").

6. Robert Daines, Ian Gow & David Larcker, *Rating the Ratings: How Good Are Commercial Governance Ratings?* 8–10 (Stanford Univ. Rock Ctr. for Corp. Governance Working Paper Series, Paper No. 1, 2008), *available at* http://ssrn.com/abstract=1152093. Firms are given a score based on their standing within their own industry and a score based on their standing within their index (for example, Microsoft standing within the S&P 500). *Id.* at 9.

7. *See Investor Group Acquires Stake in Proxy Monitor*, WALL ST. J., June 10, 1998, at A8.

8. Mark Thomsen, *Proxy Monitor Buys ISS*, SOCIALFUNDS, Aug. 13, 2001, http://www.socialfunds.com/news/article.cgi/648.html.

9. Martha McNeil Hamilton, *Player in the Proxy Wars: HP-Compaq Merger Has Brought a Shareholder-Services Firm out of Obscurity*, WASH. POST, Apr. 1, 2002, at E01 (describing ISS as "something close to a monopoly").

top 25 public pension funds."[10] In 2006, ISS was acquired by RiskMetrics Group, a publicly traded company specializing in risk management services.[11]

In addition to serving investors, ISS provides governance consulting to corporate issuers. For issuers, ISS offers "advisory services [to] help corporations understand and implement best practices in corporate governance, evaluate institutional voting behavior and design executive compensation plans, along with comprehensive risk management solutions for corporate treasurers."[12] As discussed below, the fact that ISS simultaneously issues advice to both corporations and institutional investors has garnered some criticism.

Recent regulatory and market developments increased the demand for proxy advisory services.[13] In 2003, the Securities and Exchange Commission ("SEC") promulgated regulations that require mutual funds to develop voting policies and procedures designed to ensure that the funds' voting power is exercised in the "best interest" of beneficiaries.[14] In conjunction with these regulations, the SEC adopted rule 30b1-4 under the Investment Company Act of 1940, requiring mutual funds to disclose their complete voting records annually.[15] The rule focused increased attention on mutual fund voting policies.[16] Institutional investor activism also enhanced

10. Daines et al., *supra* note 6, at 2.

11. Joann S. Lublin, *ISS Accepts Bid of $553 Million from RiskMetrics*, WALL ST. J., Nov. 1, 2006, at A10.

12. RiskMetrics Group, Corporations, http://www.riskmetrics.com/corporations (last visited Apr. 20, 2009).

13. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, REP. NO. GAO-07-765, CORPORATE SHAREHOLDER MEETINGS: ISSUES RELATING TO FIRMS THAT ADVISE INSTITUTIONAL INVESTORS ON PROXY VOTING 6–7 (2007) (describing various regulatory and market developments as leading to growth in the proxy advisory industry). *See also* PROXY Governance History, http://www.proxygovernance.com/content/pgi/content/history.shtml (last visited Apr. 20, 2009) (describing the development of proxy advisory services as "encouraged by a developing regulatory environment that would expand the market for proxy advisory and voting services").

14. 17 C.F.R. § 275.206(4)-6 (2003).

15. *Id.* § 270.30b1-4.

16. The Department of Labor had previously taken several steps to encourage mutual funds to vote shares in their portfolio companies responsibly. In 1988, the Department advised fund managers that "the decision[s] as to how proxies should be voted . . . are fiduciary acts of plan asset management." Letter from Alan D. Lebowitz, Deputy Assistant Sec'y, Dep't of Labor, to Helmuth Fandl, Chairman of the Ret. Bd., Avon Prods., Inc. (Feb. 23, 1988), *in* 15 Pens. Rep. (BNA) 371, 391 (Feb. 29, 1988). The Department reinforced this position in 1990. *See* Letter from Alan D. Lebowitz, Deputy Assistant Sec'y for Program Operations, Dep't of Labor, to Robert A. G. Monks, Institutional Shareholder Services, Inc. (Jan. 23, 1990), *in* 17 Pens. Rep. (BNA) 205, 244 (Jan. 29, 1990). It then formalized its policies in an interpretive bulletin in 1994. *See* Interpretive Bulletins Relating to the Employee Retirement Income Security Act of 1974, 29 C.F.R. § 2509.94-2 (1994), *amended by* 29 C.F.R. § 2509.08-2 (2008). Prior to the SEC's rule change in 2004, however, these efforts did not

the focus on, and importance of, shareholder voting.

As a result of these developments, several new proxy advisory firms entered the market.[17] GL was founded in 2003.[18] GL provides research and analysis on more than eighteen thousand public companies based in eighty countries around the world.[19] In 2007, GL became a wholly owned subsidiary of the Ontario Teachers' Pension Plan Board.[20]

EJ was established in 2002 as a division of Egan-Jones Rating Company, an independent company that provides credit ratings information for investors.[21] EJ "provides research, recommendations and voting services for domestic and foreign proxy proposals offered in annual subscriptions priced according to the number of securities covered."[22] EJ provides this coverage for a flat fee of $12.50 per year per company.[23]

PG is a wholly owned subsidiary of FOLIO*fn*, Inc., an innovative financial services company.[24] PG began providing recommendations for the 2005 proxy season. Its first subscriber was the Business Roundtable,

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receive extensive attention. *See* CLIFTON D. PETTY, PENSION CONSULTANTS, INC., GATHERING STRENGTH: THE REINFORCEMENT OF FIDUCIARY RESPONSIBILITY FOR PROXY VOTING 1 (2004), *available at* http://pension-consultants.com/cimages/file_85.pdf (calling the 1994 Interpretive Bulletin "far ahead of its time").

17. The analysis in this Article focuses on the four major proxy advisory firms—ISS, PG, GL, and EJ—which issue publicly reported voting recommendations on a regular basis. Several firms provide related services. For example, CtW Investment Group was organized in February 2006 and provides a limited number of recommendations to union pension funds. CtW's primary efforts are devoted to developing initiatives to support the activism of member pension funds. *See* CtW Investment Group, Who We Are, http://www.ctwinvestmentgroup.com/index.php?id=1 (last visited Apr. 20, 2009). Also, Marco Consulting Group, which is included in the GAO Report as one of the major proxy advisory firms, *see* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 13, at 8, provides investment consulting services to Taft-Hartley funds and a number of public employee benefit plans. These services include voting its clients' proxies. *See* Marco Consulting Group, Company History, http://www.marcoconsulting.com/1.2.html (last visited Apr. 20, 2009). Marco does not, however, publicly issue voting recommendations. *Id.*

18. About Glass Lewis, http://www.glasslewis.com/company/index.php (last visited Apr. 20, 2009).

19. *Id.*

20. *Id.*

21. *See* About Egan-Jones Proxy, http://www.ejproxy.com/about.aspx (last visited Apr. 20, 2009); U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 13, at 8. In 2007, EJ was recognized by the SEC as the fourth "nationally recognized statistical rating organization," a status equivalent to that enjoyed by Moody's, S&P, and Fitch. Order Granting Registration of Egan-Jones Rating Company as a Nationally Recognized Statistical Rating Organization, Exchange Act Release No. 57031, 72 Fed. Reg. 73,909 (Dec. 21, 2007). *See also* Aaron Lucchetti, *Tiny Firm Gives Ratings Giants Another Worry: Mr. Egan's Ranks Gain Favor as S&P, Fitch, Moody's Draw Scrutiny*, WALL ST. J., Feb. 9, 2008, at B1.

22. About Egan-Jones Proxy, http://www.ejproxy.com/about.aspx (last visited Apr. 20, 2009).

23. *Id.*

24. PROXY Governance History, https://wwwproxy.governance.com/content/pgi/content/history.shtml (last visited Apr. 20, 2009).

which purchased a bulk subscription for its member companies.[25]

The market for proxy advisory services continues to grow, fueled in part by the increase in institutional ownership of publicly traded equity securities. The overall percentage of institutional holdings rose from 37 percent in 1992 to over 60 percent in 2005.[26] Institutional investors are the primary, if not the exclusive, purchasers of proxy advisory services, both because their substantial holdings make the purchase of such services cost efficient and because they may lack the specialized staff or expertise to research voting issues directly.

The SEC's adoption of rule 30b1-4 increased the incentive for mutual funds in particular to purchase advisory services because reliance on the research and recommendations provided by a major proxy advisor is likely to help a mutual fund demonstrate that it has acted with appropriate diligence in exercising its voting power.[27] Mutual funds comprise a growing percentage of the institutional investor market—the percentage of U.S. equities owned by mutual funds grew from 7 percent in 1990[28] to 32 percent by the end of 2006.[29]

At the same time, corporate governance changes have increased the significance of shareholder voting. The emergence of hedge fund activism has resulted in a greater number of election contests.[30] Even in uncontested elections, shareholder voting has become more important because of the shift from plurality voting to majority voting.[31] Historically, directors in

25. *Id.*

26. John Authers & Francesco Guerrera, *Institutions Increase Equity Stakes*, FIN. TIMES (London), Jan. 22, 2007, at 27.

27. *See* 17 C.F.R. § 275.206(4)-6(a) (2003) (requiring that mutual funds "[a]dopt and implement written policies and procedures that are reasonably designed to ensure that [they] vote client securities in the best interest of clients").

28. BD. OF GOVERNORS OF THE FED. RES. SYS., FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES, FLOWS AND OUTSTANDINGS, SECOND QUARTER 1996, at 88 tbl.L.213 (1996), *available at* http://www.federalreserve.gov/releases/z1/19960912/z1.pdf.

29. BD. OF GOVERNORS OF THE FED. RES. SYS., FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES, FLOWS AND OUTSTANDINGS, FOURTH QUARTER 2006, at 90 tbl.L.213 (2007), *available at* http://www.federalreserve.gov/releases/z1/20070308/z1.pdf. Mutual funds include open-end and closed-end funds as well as exchange-traded funds.

30. Jill E. Fisch, *The Transamerica Case*, *in* THE ICONIC CASES IN CORPORATE LAW 46, 72 (2008) (stating that "as a result" of increased hedge fund activism, "proxy contests are on the rise"); Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance* 16 (Eur. Corp. Governance Inst., Fin. Working Paper No. 139/2006, 2007), *available at* http://ssrn.com/abstract=948907 (recognizing the launching of a proxy election as a hedge fund tactic). For a helpful description of hedge fund activism, see William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1401–09 (2007).

31. *See* Fisch, *supra* note 30, at 67–70 (describing the adoption and effect of majority voting policies).

most companies were elected by a plurality of the votes cast. Since most elections for directors are uncontested, with the number of nominees equal to the number of vacancies, it took just a single vote to get elected.[32] As late as February 2006, 84 percent of S&P 500 companies employed plurality voting.[33] By November 2007, that figure had declined to 34 percent, with 66 percent employing some form of majority voting where nominees must receive more for votes than withhold votes.[34] These majority voting requirements for the election of directors create a meaningful opportunity for shareholders to affect the composition of the board by casting a withhold vote without running a full-scale proxy solicitation.[35]

Other developments that increase the effectiveness of shareholders' votes compound the concerns of directors that are seeking reelection. A proposed New York Stock Exchange ("NYSE") rule change would eliminate the right of brokers to vote stock held in their accounts in uncontested director elections for which they had not received voting instructions.[36] Because discretionary broker votes typically are overwhelmingly cast for the board nominees, the proposed change to the NYSE rules would eliminate a large number of automatic for votes for the incumbent management's slate of directors.[37] Direct shareholder nomination of directors—a procedure that the SEC has repeatedly

32. *See* CLAUDIA H. ALLEN, NEAL, GERBER & EISENBERG LLP, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS, at ii (2007), *available at* http://www.ngelaw.com/files/upload/majoritystudy111207.pdf.

33. *See id.* at i.

34. *See id.*

35. Fisch, *supra* note 30, at 71. In her study of majority voting practices, Claudia H. Allen posits that the increased shareholder power that results from majority voting is augmented by developments such as the rise of proxy advisory firms, the fiduciary requirements placed on mutual funds, and the proposed New York Stock Exchange rule discussed below. ALLEN, *supra* note 32, at ii, vi.

36. In 2006, the NYSE submitted a proposed rule change to the SEC that would have eliminated such "discretionary voting" for director elections. *See* Press Release, N.Y. Stock Exch., NYSE Adopts Proxy Working Group Recommendation to Eliminate Broker Voting in 2008 (Oct. 24, 2006), *available at* http://www.nyse.com/press/1161166307645.html. Although the proposed rule was scheduled to become effective on January 1, 2008, to date, the SEC has not taken action on it. The NYSE recently refiled its proposed rule change, and recent changes in SEC leadership may increase the likelihood that the rule will be approved. Notice of Filing of Proposed Rule Change to Amend NYSE Rule 452 and Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting, Exchange Act Release No. 34-59464, 74 Fed. Reg. 9864 (proposed Feb. 26, 2009), *available at* http://www.sec.gov/rules/sro/nyse/2009/34-59464.pdf.

37. *See CtW Investment Group Urges SEC to Promptly Eliminate Broker Votes*, REUTERS, Apr. 17, 2008, http://www.reuters.com/article/pressRelease/idUS177265+17-Apr-2008+PRN20080417 (explaining that discretionary voting has enabled directors to be reelected solely on the basis of broker votes and has been criticized as "legalized ballot stuffing" by which shareholders are "disenfranchised").

considered but failed to implement[38]—would substantially increase the ability of shareholders to nominate competing director candidates.

Outside the election of directors, other developments have strengthened the influence of shareholders on company decisions. Shareholder voting on issue proposals, such as bylaw amendments, has become more common. It was only in recent years that shareholder-sponsored governance resolutions began to obtain majority approval. Research finds that issuer implementation of shareholder proposals that receive majority approval has almost doubled since 2002,[39] and that outside directors who fail to implement such proposals face an increased likelihood of losing their board seats.[40] Also, "say on pay" proposals have become one of the most recent and high-profile mechanisms for attempting to address excessive executive compensation.[41]

With the growing importance of the shareholder franchise, the influence of proxy advisors has received increased attention. ISS, in particular, has been described as exercising "tremendous clout,"[42] wielding "extraordinary" influence,[43] getting "[w]hatever [it] wants,"[44] and being able to sway up to 30 percent of the vote in any particular proxy contest.[45] Because of this influence, issuers and challengers devote substantial effort to meeting with proxy advisors and attempting to win their support.[46]

Coupled with concern about influence is concern about the basis upon which proxy advisors make their recommendations. ISS, in particular, has been criticized for the actual or potential conflicts of interest generated by its corporate consulting. Prominent corporate governance expert Ira Millstein was quoted in the *Wall Street Journal Online* denouncing the

38. *See* Fisch, *supra* note 30, at 63–67 (describing the SEC's consideration of proposals to allow shareholder nomination of directors).

39. *See* Yonca Ertimur, Fabrizio Ferri & Stephen R. Stubben, *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals* 20 (Harvard Bus. Sch., Working Paper No. 08-048, 2008), *available at* http://www.hbs.edu/research/pdf/08-048.pdf.

40. *See id.* at 30–31.

41. *See* Fisch, *supra* note 30, at 71 (describing "say on pay" initiatives).

42. Dennis K. Berman & Joann S. Lublin, *Advisor ISS Puts Itself on Sale, Could Fetch Up to $500 Million*, WALL ST. J., Sept. 6, 2006, at C4.

43. Robert D. Hershey, Jr., *A Little Industry with a Lot of Sway on Proxy Votes*, N.Y. TIMES, June 18, 2006, § 3, at 6.

44. William J. Holstein, *Is ISS Too Powerful? And Whose Interests Does It Serve?*, BNET: THE CORNER OFFICE, Feb. 7, 2008, http://blogs.bnet.com/ceo/?p=1100&tag=content;col1.

45. *Id.*

46. *See, e.g.*, Tom Johnson, *HP, Compaq Merger Now in Hands of Shareholder Adviser*, REUTERS, Dec. 11, 2001, http://www.rediff.com/money/2001/dec/11hp.htm (detailing efforts by both sides to obtain ISS support in the HP-Compaq merger vote and observing that "[m]erging companies typically place a great deal of weight" on meetings with ISS analysts).

conflicts inherent in ISS's business model, stating that "[a]nyone who can't see a conflict between consulting and standards-setting has a problem with their eyesight."[47] Another commentator described ISS's business model as engendering conflicts of interest similar to those faced by accounting firms that provided auditing and consulting services, observing that "if similar conflicts arose at one of the shareholder meetings it monitors, ISS would or should criticize the issuer."[48]

PG has received criticism similar to that of ISS, primarily because its founding subscriber was the Business Roundtable, an association of corporate CEOs and a prominent pro-issuer advocate.[49] PG addresses potential conflicts by maintaining a firewall between its proxy advising and corporate clients, but some commentators believe the firm's relationship with issuers "set[s] the stage for potential conflicts of interest."[50]

Some institutional investors have responded to these concerns by choosing proxy advisors that do not provide consulting services. Sensitive to the controversy surrounding ISS's business model, GL and EJ specifically advertise themselves as free of similar conflicts.[51] This policy led the Ohio Public Employees Retirement System ("OPERS") to replace ISS with GL in 2006.[52]

More subtle issues remain. In particular, although all the major proxy advisors provide general guidelines that purport to explain their voting policies, they describe their processes as employing substantial issuer-specific judgment, and the vast majority of criteria are applied on a case-by-case basis. PG, for example, describes its recommendations as made on

47. Tiffany Kary, *ISS Pressed on Conflict by Governance Expert Millstein*, WALL ST. J., Nov. 16, 2005, http://www.shareholderforum.com/PVN/Library/20051116_WSJ.htm.

48. Robert M. Krasne, *Proxy-Voting Concern: ISS Wields Extraordinary Clout in Recommendations to Investors, Yet Also Provides Services to Corporations*, PENSIONS & INVS., May 31, 2004, at 12, *available at* http://www.pionline.com/article/20040531/PRINTSUB/405310706/1026/TOC.

49. Arden Dale & Kaja Whitehouse, *Legg Mason CEO's Pay Questioned*, WALL ST. J., July 18, 2006, at C11; Bill Baue, *Conflict of Interests Policies and Practices Vary Widely at Proxy Advisory Firms*, SOCIALFUNDS, Apr. 19, 2006, http://www.socialfunds.com/news/article.cgi/1985.html.

50. Baue, *supra* note 49.

51. *See* GLASS, LEWIS & CO., LEADING INDEPENDENT ANALYSIS AND VOTING RECOMMENDATIONS ON GLOBAL PROXIES 2 (2008), *available at* http://www.glasslewis.com/downloads/overviews/proxypaper.pdf ("Glass Lewis does not provide consulting services to corporations, CEOs or directors; as such, Glass Lewis' research is without bias."); Egan-Jones Proxy Services, http://www.ejproxy.com (last visited Apr. 20, 2009) ("[T]he integrity of our recommendations is not clouded with the complication of also selling corporate directors and managers consulting services pertaining to these same shareholder proposals.").

52. *See* Kary, *supra* note 47 (quoting OPERS governance officer Cynthia Richson as stating that ISS had been dismissed "as a result of the 'actual or perceived conflicts'").

an "issue-by-company" basis,[53] and it describes eleven factors that it considers "[i]n evaluating whether, in the context of a particular company, [to] recommend a 'withhold' vote from certain directors or the entire board."[54] Even with respect to practices about which the advisors provide substantial detail, there is no way to determine a specific recommendation from the general policies described. For example, in its 2006 policy updates concerning withhold recommendations for compensation committee members, ISS described itself as shifting from a case-by-case analysis to a "formal policy."[55] The formal policy merely consisted, however, of recommending withhold votes if the company had "poor compensation practices"—a standard determined by considering seven case-specific factors.[56]

Thus, although some advisors identify bright-line criteria that determine whether they will issue a withhold recommendation for a director candidate, the majority of the policy guidance they publish consists of a variety of performance and governance factors that will be evaluated or weighed in an undisclosed manner and applied on a company-specific basis.[57] It is impossible to tell from these lists the relative importance of each factor. Because the lists contain most of the criteria that scholars and governance experts have identified as important, they ultimately provide limited guidance on the advisors' processes. It is the purpose of this Article to use empirical tests to identify the criteria that appear truly to drive the

53. PROXY Governance, Inc., Policy and Analysis Methodology 1 (unpublished manuscript, *available at* http://www.integrityfunds.com/PortalIntegrityFunds/DesktopModules/ViewDocument.aspx_?DocumentID=170) (refusing to take a "one-size-fits-all approach" that does not consider proxy issues in context); PROXY Governance Recommendations on an Issue-by-Company Basis, https://www.proxygovernance.com/content/pgi/content/issue_by_issue.shtml (last visited Apr. 20, 2009) (same).

54. PROXY Governance, Inc., *supra* note 53, at 3–5. PROXY Governance does not explain how these factors will be weighted or combined. *See id.*

55. INSTITUTIONAL S'HOLDER SERVS., ISS U.S. CORPORATE GOVERNANCE POLICY 2006 UPDATES 16 (2005), *available at* http://media.gibsondunn.com/fstore/documents/pubs/2006_US_Policy_Update_1117051.pdf.

56. *Id.* ISS stated that poor compensation practices "include, but are not limited to, the following:" (1) "[e]gregious employment contracts including excessive severance provisions"; (2) "[e]xcessive perks that dominate compensation"; (3) "[h]uge bonus payouts without justifiable performance linkage"; (4) "[p]erformance metrics that are changed during the performance period"; (5) "[e]gregious SERP (Supplemental Executive Retirement Plans) payouts"; (6) "[n]ew CEO with overly generous new hire package"; (7) "[i]nternal pay disparity"; and (8) "[o]ther excessive compensation payouts or poor pay practices at the company." *Id.*

57. Even where the criteria appear to be objective, the proxy advisors emphasize that they are examined and applied on a case-by-case basis. *See, e.g.*, Egan-Jones Proxy Services, Proxy Voting Principles and Guidelines 3–5 (unpublished manuscript, on file with authors) (describing policies used in formulating recommendations for directors in uncontested elections).

advisors' recommendations, a task to which this Article now turns.

III. ANALYSIS OF PROXY ADVISORY RECOMMENDATIONS

A. UNIVARIATE ANALYSIS

We analyze empirically the recommendations of the four major proxy advisors—ISS, PG, GL, and EJ—in uncontested director elections. In these elections, there are no competing director candidates, so the advisor either recommends a vote for the director candidate or issues a withhold recommendation. During the time period of this study, most issuers utilized plurality voting, so a withhold recommendation, even if followed, would not directly result in the removal of a director. Nonetheless, a large number of withhold votes, even if technically symbolic, can have a powerful effect. For example, the highly publicized withhold campaign in the 2004 Walt Disney director election resulted in 45 percent of the votes being withheld from Disney's CEO Michael Eisner.[58] Although Eisner was elected to the board, the company announced six months later that he would retire in 2006.[59]

We focus on uncontested director elections for two reasons. First, the election of directors, who have the power to manage the corporation, is one of the most important governance rights of shareholders and is more significant than a vote on a precatory shareholder resolution.[60] The board of directors has the power to manage the corporation, and a substantial number of regulatory and policy reforms in recent years have focused on increasing the independence, efficiency, and monitoring capacity of the corporate board.[61] Moreover, several recent studies have shown that boards

58. Jay Sherman, *Eisner Still in Charge, Disney Shareholders Re-Elect Board, Book Stirs Iger Doubts*, TELEVISION WK., Feb. 14, 2005, at 3.

59. *See id.* (reporting Disney's September 2004 announcement that Eisner intended to retire when his contract expired in September 2006).

60. Concededly, shareholder votes on mergers, spin-offs, and similar transactions are very important. By the same token, shareholder votes in contested elections are important, because election contests typically occur in situations involving a control or structural change. *See generally* Cindy R. Alexander et al., The Role of Advisory Services in Proxy Voting (Jan. 2008) (unpublished manuscript, *available at* http://www.law.yale.edu/images/CBL_Workshop/ACSS_proxy_advice_1_2008b__.pdf) (studying the role of proxy advisors in election contests). In transaction-driven votes, however, the shareholder vote is driven largely, if not exclusively, by the perceived economics of the proposed transaction—economics that are company specific. It is impossible to compare a recommendation for a merger at one company with one involving a different transaction at another company.

61. *See* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1477–1500 (2007) (describing the developments that led to increased board independence beginning in the 1970s).

respond to high withhold votes in director elections by taking actions that are beneficial to shareholders.[62] Second, unlike other important voting decisions (such as a vote on a merger), director elections are common, which makes it easier to determine the factors that account for a recommendation.

Our dataset examines director elections in 2005 and 2006. We focus only on director elections for U.S. companies listed in the S&P 1500 as of June 30 for the year prior to the relevant director election (June 30, 2004, and June 30, 2005, respectively).

We first examined the factors that affect voting recommendations in a univariate analysis. Using a variety of sources, including academic articles, popular press, policy-governance initiatives, and regulatory proposals and reforms, we attempted to identify the director- and company-specific factors that investors are likely to consider important in formulating their votes. Based on this analysis, for each director in our sample of S&P 1500 companies who received either a for or a withhold recommendation from at least one of the four proxy advisors, we collected the following data about the director's characteristics:[63] (1) whether the director was the CEO ("*CEO*"), an employee of the company other than the CEO ("*Empl_Dir*"), an outside director with certain links to the company ("*OutDirLink*"), or a new director ("*New Director*"); (2) whether the director was a member of the audit committee ("*AuditMbr*"), the compensation committee ("*CompMbr*"), or the nominating committee ("*NomMbr*"); and (3) the number of other major company boards on which the director sat ("*ManyBds*"), whether the director attended less than 75 percent of the director meetings ("*Attendance*"), whether the director held at least 20 percent of the company's stock ("*BlockDir*"), whether the director was an interlocking director ("*Interlock*"), whether the director was a nonexecutive chairman of the board ("*Chairman Only*"), and whether the director was seventy-five years old or older ("*Age75*").

62. *See, e.g.*, Paul E. Fischer et al., Investor Perceptions of Board Performance and Board Response to Those Perceptions: Evidence from Uncontested Director Elections 18–28 (Oct. 2008) (unpublished manuscript, *available at* http://ssrn.com/abtract=928843) (finding that boards who perform poorly in elections are more likely to dismiss CEOs, rein in compensation, and scrutinize acquisitions and divestitures). *See generally* Jie Cai, Jacqueline L. Garner & Ralph A. Walkling, *Electing Directors*, 64 J. FIN. (forthcoming Oct. 2009), *available at* http://ssrn.com/abstract=1101924 (finding evidence that boards with low shareholder approval tend to reduce management compensation, dismiss CEOs, and remove takeover defenses); Diane Del Guercio, Laura Seery & Tracie Woidtke, Do Boards Pay Attention When Institutional Investor Activists "Just Vote No"? (Jan. 2008) (unpublished manuscript, *available at* http://ssrn.com/abstract=575242) (finding a correlation between "vote no" campaigns and subsequent improvements in operating performance).

63. *See infra* app.

TABLE 1. Sample Summary

Advisory Firm	*N*	*Number of W/H Recs.*	*Number of For Recs.*	*W/H Rate*	t-*statistic W/H Rate = ISS W/H Rate*	t-*statistic W/H Rate = PG W/H Rate*	t-*statistic W/H Rate = GL W/H Rate*
All	16,038						
ISS	13,869	917	12,953	0.066			
PG	5437	202	5235	0.037	-8.7***		
GL	15,722	2956	12,766	0.188	32.4***	37.4***	
EJ	14,147	1551	12,596	0.110	12.9***	19.7***	-19.2***

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

In addition, for each company and each year, we collected data from SEC filings, press releases, the Investor Responsibility Research Center ("IRRC") Governance Database, the Georgeson Annual Corporate Governance Reviews, and the Center for Research in Security Prices ("CRSP") on the following company-specific factors: (1) whether the first public report of a restatement to a company's financial statement occurred within two years prior to the annual meeting ("*Prior Restat*"), whether the first public statement of an SEC investigation or enforcement action occurred within two years prior to the annual meeting ("*Prior SEC*"), and whether the company rejected an issue proposal that had received majority shareholder support in the previous year ("*IP No*"); (2) whether the company had a classified board ("*ClassBd*"), a poison pill ("*PPill*"), cumulative voting ("*CumVote*"), or golden parachutes ("*GP*"); (3) whether the company was in the top or bottom 5 percent of companies ranked based on abnormal holding period returns for the three-year period prior to the meeting date for the year of the recommendation, adjusted based on the CRSP value-weighted market index ("*Top5AbRet*," "*Bot5AbRet*"); and (4) whether the CEO of the company was in the top 5 percent of total excess compensation ("*Top5AbComp*").

Table 1 provides some summary statistics about the coverage and withhold ratios for each of the four proxy advisors. We found that the advisors differed substantially in the percentage of withhold recommendations they issued. ISS issued withhold recommendations for 6.6% of the directors in the sample, PG for 3.7%, GL for 18.8%, and EJ for 11.0%. The difference in withhold percentages for each pair of advisors is statistically significant at the 1% level.

To see how specific director and company attributes related to the likelihood of a withhold, we tabulated in tables 2.1–2.4 the voting recommendations for directors along several dimensions, and calculated for each proxy advisor whether the likelihood that a director with a certain

attribute (for example, a CEO) received a withhold recommendation from a certain advisor (for example, ISS) was significantly higher or lower than the average for that advisor.

We divided the attributes into several categories and subcategories: (1) audit/disclosure-related attributes (audit committee member, prior restatement, prior SEC investigation); (2) compensation-related attributes (compensation committee member, top 5% abnormal compensation); (3) board-related attributes with the following subcategories: board effectiveness (attendance, many boards, age greater than 75), board composition (nominating committee member), board independence (employee director, outside linked director, block director, interlocking director, chairman only), and board responsiveness (shareholder proposal ignored); (4) takeover-related attributes (classified board, poison pill, cumulative voting, and golden parachutes); (5) performance-related attributes (bottom 5% abnormal return, top 5% abnormal return); and (6) uncategorized attributes (whether the director was a new director or the CEO).

Since each advisor issues many more for than withhold recommendations, we posit that withhold recommendations are triggered by specific problems, either problems with a specific director or issuer-level concerns. Several attributes in tables 2.1–2.4 reflect problems (or an increased likelihood of a problem) that we expect would be important to investors in deciding how to vote and should therefore affect the voting recommendations issued by proxy advisors. For example, commentators have identified low attendance and multiple board positions as factors correlated with reduced director effectiveness.[64] Older directors may be less energetic or involved.[65] Director performance may be impaired by a lack of independence or the presence of conflicts of interest (such directors may include employee directors other than the CEO,[66] outside directors with linked affiliations with the company, directors with substantial block

64. *See, e.g.*, John K. Wells, *Multiple Directorships: The Fiduciary Duties and Conflicts of Interest That Arise When One Individual Serves More Than One Corporation*, 33 J. MARSHALL L. REV. 561, 581 (2000) ("More and more corporate watchdogs call for directors to limit the number of boards on which they serve."); *CPP Investment Board Releases Proxy Voting Guidelines*, CANADIAN CORP. NEWSWIRE, Feb. 24, 2003 (identifying poor meeting attendance as an indicator of potential director ineffectiveness).

65. *See, e.g.*, *Useless at 70? Trends in Mandatory Director Retirement*, ALLBUSINESS, Oct. 1, 2001, http://www.allbusiness.com/business-planning-structures/business-structures/958172-1.html (reporting age limits and mandatory retirement policies among publicly traded companies).

66. Since it is generally accepted that CEOs should be on the board of their companies, their presence does not raise similar issues.

shareholdings, and directors that have interlocking board relationships with the company).

Potential company-specific problems include poor governance and poor performance. Poor performance may be an important factor contributing to shareholder dissatisfaction with the existing directors. Shareholders may become dissatisfied with unresponsive directors, as evidenced by a failure to adopt a shareholder proposal that has received majority support.[67] Shareholders may also view directors as unresponsive or entrenched if the company has a high level of antitakeover protection.[68]

With respect to company problems, some directors may be viewed by shareholders as more responsible than others. Directors who sit on certain key committees may be held responsible for problems associated with that committee's function.[69] In particular, members of audit committees may be held more responsible for audit-related problems such as restatements and thus be more likely to receive a withhold recommendation. Compensation committee members may be held more accountable for excessive executive pay. New directors may be viewed as less responsible for company-level problems because such problems did not arise on their watch.

It is difficult to predict how shareholders will view the responsibility of the CEO for issuer-specific problems, but we posit that CEOs will be viewed as having greater responsibility for corporate performance. On the other hand, given the more severe implications of not reelecting a CEO to the board, investors may view a withhold vote from a CEO as a more economically significant event and be wary of casting such votes.

For each of the four proxy advisory firms, tables 2.1–2.4 report (as "% Total") the frequency of each attribute as a percentage of each proxy advisor's recommendations. For example, ISS made 1344 recommendations for directors who are also CEOs and 12,917 recommendations in total (where data exist on whether the director is a CEO or not) for a % ISS Total of 10.40%. Tables 2.1–2.4 also report the number of withhold recommendations for directors with the particular

67. *See* Ertimur et al., *supra* note 39, at 30 (finding outside directors who failed to adopt a shareholder proposal were more likely to be removed).

68. For an examination of the relationship between antitakeover and other entrenchment devices and equity prices, see Paul Gompers, Joy Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107 (2003).

69. Shareholders may, in particular, impose greater accountability on directors with specialized expertise. *See* Jill E. Fisch & Caroline M. Gentile, *The Qualified Legal Compliance Committee: Using the Attorney Conduct Rules to Restructure the Board of Directors*, 53 DUKE L.J. 517, 561–63 (2003) (assessing the effectiveness of using "expert" directors on specialized board committees).

TABLE 2.1. Summary Statistics on ISS Withhold Recommendations

Attribute	*Category*	*Predicted Effect on W/H Recs.*	*ISS Tot. Recs.*	*ISS Att. Recs.*	*% ISS Total*	*ISS Tot. W/H*	*ISS Att. W/H*	*% ISS W/H*	*Diff. Between % ISS W/H and % ISS Total*
All Directors			13,869	13,869	100.00	916	916	100.00	
CEO	General	?	12,917	1344	10.40	839	74	8.82	-1.58
New Director	General	-	13,869	2023	14.59	916	53	5.79	-8.80***
AuditMbr	Audit	+	12,829	5105	39.79	831	233	28.04	-11.75***
Prior Restat	Audit	+	13,869	1671	12.05	916	102	11.14	-0.91
Prior SEC	Audit	+	13,869	1005	7.25	916	81	8.84	1.60*
CompMbr	Compensation	+	12,829	4919	38.34	831	351	42.24	3.90**
Top5AbComp	Compensation	+	13,267	657	4.95	868	65	7.49	2.54***
Attendance	Board Effect.	+	12,798	81	0.63	831	36	4.33	3.70***
ManyBds	Board Effect.	+	12,473	1221	9.79	797	120	15.06	5.27***
Age75	Board Effect.	+	13,869	1473	10.62	916	132	14.41	3.79***
NomMbr	Board Comp.	+	12,829	5042	39.30	831	349	42.00	2.70
Empl_Dir	Board Indep.	+	12,829	804	6.27	831	86	10.35	4.08***
OutDirLink	Board Indep.	+	12,829	1358	10.59	831	268	32.25	21.66***
BlockDir	Board Indep.	+	12,812	107	0.84	831	28	3.37	2.53***
Interlock	Board Indep.	+	12,829	33	0.26	831	3	0.36	0.10
Chairman Only	Board Indep.	-	12,917	286	2.21	839	19	2.26	0.05
IP No	Board Resp.	+	13,869	135	0.97	916	67	7.31	6.34***
ClassBd	Takeover	+	13,647	5074	37.18	908	364	40.09	2.91*
PPill	Takeover	+	13,647	7014	51.40	908	436	48.02	-3.38**
CumVote	Takeover	+	13,647	1526	11.18	908	116	12.78	1.59
GP	Takeover	+	13,647	10,238	75.02	908	569	62.67	-12.35***
Bot5AbRet	Performance	+	13,847	526	3.80	916	47	5.13	1.33**
Top5AbRet	Performance	-	13,847	744	5.37	916	59	6.44	1.07

Note: "% ISS Total" is defined as the ratio of ISS recommendations for the specific attribute ("ISS Att. Recs.") over the total number of ISS recommendations where data exist for the specific attribute ("ISS Tot. Recs."). The definition of "% PG Total," "% GL Total," and "% EJ Total" is analogous. "% ISS W/H" is defined as the ratio of ISS withhold recommendations for the specific attribute ("ISS Att. W/H") over the total number of ISS withhold recommendations where data exist for the specific attribute ("ISS Tot. W/H"). The definition of "% PG W/H," "% GL W/H," and "% EJ W/H" is analogous.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$ (from a x^2 test of the null hypothesis that there is no difference between the proportion of ISS recommendations (for or W/H) for a specific attribute (for example, CEO) relative to all ISS recommendations (for or W/H) and the proportion of ISS withhold recommendations for a specific attribute relative to all ISS withhold recommendations)

TABLE 2.2. Summary Statistics on PG Withhold Recommendations

Attribute	*Category*	*Predicted Effect on W/H Recs.*	*PG Tot. Recs.*	*PG Att. Recs.*	*% PG Total*	*PG Tot. W/H*	*PG Att. W/H*	*% PG W/H*	*Diff. Between % PG W/H and % PG Total*
All Directors			5437	5437	100.00	202	202	100.00	
CEO	General	?	5078	528	10.40	182	5	2.75	-7.65***
New Director	General	-	5437	816	15.01	202	8	3.96	-11.05***
AuditMbr	Audit	+	5047	2014	39.90	182	74	40.66	0.75
Prior Restat	Audit	+	5437	655	12.05	202	11	5.45	-6.60***
Prior SEC	Audit	+	5437	324	5.96	202	16	7.92	1.96
CompMbr	Compensation	+	5047	1949	38.62	182	150	82.42	43.80***
Top5AbComp	Compensation	+	5236	289	5.52	190	45	23.68	18.16***
Attendance	Board Effect.	+	5040	40	0.79	182	6	3.30	2.50***
ManyBds	Board Effect.	+	5042	470	9.32	180	23	12.78	3.46
Age75	Board Effect.	+	5437	558	10.26	202	35	17.33	7.06***
NomMbr	Board Comp.	+	5047	2003	39.69	182	87	47.80	8.12**
Empl_Dir	Board Indep.	+	5047	305	6.04	182	2	1.10	-4.94***
OutDirLink	Board Indep.	+	5047	525	10.40	182	18	9.89	-0.51
BlockDir	Board Indep.	+	5047	52	1.03	182	4	2.20	1.17
Interlock	Board Indep.	+	5047	10	0.20	182	0	0.00	-0.20
Chairman Only	Board Indep.	-	5078	104	2.05	182	0	0.00	-2.05*
IP No	Board Resp.	+	5437	65	1.20	202	6	2.97	1.77**
ClassBd	Takeover	+	5330	1932	36.25	193	66	34.20	-2.05
PPill	Takeover	+	5330	2929	54.95	193	108	55.96	1.01
CumVote	Takeover	+	5330	634	11.89	193	27	13.99	2.09
GP	Takeover	+	5330	4008	75.20	193	153	79.27	4.08
Bot5AbRet	Performance	+	5432	262	4.82	200	1	0.50	-4.32***
Top5AbRet	Performance	-	5432	306	5.63	200	10	5.00	-0.63

Note: See notes to table 2.1.

TABLE 2.3. Summary Statistics on GL Withhold Recommendations

Attribute	*Category*	*Predicted Effect on W/H Recs.*	*GL Tot. Recs.*	*GL Att. Recs.*	*% GL Total*	*GL Tot. W/H*	*GL Att. W/H*	*%GL W/H*	*Diff. Between % GL W/H and % GL Total*
All Directors			15,722	15,722	100.00	2956	2956	100.00	
CEO	General	?	14,526	1526	10.51	2673	58	2.17	-8.34***
New Director	General	-	15,722	2295	14.60	2956	172	5.82	-8.78***
AuditMbr	Audit	+	14,436	5765	39.93	2662	1223	45.94	6.01***
Prior Restat	Audit	+	15,722	1914	12.17	2956	499	16.88	4.71***
Prior SEC	Audit	+	15,722	1115	7.09	2956	254	8.59	1.50***
CompMbr	Compensation	+	14,436	5558	38.50	2662	1249	46.92	8.42***
Top5AbComp	Compensation	+	15,005	745	4.97	2782	169	6.00	1.04**
Attendance	Board Effect.	+	14,396	98	0.68	2660	73	2.74	2.06***
ManyBds	Board Effect.	+	13,742	1302	9.47	2527	344	13.61	4.14***
Age75	Board Effect.	+	15,722	1770	11.26	2956	424	14.34	3.09***
NomMbr	Board Comp.	+	14,436	5665	39.24	2662	1299	48.80	9.56***
Empl_Dir	Board Indep.	+	14,436	930	6.44	2662	180	6.76	0.32
OutDirLink	Board Indep.	+	14,436	1523	10.55	2662	587	22.05	11.50***
BlockDir	Board Indep.	+	14,419	123	0.85	2656	29	1.09	0.24
Interlock	Board Indep.	+	14,436	36	0.25	2662	27	1.01	0.76***
Chairman Only	Board Indep.	-	14,526	329	2.26	2673	36	1.35	-0.92***
IP No	Board Resp.	+	15,722	146	0.93	2956	44	1.49	0.56***
ClassBd	Takeover	+	15,423	5577	36.16	2873	998	34.74	-1.42
PPill	Takeover	+	15,423	7902	51.24	2873	1426	49.63	-1.60
CumVote	Takeover	+	15,423	1683	10.91	2873	291	10.13	-0.78
GP	Takeover	+	15,423	11,530	74.76	2873	2072	72.12	-2.64***
Bot5AbRet	Performance	+	15,717	794	5.05	2956	230	7.78	2.73***
Top5AbRet	Performance	-	15,717	794	5.05	2956	141	4.77	-0.28

Note: See notes to table 2.1.

TABLE 2.4. Summary Statistics on EJ Withhold Recommendations

Attribute	*Category*	*Predicted Effect on W/H Recs.*	*EJ Tot. Recs.*	*EJ Att. Recs.*	*% EJ Total*	*EJ Tot. W/H*	*EJ Att. W/H*	*% EJ W/H*	*Diff. Between % EJ W/H and % EJ Total*
All Directors			14,147	14,147	100.00	1551	1551	100.00	
CEO	General	?	12,981	1340	10.32	1419	43	3.03	-7.29***
New Director	General	-	14,147	2032	14.36	1551	135	8.70	-5.66***
AuditMbr	Audit	+	12,892	5108	39.62	1405	551	39.22	--0.40
Prior Restat	Audit	+	14,147	1614	11.41	1551	157	10.12	-1.29
Prior SEC	Audit	+	14,147	1070	7.56	1551	139	8.96	1.40*
CompMbr	Compensation	+	12,892	4909	38.08	1405	642	45.69	7.62***
Top5AbComp	Compensation	+	13,597	745	5.48	1502	116	7.72	2.24***
Attendance	Board Effect.	+	12,854	84	0.65	1403	47	3.35	2.70***
ManyBds	Board Effect.	+	12,439	1235	9.93	1362	537	39.43	29.50***
Age75	Board Effect.	+	14,147	1683	11.90	1551	201	12.96	1.06
NomMbr	Board Comp.	+	12,892	5047	39.15	1405	698	49.68	10.53***
Empl_Dir	Board Indep.	+	12,892	826	6.41	1405	47	3.35	-3.06***
OutDirLink	Board Indep.	+	12,892	1359	10.54	1405	377	26.83	16.29***
BlockDir	Board Indep.	+	12,875	98	0.76	1404	27	1.92	1.16***
Interlock	Board Indep.	+	12,892	33	0.26	1405	4	0.28	0.03
Chairman Only	Board Indep.	-	12,981	292	2.25	1419	30	2.11	-0.14
IP No	Board Resp.	+	14,147	133	0.94	1551	15	0.97	0.03
ClassBd	Takeover	+	13,916	4987	35.84	1526	493	32.31	-3.53***
PPill	Takeover	+	13,916	7098	51.01	1526	715	46.85	-4.15***
CumVote	Takeover	+	13,916	1514	10.88	1526	147	9.63	-1.25
GP	Takeover	+	13,916	10,455	75.13	1526	1119	73.33	-1.80
Bot5AbRet	Performance	+	14,147	566	4.00	1551	57	3.68	-0.33
Top5AbRet	Performance	-	14,147	741	5.24	1551	62	4.00	-1.24**

Note: See notes to table 2.1.

attribute ("Att. W/H") and the extent to which that attribute is reflected in the total number of withhold recommendations ("% W/H") (where data exist for the attribute in question). For example, ISS issued 74 withhold recommendations for CEO directors, which accounted for 8.82% of the total number of ISS withhold recommendations where data exist on whether the director is a CEO.

Tables 2.1–2.4 then provide the difference between % W/H and % Total. This difference gives a measure of the relative effect of this attribute on the likelihood of a withhold recommendation. With respect to ISS, for example, the difference is equal to -1.58 percentage points for CEOs. This difference is not significant, indicating that CEOs are not less likely to receive an ISS withhold recommendation than average directors. We provide similar statistics for PG, GL, and EJ recommendations.

As tables 2.1–2.4 show, both director and company attributes are associated with recommendations, largely in the predicted direction. The results suggest, however, that different proxy advisors are concerned with different categories. ISS seems to be most concerned about board-related factors generally. Of the ten board-related factors, seven are associated with a significantly increased probability of a withhold recommendation (all at the 1% level). Secondarily, ISS appears concerned about performance- and compensation-related factors (*CompMbr* and *Bot5AbRet* are both significant at the 5% level, and *Top5AbComp* is significant at the 1% level). By contrast, neither takeover- nor audit/disclosure-related factors are consistently significant in the predicted direction.

PG, although generally least likely to issue withhold recommendations, seems to be particularly concerned with compensation. Both compensation-related factors (*CompMbr* and *Top5AbComp*) are significant at the 1% level and numerically important. Several board-related factors—*Age75*, *Attendance*, and *IP No*—are also significant. Employee directors (as well as CEOs) are less likely than average to receive a withhold recommendation (possibly due to the fact that they do not sit on compensation committees). Audit/disclosure-, performance-, and takeover-related factors are not associated with an increased likelihood of a PG withhold recommendation.

GL issues the largest number of withhold recommendations. GL seems to pay particular attention to audit/disclosure-related factors (each of the three factors is significant at the 1% level) and performance-related factors (*Bot5AbRet* is significant in the predicted direction at the 1% level). In addition, most board-related factors (eight of ten) and both

compensation-related factors are significant. Takeover-related factors are not associated with an increased likelihood of a withhold recommendation.

EJ appears to place weight on factors related to compensation (both factors are significant at the 1% level), board effectiveness (two of three are significant at the 1% level), and board composition (*NomMbr* is significant at the 1% level). Although being an outside linked director (*OutDirLink*) is associated with a statistically and economically significant increase in the likelihood of a withhold recommendation, being an employee director (*Empl_Dir*) is associated with a significant *decrease* in the likelihood of a withhold recommendation. EJ also seems relatively unconcerned about audit/disclosure-, performance-, and takeover-related factors.

B. BASE REGRESSIONS

We next estimate a logit model for each of the proxy advisors with the recommendation by the advisor as a dependent variable (withhold = 1 and for vote = 0) and the director and company attributes in tables 2.1–2.4 as independent variables. In addition, we control for three factors: the year in which the recommendation was made (*Year06*), the standard deviation in the company's stock return measured for the one-year period prior to the annual meeting date for the year in which the recommendation was made (*Sdret*), and the log of the market capitalization of the firm (*ln(market capitalization)*). The results of the logit models are reported in table 3. In table 3, we also report in brackets the marginal effect on the probability of a withhold recommendation for each factor, calculated in each case at the mean of the other factors. For example, for ISS, being a CEO increases the probability of a withhold recommendation by 3.5% if each of the other factors is at its mean level. Unless otherwise noted, all reported statistics are based on two-sided tests.

Overall, the regression results are stronger than those of the univariate analysis. Of eighty-five variables for which we developed a one-sided hypothesis and obtained estimates, forty-six are significant in the predicted direction, but only two are significant in the opposite direction (compared with ten in tables 2.1–2.4).

TABLE 3. Base Model

Attribute	*Category*	*VoteISS*	*VotePG*	*VoteGL*	*VoteEJ*
CEO	General	0.689***	-0.101	-1.087***	-0.307
		(3.86)	(-0.25)	(-6.11)	(-1.48)
		[0.035]	[-0.002]	[-0.101]	[-0.019]
New Director	General	-0.746***	-1.150***	-1.065***	-0.170
		(-4.18)	(-3.44)	(-10.99)	(-1.42)
		[-0.024]	[-0.013]	[-0.104]	[-0.011]
AuditMbr	Audit	-0.0599	0.179	0.446***	0.196**
		(-0.55)	(0.96)	(6.81)	(2.27)
		[-0.002]	[0.003]	[0.058]	[0.013]
Prior Restat	Audit	-0.292	-0.759	0.406***	-0.397***
		(-1.31)	(-1.23)	(3.99)	(-2.72)
		[-0.010]	[-0.009]	[0.057]	[-0.023]
Prior SEC	Audit	0.230	0.787	0.329**	0.235
		(0.79)	(1.42)	(2.22)	(1.41)
		[0.010]	[0.018]	[0.046]	[0.017]
CompMbr	Compensation	0.533***	2.169***	0.384***	0.413***
		(4.59)	(5.13)	(5.82)	(4.76)
		[0.022]	[0.051]	[0.050]	[0.029]
Top5AbComp	Compensation	0.614*	2.220***	0.320**	0.368**
		(1.78)	(5.22)	(2.03)	(2.28)
		[0.031]	[0.102]	[0.044]	[0.028]
Attendance	Board Effect.	2.903***	1.690***	2.679***	2.975***
		(10.01)	(2.99)	(10.45)	(11.04)
		[0.394]	[0.064]	[0.567]	[0.529]
ManyBds	Board Effect.	0.826***	0.512*	0.530***	2.424**(
		(5.96)	(1.75)	(6.54)	(24.82)
		[0.045]	[0.010]	[0.077]	[0.350]
Age75	Board Effect.	0.136	0.966***	0.243*	-0.00849
		(0.68)	(2.66)	(1.95)	(-0.05)
		[0.006]	[0.024]	[0.033]	[-0.001]
NomMbr	Board Comp.	0.356***	-0.210	0.344***	0.534***
		(3.33)	(-1.13)	(5.93)	(6.84)
		[0.015]	[-0.003]	[0.044]	[0.038]
Empl_Dir	Board Indep.	1.585***	0.146	1.036***	0.417
		(6.52)	(0.15)	(7.92)	(1.50)
		[0.122]	[0.003]	[0.174]	[0.033]
OutDirLink	Board Indep.	1.976***	0.245	1.422***	1.884***
		(12.08)	(0.47)	(15.73)	(15.51)
		[0.167]	[0.004]	[0.252]	[0.236]
BlockDir	Board Indep.	1.039***	2.165**	0.593**	1.532***
		(2.97)	(2.00)	(1.97)	(3.68)
		[0.067]	[0.107]	[0.090]	[0.191]

TABLE 3 (*continued*)

Attribute	*Category*	*VoteISS*	*VotePG*	*VoteGL*	*VoteEJ*
Interlock	Board Indep.	-0.754	...	1.787***	-1.076
		(-1.23)		(3.78)	(-1.25)
		[-0.021]		[-0.360]	[-0.047]
Chairman Only	Board Indep.	-0.767**	...	-1.112***	0.0708
		(-2.48)		(-4.65)	(0.26)
		[-0.022]		[-0.095]	[0.005]
IP No	Board Resp.	3.028***	1.432	0.851***	-0.553
		(6.17)	(1.57)	(3.01)	(-1.20)
		[0.422]	[0.047]	[0.140]	[-0.030]
ClassBd	Takeover	0.334**	0.0335	-0.0169	-0.0347
		(2.18)	(0.10)	(-0.25)	(-0.38)
		[0.014]	[0.001]	[-0.002]	[-0.002]
PPill	Takeover	-0.0145	-0.0683	-0.0132	-0.0494
		(-0.09)	(-0.19)	(-0.19)	(-0.53)
		[-0.001]	[-0.001]	[-0.002]	[-0.003]
CumVote	Takeover	0.381*	0.269	-0.108	-0.0140
		(1.83)	(0.66)	(-0.90)	(-0.11)
		[0.017]	[0.005]	[-0.013]	[-0.001]
GP	Takeover	-0.557***	0.398	-0.115	-0.0585
		(-3.24)	(1.04)	(-1.42)	(-0.56)
		[-0.025]	[0.006]	[-0.015]	[-0.004]
Top5AbRet	Performance	-0.0534	-1.359*	-0.280	-0.193
		(-0.18)	(-1.92)	(-1.52)	(-1.11)
		[-0.002]	[-0.013]	[-0.032]	[-0.012]
Bot5AbRet	Performance	0.369	...	0.393***	0.133
		(1.27)		(2.87)	(0.60)
		[0.017]		[0.056]	[0.009]
Sdret		28.56***	20.83	12.97***	-1.915
		(2.90)	(1.01)	(2.64)	(-0.26)
		[1.124]	[0.328]	[1.626]]	[-0.128]
ln(market cap.)		-0.0839	-0.0236	-0.0662**	0.0803**
		(-1.40)	(-0.21)	(-2.31)	(2.12)
		[-0.003]	[-0.000]	[-0.008]	[0.005]
Year06		-0.126	0.162	0.145**	-0.224***
		(-0.95)	(0.72)	(2.34)	(-3.07)
		[-0.005]	[0.003]	[0.018]	[-0.015]
Constant		-3.454***	-5.561***	-1.996***	-3.856***
		(-5.31)	(-3.74)	(-6.27)	(-8.17)
N		11,833	4509	12,973	11,809
pseudo R^2		0.152	0.198	0.106	0.206

Note: t-statistics are in parentheses; marginal probabilities (calculated with all other variables set at their mean) are in brackets. Marginal probabilities are calculated using Stata's mfx command. Where data are not available, ellipsis dots are inserted.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

1. ISS

The results for ISS are largely consistent with those from the univariate analysis. Of the ten board-related factors, eight are significant in the predicted direction. Furthermore, as reported in table 3, several of the board-related factors have a material economic impact on the likelihood of a withhold recommendation. This is true for factors that affect relatively few directors,[70] such as *IP No* (42.2 percentage point increase) or *Attendance* (39.4 percentage point increase); but notably it is also true for factors that affect an intermediate number of directors, such as *Empl_Dir* (6.3% of the sample of ISS recommendations, 12.2 percentage point increase in probability) or *OutDirLink* (10.6% of the ISS sample, 16.7 percentage point increase).

Among the compensation-related factors, membership on the compensation committee (*CompMbr*) is statistically significant, but has a small quantitative impact. Contrary to the univariate results and to the logit models for the other proxy advisors, CEOs are *more* likely to receive withhold recommendations from ISS. None of the audit/disclosure- or performance-related factors is significant. Of the takeover-related factors, golden parachutes (*GP*) are associated with a significant decrease in the likelihood of a withhold recommendation (at the 1% level), and classified boards (*ClassBd*) and cumulative voting (*CumVote*) are associated with a significant increase (at the 5% and 10% levels, respectively). New directors are less likely to receive withhold recommendations.

2. PG

For PG, the regressions confirm the importance it places on compensation. Membership on the compensation committee (*CompMbr*) and top 5% abnormal compensation (*Top5AbComp*) are highly significant and yield high coefficient estimates. The marginal effects of *CompMbr* and *Top5AbComp* on the probability of a withhold recommendation are substantially higher than those for ISS—respectively, 5.1% versus 2.2% for compensation committee members (38.6% of the PG sample) and 10.2% versus 3.1% for top 5% abnormal compensation (5.5% of the PG sample). Of the eight board-related variables for which we could obtain estimates,[71]

70. We define a factor as affecting relatively few directors if it affects less than 1% of the sample.

71. Both *Interlock* = 1 and *Chairman Only* = 1 were perfectly correlated with a for recommendation by PG and, as a result, were dropped from the sample.

all three board effectiveness variables are significant at varying levels, and the variable for block director is significant at the 5% level. But the board-related variables either affect only few directors (*Attendance* and *BlockDir*) or have only a small marginal effect on the probability of a withhold recommendation (*ManyBds* and *Age75*). Top 5% abnormal return (*Top5AbRet*) is associated with a marginal (both statistically and economically) reduction in the likelihood of a withhold recommendation; bottom 5% abnormal return (*Bot5AbRet*) was dropped from the regressions because it was perfectly correlated with a for recommendation. Neither CEO status nor any of the audit/disclosure- or takeover-related factors is significant. New directors are less likely to receive a withhold recommendation.

3. GL

For GL, all audit/disclosure-related factors are significant, as are all ten board-related factors (all in the predicted direction). Membership on the compensation committee (*CompMbr*) and top 5% abnormal CEO compensation (*Top5AbComp*) are also significant, as is the indicator variable for bottom 5% abnormal returns (*Bot5Ret*). None of the takeover-related factors is significant. In terms of marginal effect, board-, audit/disclosure-, performance-, and compensation-related factors are all highly significant. New directors are less likely to receive a withhold recommendation.

4. EJ

The regression results for EJ confirm its focus on compensation (*CompMbr* and *Top5AbComp* are significant). As for board-related attributes, the regression results indicate a focus on composition (*NomMbr* is significant) as well as effectiveness (two of three attributes are significant, as in the univariate test). EJ also appears to focus on board independence (*OutDirLink* and *BlockDir* are significantly positive), but not board responsiveness (*IP No* is insignificant). In terms of marginal effect, the most important factors—considering both their impact and the number of directors affected—are *OutDirLink* (10.5% of the sample of EJ recommendations, 23.6% increase in the likelihood of a withhold recommendation), *ManyBds* (9.9% of the EJ sample, 35.0% increase in likelihood), and *NomMbr* (39.2% of the EJ sample, 3.8% increase in likelihood). Of the audit/disclosure-related factors, being a member of the audit committee increases the likelihood of a withhold recommendation, but having had a restatement *decreases* that likelihood. None of the

TABLE 4. Summary of Results

Weight	*ISS*	*PG*	*GL*	*EJ*
Focus	Board	Compensation	Audit	Eclectic
Primary Factors	Board (generally)	Compensation	Audit Board (generally) Compensation Performance	Board (selective)
Secondary Factors	Compensation	Board (effect.) Block Director		Compensation
No Effect or Inconsistent Treatment	Audit Performance Takeover	Audit Board (other) Takeover Performance	Takeover	Audit Board (resp.) Takeover

performance- or takeover-related factors is significant, nor is being a CEO or new director.

C. SUMMARY OF DIFFERENCES BETWEEN PROXY ADVISORS

Table 4 summarizes and compares the factors that affect recommendations by the four proxy advisors. Overall, other than takeovers, each category is important for at least one proxy advisor, and two categories—compensation and board effectiveness—are at least secondary factors for each of the proxy advisors. Nevertheless, there are important differences among the advisors. ISS stands out in its attention to board-related factors, paying less relative attention to compensation-related factors than PG and GL, and apparently no attention to audit/disclosure-related factors. PG's primary focus, by contrast, is on compensation, to which it attributes greater weight than it does to other factors and than do other proxy advisors. GL distinguishes itself from the other proxy advisors by the significant weight it places on audit/disclosure-related factors, which the other proxy advisors either ignore or (in the case of EJ) treat inconsistently. EJ is the most eclectic of the proxy advisors. It gives weight to selective board-related factors (but less consistently so than do ISS and GL), as well as to compensation-related factors (but less so than PG), and treats audit/disclosure-related factors inconsistently.

IV. REGRESSIONS WITH INTERACTION VARIABLES

To refine our base regressions, we test whether certain factors are of special (or exclusive) importance for certain types of directors by adding

interaction variables. Specifically, we look at the interaction between several company-specific factors and the board members who are most likely to be viewed by investors as responsible for those factors. The existence of an interaction between a director's role or responsibility for a problem and the presence of that problem would suggest that proxy advisors are paying attention to relative accountability within the board. We test four specific interactions: (1) the interaction between audit committee membership and the presence of an audit-related problem such as an SEC investigation or a restatement; (2) the interaction between compensation committee membership and the presence of abnormally high levels of executive compensation; (3) the interaction between corporate performance and a director's status as CEO, employee director, or outside director; and (4) the interaction between service on a high number of boards and a director's status as CEO, employee director, or outside director.

Our hypothesis is that proxy advisors are more likely to issue withhold recommendations to target directors with specific responsibility for a problem. Thus, for the first two interactions, we expect the effect of a company problem to be focused on members of the relevant committee. We expect CEOs and employee directors to be more affected by corporate performance—receiving more withhold recommendations than the average director when the company underperforms and receiving fewer withhold recommendations when the company is doing well. As to membership on many boards, there are two opposing hypotheses. On one hand, if membership on other boards is a distraction, the effect is more likely to be important for CEOs and employee directors than for outside directors. On the other hand, if membership on other boards is related to one's success as CEO (or officer), and our performance variable controls for CEO success only imperfectly, CEO or employee director membership on many other boards could serve as a proxy for success, partially offsetting any adverse effect otherwise associated with such membership.

A. AUDITING PROBLEMS AND AUDIT COMMITTEE MEMBERSHIP

To examine the relationship between restatements or SEC investigations and audit committee membership, we ran the base logit model for a withhold recommendation with the addition of the variables *Prior Restat* × *AuditMbr* and *Prior SEC* × *AuditMbr*.

Table 5 reports our results for the four proxy advisory firms' recommendations. In these regressions, *Prior Restat* estimates the average

effect of a restatement on non-audit-committee members; the sum of *Prior Restat* and *Prior Restat* × *AuditMbr* estimates the effect of a restatement on audit committee members; and the sum of *AuditMbr*, *Prior Restat*, and *Prior Restat* × *AuditMbr* estimates the effect of being both an audit committee member and experiencing a restatement. The effects for *Prior SEC* are analogous.

In our base regressions, the audit/disclosure-related variables were consistently significant in the predicted direction only for GL. With the addition of interaction terms, the coefficient for restatements is no longer significant for GL, but the sum of *Prior Restat* and *Prior Restat* × *AuditMbr* is significantly different from zero at the 1% level. This suggests that for GL, restatements affect the recommendations for audit committee members, but not for non-audit-committee members (the coefficient for *Prior Restat* alone is not significantly different from zero). As to prior SEC investigations, the results indicate that they affect both audit committee members and nonmembers, and we cannot reject the null hypothesis that there is no differential in the effect.

As to ISS and PG, audit/disclosure-related variables remain insignificant, as they were in the base regressions. For EJ, in the base regressions, a prior SEC investigation was associated with an *increased* likelihood of a withhold recommendation, but a restatement was associated with a *reduced* likelihood of a withhold recommendation. The addition of interaction terms indicates that the effect of an SEC investigation is confined to members of audit committees; the coefficient for *Prior SEC* is no longer significant, but the sum of *Prior SEC* and *Prior SEC* × *AuditMbr* is significant at the 10% level. As to restatements, the results indicate that the apparent reduction in the likelihood of a withhold recommendation is confined to non-audit-committee members; the coefficient for *Prior Restat* is significant and negative, but the coefficient for *Prior Restat* × *AuditMbr* is significant and positive, and the sum of *Prior Restat* and *Prior Restat* × *AuditMbr* is not significantly different from zero, indicating no significant reduction in the likelihood of a withhold recommendation due to a restatement for audit committee members.

TABLE 5. Interaction Between *Prior Restat* and *Prior SEC* and *AuditMbr*; Interaction Between *Top5AbComp* and *CompMbr*

Attribute	*VoteISS*	*VotePG*	*VoteGL*	*VoteEJ*
AuditMbr	-0.104	0.228	0.377***	0.129
	(-0.88)	(1.13)	(5.50)	(1.42)
Prior Restat	-0.381	-1.015	0.147	-0.640***
	(-1.48)	(-1.44)	(1.03)	(-3.61)
Prior Restat × *AuditMbr*	0.277	0.531	0.554***	0.570*
	(0.90)	(0.93)	(2.88)	(2.23)
Prior SEC	0.164	1.069	0.361**	0.159
	(0.48)	(1.51)	(2.04)	(0.68)
Prior SEC × *AuditMbr*	0.233	-1.064	-0.0673	0.213
	(0.60)	(-1.22)	(-0.33)	(0.70)
CompMbr	0.502***	1.675***	0.344***	0.432***
	(4.30)	(4.33)	(5.24)	(4.85)
Top5AbComp	0.411	-0.567	-0.0201	0.436*
	(0.89)	(-0.51)	(-0.12)	(1.93)
Top5AbComp × *CompMbr*	0.481	3.374***	0.752***	-0.164
	(0.90)	(2.89)	(2.67)	(-0.56)
Year06	-0.126	0.165	0.148**	-0.223***
	(-0.95)	(0.71)	(2.38)	(-3.06)
Constant	-3.426***	-5.164***	-1.948***	-3.852***
	(-5.26)	(-3.43)	(-6.06)	(-8.16)
N	11,833	4509	12,973	11,809
pseudo R^2	0.153	0.216	0.108	0.207
Select F-Tests				
Prior Restat + *Prior Restat* × *AuditMbr*	0.7086	0.4721	0.0000	0.7404
Prior Restat + *AuditMbr* + *Prior Restat* × *AuditMbr*	0.4566	0.6995	0.0000	0.7867
Prior SEC + *Prior SEC* × *AuditMbr*	0.2434	0.9931	0.1034	0.0635
Prior SEC + *AuditMbr* + *Prior SEC* × *AuditMbr*	0.3887	0.7006	0.0003	0.0153
Top5AbComp+ *Top5AbComp* × *CompMbr*	0.0275	0.0000	0.0033	0.1721
Top5AbComp + *CompMbr* + *Top5AbComp* × *CompMbr*	0.0007	0.0000	0.0000	0.0007

Note: t-statistics are in parentheses. F-tests are of the null hypothesis that the sum of the coefficients equals 0. All models use the base models in table 3 with the addition of interaction terms. We report only the coefficients for the additional interaction terms and associated variables.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

B. HIGH COMPENSATION AND COMPENSATION COMMITTEE MEMBERSHIP

To examine the relationship between top 5% abnormal compensation (*Top5AbComp*) and compensation committee membership (*CompMbr*), we also estimated the base logit model for a withhold recommendation with the addition of the interaction variable *Top5AbComp* × *CompMbr*. Table 5 reports our results for the four proxy advisory firms' recommendations. *Top5AbComp* estimates the average effect of *Top5AbComp* on non-compensation-committee members, and the sum of *Top5AbComp* and *Top5AbComp* × *CompMbr* estimates the effect on compensation committee members (in each case relative to having the same position but not paying top compensation).

In the base logit models reported in table 3, paying abnormally high CEO compensation was associated with an increased likelihood of a withhold recommendation by ISS, PG, GL, and EJ. For GL and PG, the results of the logit models with interaction terms reported in table 5 indicate that paying abnormally high CEO compensation raises the likelihood of a withhold recommendation only for members of the compensation committee. The coefficient for *Top5AbComp* alone (measuring the effect of high CEO compensation for nonmembers) is insignificant; but the sum of *Top5AbComp* and *Top5AbComp* × *CompMbr* is positive and significant at the 1% level for each advisor. In the logit models with interaction terms, we obtain similar results for ISS, even though paying abnormally high compensation was insignificant for ISS in the base models. For EJ, by contrast, the regressions with interaction terms indicate that paying abnormally high CEO compensation is associated with a significant increase in the likelihood of a withhold recommendation for non-compensation-committee members (as measured by *Top5AbComp*). While *Top5AbComp* + *Top5AbComp* × *CompMbr* is positive, the sum is not significantly different from zero, and we thus cannot reject the hypothesis that paying abnormally high compensation has no effect on recommendations for compensation committee members.

C. PERFORMANCE AND INSIDE DIRECTORS

To examine the effect of performance on withhold recommendations for inside directors, we estimated the base logit models with the addition of the following variables: *Top5AbRet* × *CEO*, *Top5AbRet* × *Empl_Dir*, *Bot5AbRet* × *CEO*, and *Bot5AbRet* × *Empl_Dir*. Table 6 reports our results.

TABLE 6. Interaction Between *Top5AbRet* and *CEO* and *Empl_Dir*

Attribute	*VoteISS*	*VotePG*	*VoteGL*	*VoteEJ*
CEO	0.630***	-0.0755	-1.064***	-0.330
	(3.42)	(-0.18)	(-5.69)	(-1.56)
Empl_Dir	1.487***	0.162	1.069***	0.345
	(6.05)	(0.17)	(8.02)	(1.28)
Top5AbRet	-0.240	-1.319*	-0.308	-0.284
	(-0.84)	(-1.85)	(-1.62)	(-1.61)
Top5AbRet × CEO	0.495	...	0.752	0.626
	(1.36)		(1.37)	(0.92)
Top5AbRet × Empl_Dir	0.905+	...	-0.0316	0.890
	(1.67)		(-0.08)	(1.21)
Bot5AbRet	0.264	...	0.467***	0.126
	(0.88)		(3.23)	(0.59)
Bot5AbRet × CEO	0.412	...	-1.502	-0.341
	(0.95)		(-1.48)	(-0.31)
Bot5AbRet × Empl_Dir	0.614	...	-0.904*	0.411
	(0.88)		(-1.66)	(0.37)
Year06	-0.125	0.162	0.144**	-0.224***
	(-0.94)	(0.72)	(2.32)	(-3.07)
Constant	-3.430***	-5.562***	-2.002***	-3.853***
	(-5.28)	(-3.75)	(-6.27)	(-8.22)
N	11,833	4468	12,973	11,809
pseudo R^2	0.153	0.197	0.107	0.207
Select F-Tests				
Top5AbRet + *Top5AbRet × CEO*	0.5985	...	0.4176	0.6028
Top5AbRet + *CEO* + *Top5AbRet × CEO*	0.0764	...	0.2401	0.9853
Top5AbRet + *Top5AbRet × Empl_Dir*	0.2384	...	0.3803	0.3865
Top5AbRet + *Empl_Dir* + *Top5AbRet × Empl_Dir*	0.0003	...	0.0611	0.1939
Bot5AbRet + *Bot5AbRet × CEO*	0.1492	...	0.3055	0.8425
Bot5AbRet + *CEO* + *Bot5AbRet × CEO*	0.0064	...	0.0363	0.6189
Bot5AbRet + *Bot5AbRet × Empl_Dir*	0.1992	...	0.4068	0.6282
Bot5AbRet + *Empl_Dir* + *Bot5AbRet × Empl_Dir*	0.0009	...	0.2368	0.4395

Note: t-statistics are in parentheses. F-tests are of the null hypothesis that the sum of the coefficients equals 0. All models use the base models in table 3 with the addition of interaction terms. We report only the coefficients for the additional interaction terms and associated variables. Where data are unavailable, ellipsis dots are inserted.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

In these regressions, *Top5AbRet* estimates the effect of top returns on directors who are neither the CEO nor employees of the company, and the sum of *Top5AbRet* and *Top5AbRet* × *CEO* estimates the effect of top returns on the CEO. Effects for employee directors and bottom returns are analogous.

For ISS, as in the base logit models, the logit models with interactive terms produce no evidence that top or bottom returns affect ISS recommendations.

For GL, the logit models with interaction terms indicate that bottom returns affect the likelihood of a withhold recommendation only for outside directors (as measured by the *Bot5AbRet* variable). Contrary to our hypothesis, there is no evidence that bottom returns affect recommendations for inside directors (as measured by the sum of *Bot5AbRet* and *Bot5AbRet* × *CEO*). The logit models also indicate that top returns do not affect the likelihood of a withhold recommendation for any director (as measured by *Top5AbRet* and the sums of *Top5AbRet* and *Top5AbRet* × *CEO* and of *Top5AbRet* and *Top5AbRet* × *Empl_Dir*).

For EJ, neither the base regressions nor the regressions with interactive terms generate evidence that our performance measures affect recommendations. For PG, we were unable to estimate the logit model with interaction terms because *Top5AbRet* × *CEO* = 1, *Top5AbRet* × *Empl_Dir* = 1, *Bot5AbRet* × *CEO* = 1, and *Bot5AbRet* × *Empl_Dir* = 1 were each perfectly correlated with a for recommendation by PG and, as a result, were dropped from the model.

D. MULTIPLE BOARD SEATS

To examine the effect of membership on many boards, we estimated the base logit models with the addition of the interaction variables *ManyBds* × *CEO* and *ManyBds* × *Empl_Dir*. Table 7 reports our results.

In these models, *ManyBds* estimates the effect of sitting on multiple boards on directors who are neither the CEO nor an employee of the company, and the sum of *ManyBds* and *ManyBds* × *CEO* estimates the total effect of many board seats on the CEO. Effects for employee directors are analogous.

TABLE 7. Interaction Between *ManyBds* and *CEO* and *Empl_Dir*

Attribute	*VoteISS*	*VotePG*	*VoteGL*	*VoteEJ*
CEO	0.786***	-0.0300	-1.111***	-0.295
	(4.38)	(-0.07)	(-6.12)	(-1.28)
Empl_Dir	1.615***	0.152	1.040***	0.480*
	(6.63)	(0.15)	(7.93)	(1.72)
ManyBds	0.903***	0.531*	0.527***	2.440***
	(6.44)	(1.82)	(6.42)	(24.45)
ManyBds × CEO	...	...	0.353	-0.0345
			(0.52)	(-0.07)
ManyBds × Empl_Dir.	...	...	-0.327	-1.276
			(-0.36)	(-1.60)
Year06	-0.130	0.163	0.146**	-0.225***
	(-0.98)	(0.72)	(2.34)	(-3.08)
Constant	-3.454***	-5.560***	-1.997***	-3.860***
	(-5.32)	(-3.74)	(-6.26)	(-8.16)
N	11,777	4491	12,973	11,809
pseudo R^2	0.153	0.198	0.106	0.207
Select F-Tests				
ManyBds + ManyBds × CEO	...	...	0.1891	0.0000
ManyBds + CEO + ManyBds × CEO	...	...	0.7252	0.0000
ManyBds + ManyBds × Empl_Dir	...	...	0.8261	0.1392
ManyBds + Empl_Dir + ManyBds × Empl_Dir	...	...	0.1741	0.0384

Note: t-statistics are in parentheses. F-tests are of the null hypothesis that the sum of the coefficients equals 0. All models use the base models in table 3 with the addition of interaction terms. We report only the coefficients for the additional interaction terms and associated variables. Where data are unavailable, ellipsis dots are inserted.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

In the base logit models reported in table 3, sitting on multiple boards increased the likelihood of a withhold recommendation for GL and EJ. The logit models with interaction terms reported in table 7 suggest that, in the case of GL, this effect may be confined to outside directors. For outside directors, sitting on multiple boards is associated with a higher likelihood of a withhold recommendation for non-CEOs (at the 1% level), as measured by the coefficient for *ManyBds* alone. By contrast, neither *ManyBds* + *ManyBds* × *Empl_Dir* (for GL and EJ) nor *ManyBds* + *ManyBds* × *CEO* (for GL) is significantly different from zero.

For EJ, both *ManyBds* alone and *Many Bds* + *ManyBds* × *CEO* are highly significant, and the sum of *ManyBds* and *ManyBds* × *Empl_Dir* is borderline insignificant. For ISS and PG, we were unable to estimate the logit model with interaction terms because, for both, *ManyBds* × *Empl_Dir*

= 1 and *ManyBds* × *CEO* = 1 were perfectly correlated with a for recommendation and, as a result, were dropped from the model.

E. SUMMARY

Overall, the set of regressions with interaction variables indicates that, at least in the case of some advisors, members of the relevant committee are held particularly responsible for problems within that committee's jurisdiction. Thus, we find that for ISS, PG, and GL, the adverse effects of high compensation are focused on compensation committee members; for GL, the adverse effects of a restatement are felt by audit committee members; for EJ, the adverse effects of an SEC investigation are tied to audit committee members; for ISS, the adverse effects of bottom returns are confined to CEOs; and for GL, the adverse effects of sitting on multiple boards relate only to outside directors.

V. MULTIPLE NOMINATIONS

A large number of individuals in our sample were nominated for election to the boards of several companies in the same year and received multiple recommendations by the same proxy advisor, as reported in table 8.1. For these sets of nominees, we investigated the relationship between the multiple recommendations for the same person made by each advisor.

As a starting point, we examined whether the overall withhold percentage for directors who received multiple recommendations from a proxy advisor differs from the withhold percentage for directors who received only a single recommendation from the same proxy advisor. Note that the number of recommendations from a proxy advisor is correlated with, but not identical to, the number of board seats because (1) the director may sit on a staggered board of a different company that does not have an election in that year or (2) even if the other company has an election in the same year, the proxy advisor may not issue a recommendation because its coverage is less than 100 percent. Table 8.2 provides the withhold percentages for each advisor depending on whether the individual received one, two, or three recommendations from that advisor.[72] Except for EJ, the differences in withhold percentages are statistically (and, for the most part, economically) insignificant.

72. ISS, GL, and EJ had some individuals who received more than three recommendations, but those numbers of individuals were too small for statistical analysis.

TABLE 8.1. Number of Individuals with Multiple Nominations

ISS	1547
PG	295
GL	1792
EJ	1638

TABLE 8.2. Withhold Percentages for Nominees

N	*ISS*	*PG*	*GL*	*EJ*
1	0.067565	0.035389	0.187367	0.079342
2	0.056641	0.048214	0.176570	0.144131[a]
3	0.070175	0.088889	0.217662	0.305785[b]

Note: *N* is the number of boards for which an individual received a recommendation by an advisor. For EJ, [a] indicates the *t*-test of the difference in withhold percentage for N = 2 versus N = 1 is significant at the 1% level; [b] indicates the *t*-test of the difference in withhold percentage for N = 3 versus N = 1 is significant at the 1% level.

TABLE 8.3. Conditional Probabilities

N	*Calculation*	*ISS*	*PG*	*GL*	*EJ*
2	P(W/H, F)	4.8	4.3	16.6	8.9
2	P(W/H, W/H)	19.3	14.8	22.6	47.0
3	P(W/H-W/H, F)	1.4		3.7	4.8
3	P(W/H-W/H, W/H)	12.5		24.0	64.9
3	P(W/H-*, F)	8.9		31.3	16.7
3	P(W/H-*, W/H)	50.0		50.3	86.5
3	P(W/H-F, F)	7.5		27.6	11.9
3	P(W/H-F, W/H)	37.5		26.7	21.6

Note: N is the number of boards for which an individual received a recommendation by an advisor. "P(W/H, F)" and "P(W/H, W/H)" are, respectively, the conditional probabilities of a withhold recommendation conditional (for nominees with 2 recommendations) on the other recommendation being for or withhold. "P(W/H-W/H, F)" and "P(W/H-W/H, W/H)" are, respectively, the conditional probabilities of two withhold recommendations conditional (for nominees with 3 recommendations) on the other recommendation being for or withhold. "P(W/H-*, F)" and "P(W/H-*, W/H)" are, respectively, the conditional probabilities of at least one withhold recommendation conditional (for nominees with 3 recommendations) on the other recommendation being for or withhold. "P(W/H-F, F)" and "P(W/H-F, W/H)" are, respectively, the conditional probabilities of exactly one withhold recommendation conditional (for nominees with 3 recommendations) on the other recommendation being for or withhold.

We next turn to whether recommendations for the same individual from the same advisor are correlated. Our null hypothesis is that recommendations are not correlated. To test this hypothesis, we calculated the following: for individuals who received two recommendations (i, j), we calculated the conditional probabilities for each advisor that i = withhold, conditional on j = for and on j = withhold; for individuals who received three recommendations (i, j, k), we calculated the conditional probabilities for each advisor (other than PG, which had too few observations) that both i = withhold and j = withhold, or that either i = withhold or j = withhold, conditional on k = for and on k = withhold. The results are reported in table 8.3.

For each of the advisors, we can reject the null hypothesis that the recommendations are independent. Note, however, that the degree of

correlation in the recommendations differs substantially among advisors. Generally, the correlation is strongest for EJ and weakest for GL, with ISS and PG occupying an intermediate position. For EJ, for example, the conditional probability of a withhold recommendation for a double-nomination individual increases from 9% to 47% depending on whether the other recommendation is for or withhold. For GL, that increase is much more modest, from 17% to 23%; for ISS and PG, it is, respectively, from 5% to 19% and from 4% to 15%.

Three reasons may account for the correlation among recommendations. First, there may be a spillover effect in that the proxy advisor will take into account the conduct that led to a withhold recommendation for board 1 in issuing its recommendation for board 2 (the "spillover hypothesis"). Second, the same factor (for example, a criminal conviction), which is not tied to service on a particular board, may account for multiple withhold recommendations (the "single factor hypothesis"). Third, certain individuals may be more likely to engage in conduct (for example, because they are lazy) that results in a withhold recommendation (the "higher proclivity hypothesis"). For these individuals, the ex ante likelihood of a withhold recommendation is higher than for others. Although, given this higher ex ante likelihood, each recommendation is independent, the recommendations are correlated when they are pooled with individuals who have a lower ex ante likelihood of a withhold recommendation.

To differentiate between these hypotheses, the following test was performed. The spillover hypothesis suggests that the order in which the conduct of directors is assessed matters. Conduct on board 1 that results in a withhold recommendation should result in a withhold recommendation for board 2 only if that conduct has been evaluated by the time the recommendation for board 2 is released. Proxy advisors, of course, do not release all recommendations at the same time but generally release each recommendation shortly before the corresponding annual meeting. The dates of the annual meetings should thus provide a rough benchmark of the timing of the proxy advisor's evaluation. The spillover hypothesis would thus suggest that a withhold recommendation for board 1 should be correlated with a withhold recommendation for board 2 only if the annual meeting for board 1 preceded the meeting for board 2. The data, however, provide no support for the spillover hypothesis for any of the proxy advisors. In each case, the order of the meetings had no effect on

correlations.[73]

To differentiate between the single factor and the higher proclivity hypothesis, we focused on individuals who received three recommendations by a single advisor. The single factor hypothesis would predict that, if one of these recommendations is withhold, the likelihood of both of the other recommendations being withhold should increase substantially, but there should be no increase in the likelihood that one of the other two (but *not* both) is withhold. The higher proclivity hypothesis would predict a lesser increase in the former likelihood but an increase in the latter.

The data indicate strong support for the single factor hypothesis with respect to GL. If one recommendation is withhold rather than for, the likelihood that both other recommendations are also withhold increases from 4% to 24%; but the likelihood that only one (but not both) of them is withhold stays roughly the same (27.6% versus 26.7%).

For ISS, by contrast, the data support the higher proclivity hypothesis. If one recommendation is withhold, the likelihood of getting a single other withhold increases from 8% to 38%. The likelihood of getting two withholds, of course, also increases (from 1.4% to 12.5%), but that increase is in line with the increase that would be expected given a higher proclivity to get a withhold recommendation.

For EJ, in turn, the data support both hypotheses. The likelihood of getting a single other withhold increases from 12% to 22%, showing support for the higher proclivity hypothesis, and the likelihood of getting two withholds increases from 5% to 65%, which is more than what one would expect if only the higher proclivity hypothesis were correct.

On the whole, therefore, the data indicate significant differences in the manner in which, and the reasons why, recommendations for the same individual are correlated. For GL, the correlation is driven predominantly by the same factors that, when present, result in across-the-board withhold recommendations. For ISS, the correlation is likely due to the fact that some individuals are more prone to take (or refrain from taking) actions that result in a withhold recommendation. Given this trait, however, recommendations are independent. For EJ, it is likely that both of these forces are at work for different individuals. For none of the advisors did we

73. In particular, the spillover hypothesis would predict that, for advisors who issued two recommendations, there would be fewer withhold/for recommendations (in that chronological order) than for/withhold recommendations. For all advisors, these numbers were virtually identical.

find evidence that they consider a director's conduct on one board in issuing a recommendation for a different board.

To further investigate the reasons why some directors receive across-the-board withhold recommendations, we compared, for each proxy advisor, the characteristics of nominees who received all withhold recommendations (the "all withhold" group) and those who received at least one withhold recommendation but at least one other for recommendation (the "mixed withhold" group). For ISS and PG, the former group was too small to make meaningful comparisons.

For GL, we found that nominees who sat on more than the median number of boards, and those who were members of audit committees, were much more prevalent in the all withhold group than in the mixed withhold group (55% versus 35% for members of many boards, 60% versus 46% for audit committee members), but members of compensation committees were less prevalent in the all withhold group than in the mixed withhold group (38% versus 55%). One plausible explanation is that membership on too many boards, and certain conduct on the part of audit committee members (or membership on too many audit committees), lead to across-the-board withhold recommendations for GL.

For EJ, we also found that nominees who sat on more than the median number of boards were more prevalent in the all withhold group than in the mixed withhold group (81% versus 51%). In addition, members of compensation committees were somewhat more prevalent in the all withhold group (54% versus 46%), but outside linked directors were substantially less prevalent in the all withhold group than in the mixed withhold group (7% versus 24%). Again, a plausible explanation is that membership on too many boards, and possibly certain conduct on the part of compensation committee members, lead to across-the-board withhold recommendations for EJ. As to why outside linked directors are relatively uncommon in the all withhold group, the likely explanation is that the factors associated with across-the-board withhold recommendations are negatively correlated with being an outside linked director.

VI. GROUP-BASED RECOMMENDATIONS AND INTRACOMPANY SPILLOVER RECOMMENDATIONS

We next examined how the recommendations for nominees to the board of a single company relate to each other. To do this, we examined, for each advisor, those recommendations where the advisor issued recommendations (either for or withhold) for at least six nominees to the

same board. We further divided these recommendation samples into three subsets: recommendation subsamples where the fraction of withhold recommendations for nominees to the same board was less than 0.34 (the "low-withhold" subsample); those where that fraction was greater than 0.34 but less than 0.66 (the "medium-withhold" subsample); and those were that fraction was greater than 0.66 (the "high-withhold" subsample). High-withhold situations thus occur when a proxy advisor issues a withhold recommendation for a substantial (more than two-thirds) fraction of the board. Low-withhold situations occur when a proxy advisor focuses its withhold recommendation on one or a small number of directors on a specific board.

Table 9.1 provides, for each proxy advisor, the number of withhold recommendations in each subsample. Table 9.1 shows that the percentages of withhold recommendations in each subsample (as the percentage of all withhold recommendations) are not equally distributed for each proxy advisor. Specifically, for ISS and PG, a much greater proportion of all withhold recommendations are in the medium- and high-withhold subsamples than for GL and EJ. Notably, one would expect that advisors that are generally more likely to issue withhold recommendations would have a higher proportion of their withhold recommendations in the medium- and high- withhold subsamples. However, ISS and PG are generally less likely to issue withhold recommendations than GL and EJ.

To take direct account of the differences in the overall withhold rate, we calculated, based on the actual distribution of board sizes in each subsample, the expected number of withhold recommendations, in each subsample and for each advisor, given the overall rate of withhold recommendations for that advisor and assuming that recommendations for each nominee are independent. Comparing the expected and actual number of withhold recommendations shows that, for each advisor, the number of actual withhold recommendations in the medium- and high-withhold subsamples is higher than expected, given the assumption that recommendations are independent. This suggests that withhold recommendations among nominees for the same board by the same advisor are positively correlated.

TABLE 9.1. Withhold Subsamples

	Low-Withhold	*Medium-Withhold*	*High-Withhold*	*Total Withhold*
ISS Actual Number of W/H Recs. in Subsample	250	180	126	556
ISS % of Total W/H Recs.	45%	32%	23%	100%
ISS Expected Number of W/H Recs.	543.3	12.6	0.1	556
PG Actual Number of W/H Recs. in Subsample	43	83	8	134
PG % of Total W/H Recs.	32%	62%	6%	100%
PG Expected Number of W/H Recs.	132.9	1.0	0.0	134
GL Actual Number of W/H Recs. in Subsample	1061	713	147	1921
GL % of Total W/H Recs.	55%	37%	8%	100%
GL Expected Number of W/H Recs.	1471.3	436.1	13.7	1921
EJ Actual Number of W/H Recs. in Subsample	834	267	16	1117
EJ % of Total W/H Recs.	75%	24%	1%	100%
EJ Expected Number of W/H Recs.	1014.8	100.6	1.6	1117

The degree to which the number of withhold recommendations in the medium and high groups exceeds the expected number differs substantially among advisors. For GL and EJ, the number of actual withhold recommendations in the medium and high subsamples combined is, respectively, 1.9 and 2.8 times the expected number. By contrast, for ISS and PG, the number of actual withhold recommendations in the medium and high groups is, respectively, 24.1 and 91.0 times the expected number. This indicates that the positive correlation of recommendations among nominees to the same board is higher for ISS and PG than for GL and EJ.

Two factors can generate a positive correlation in recommendations among nominees to the board. First, the proxy advisor may issue "group-based" recommendations. For example, the advisor may issue withhold recommendations for the whole compensation committee (or even the whole board) if it finds that the CEO is receiving excessive compensation. Second, the advisor may issue "spillover" recommendations, where attributes of one nominee affect the recommendation of other nominees. For example, a proxy advisor may not generally issue withhold recommendations for outside linked directors if the total number of such nominees to the board of a single company is sufficiently low, but may

TABLE 9.2. Attribute Representation in ISS and PG Withhold Subsamples

Attribute	*ISS Low*	*ISS Medium*	*ISS High*	*PG Low*	*PG Medium*
CEO	2.7%	15.0%	11.8%	0.0%	1.2%
New Director	15.0%	8.9%	7.9%	2.3%	3.6%
AuditMbr	28.7%	13.9%	38.2%	39.4%	47.6%
Prior Restat	12.4%	7.2%	3.2%	9.3%	3.6%
Prior SEC	10.4%	10.0%	8.7%	4.7%	14.5%
CompMbr	50.2%	27.7%	44.6%	81.8%	93.9%
Top5AbComp	7.5%	17.8%	8.9%	16.3%	30.3%
Attendance	9.0%	1.2%	0.0%	9.1%	2.4%
ManyBds	27.6%	5.1%	10.4%	18.2%	6.1%
Age75	16.0%	12.8%	16.7%	23.3%	16.7%
NomMbr	57.0%	21.2%	35.5%	48.5%	46.3%
Empl_Dir	3.1%	31.3%	6.4%	0.0%	0.0%
OutDirLink	48.0%	28.3%	18.2%	12.1%	7.3%
BlockDir	1.8%	8.4%	2.7%	0.0%	0.0%
IP No	0.0%	0.0%	17.8%	0.0%	0.0%
Bot5AbRet	6.8%	0.0%	4.8%	0.0%	0.0%
Top5AbRet	6.4%	6.7%	9.5%	7.0%	3.6%

Note: Numbers are the percentages of the withhold recommendations for the particular subsample. For example, directors with the *IP No* attribute account for 17.8% of the ISS withhold recommendations that resulted in the high category.

issue withhold recommendations for *all* outside linked director nominees if too many of them are nominated to the same board. Correlations may be higher for those proxy advisors that employ group-based or spillover recommendations relatively more frequently.

To determine what accounts for the high positive correlation among nominees in recommendations made by ISS and PG, we compared the nominees who received withhold recommendations in the low-withhold subsample to those who received withhold recommendations in the medium-withhold and high-withhold subsamples. (Given the low number of withhold recommendations in the PG high-withhold group, we did not include figures for that subsample.) In the absence of group-based and spillover recommendations, we would expect no systematic difference in these attributes. The data are presented in table 9.2.

For ISS, we find that CEOs account for a significantly greater percentage of the withhold recommendations in the medium-withhold group than in the low-withhold group. Similarly, employee directors and

block directors are more highly represented in the medium- (and, to a lesser extent, in the high-) withhold group than in the low-withhold group. In contrast to these insider and quasi-insider directors, members of audit, compensation or nominating committees (which consist predominantly of outside directors) and outside linked directors are relatively underrepresented in the medium-withhold group. This suggests a possible spillover effect that we investigate further below.

In addition, table 9.2 provides evidence that ISS issues group-based withhold recommendations (covering all or almost all nominees) when it determines that the board has inappropriately ignored a shareholder proposal. Such nominees account for 17.8% of the withhold recommendations in the high withhold group, but none in the low- and medium-withhold groups. Notably, GL, the only other advisor for which *IP No* was statistically significant, does not make it a basis for group-based withhold recommendations. Nominees coded as *IP No* account for 0.9% of the withhold recommendations in the low group and, respectively, 1.1% and 0.0% of the withhold recommendations in the medium and high groups.

Consistent with our earlier finding that paying abnormally high compensation is associated with an increased likelihood of a withhold recommendation for compensation committee members (but not for other directors), we also find that *Top5AbComp* accounts for a higher percentage of the withhold recommendations in the medium group than in the other groups.

For PG, the most salient result is that withhold recommendations in the medium-withhold group consist disproportionally of nominees on boards where the CEO receives abnormally high compensation compared with the low-withhold group (30.3% of the withhold recommendations in the medium group versus 16.3% in the low-withhold group) and almost entirely of members of the compensation committee (93.9%, or seventy-seven of eighty-two nominees that received withhold recommendations, in the medium group versus 81.8% in the low-withhold group). Conversely (and not reported in table 9.2), only two of seventy-nine compensation committee members in the medium-withhold subsample received a for recommendation. This evidence indicates that PG issues group-based recommendations on compensation committee members for compensation issues (but not for any other directors and other issues), holding the entire committee responsible for inappropriate compensation practices.

We now turn to examining more closely our earlier finding that, as to ISS, CEOs, as well as employee directors and block directors, are more highly represented in the medium-withhold group than in the low-withhold group. This finding is of special interest because ISS is reported to be the most influential proxy advisor and because it is the only advisor for which being a CEO is associated with an increased likelihood of a withhold recommendation (see table 3 above). The data in table 9.2 suggest that this association is attributable to group-based or spillover effects, since CEOs are substantially underrepresented in the low-withhold subsample.

We hypothesize that withhold recommendations for CEOs in the medium-withhold subsample represent a spillover effect from the presence of excessive numbers of "suspect" directors on the board. When ISS considers that number to be inappropriately high, it issues withhold recommendations for both the suspect directors and the CEO, with the result that CEOs are overrepresented in the medium-withhold subsample.[74]

For the purpose of our hypothesis, we consider three types of directors as potentially suspect: employee directors, outside linked directors, and block directors. Note that employee and block directors are themselves overrepresented in the medium-withhold subsample. This may be due to a spillover effect—that is, ISS may be more likely to issue withhold recommendations for these types of suspect directors when their number is inappropriately high. By contrast, outside linked directors are more highly represented in the low-withhold subsample than in the medium-withhold subsample. This suggests that ISS tends to issue withhold recommendations for outside linked directors regardless of their number (that is, without any spillover effect). Indeed, as shown in table 9.3, outside linked directors account for 9.9% of all nominees (who received either a for or a withhold recommendation) in the low-withhold subsample; but they account for 43% of nominees who received a withhold recommendation in the low-withhold subsample. Thus, even in that subsample, being an outside linked director is associated with an increased likelihood of an ISS withhold recommendation. By contrast, being a CEO or employee director is not associated with an increased likelihood of a withhold recommendation in the low-withhold subsample. (As shown in table 9.3, CEOs and employee directors are less frequently represented among nominees who received withhold recommendations than among nominees overall in the low-withhold subsample.)

74. In effect, ISS may be holding the CEO responsible for allowing the issuer to maintain an ineffective board or lobbying for the CEO's replacement in circumstances in which the board is unresponsive.

TABLE 9.3. Types of Directors in ISS Withhold Subsamples

Attribute	*Low Subsample: All Recs.*	*Low Subsample: W/H Recs. Only*	*Med. Subsample: All Recs.*	*Med. Subsample: W/H Recs. Only*
All Nominees	8434	250	361	180
CEO	840 (10.0%)	6 (2.4%)	35 (9.7%)	25 (13.9%)
Empl_Dir	496 (5.9%)	7 (2.8%)	57 (15.8%)	52 (28.9%)
OutLinkDir	834 (9.9%)	107 (42.8%)	57 (15.8%)	47 (26.1%)
BlockDir	57 (0.6%)	4 (1.6%)	15 (4.2%)	14 (7.8%)

Note: Percentages of all nominees are in parentheses.

Even if ISS issues withhold recommendations for outside linked directors regardless of their number, the number of outside linked directors may affect the likelihood that other types of directors, specifically CEOs, receive a withhold recommendation. Note, in this respect, that outside linked directors account for a higher proportion of all nominees for medium-withhold boards than they do for all nominees for low-withhold boards. This indicates that the number of outside linked directors on a board may be related to the percentage of nominees who received withhold recommendations.

To test for the presence of spillover effects, we repeat our base regression with several additions. First, we add dummy variables for the presence of various types of potentially suspect directors as follows: *Many_Empl_Dir*, taking the value of 1 if the number of employee director nominees is two or more and 0 otherwise; *Many_OutDirLink*, taking the value of 1 if the number of outside linked director nominees is two or more and 0 otherwise; and *Many_BlockDir*, taking the value of 1 if the number of block director nominees is one or more and 0 otherwise. We then interact each of these dummy variables with *CEO* and further interact *Many_Empl_Dir* with *Empl_Dir*, *Many_OutDirLink* with *OutDirLink*, and *Many_BlockDir* with *BlockDir* (the latter variable being collinear with *BlockDir*). The results of this regression are presented in table 10. (For simplicity, we report only the results for the added variables as well as for *CEO*, *Empl_Dir*, and *OutDirLink*.)

TABLE 10. Suspect Directors

Attribute	*VoteISS*	*VotePG*	*VoteGL*	*VoteEJ*
CEO	0.242	-0.856*	-1.183***	-0.607**
	(1.18)	(-1.88)	(-5.87)	(-2.37)
Empl_Dir	1.172***	0.750	0.882***	-0.101
	(4.26)	(0.71)	(5.10)	(-0.31)
Many_Empl_Dir	0.0573	0.473	0.223*	-0.139
	(0.23)	(0.64)	(1.82)	(-0.86)
Many_Empl_Dir × *Empl_Dir*	0.838**	...	0.173	1.145**
	(2.20)		(0.83)	(2.35)
Many_Empl_Dir × *CEO*	1.212***	...	-1.383*	0.819
	(3.20)		(-1.83)	(1.44)
OutDirLink	1.895***	0.654	1.401***	1.663***
	(10.64)	(1.43)	(12.69)	(11.50)
Many_OutDirLink	0.139	0.705	0.023	0.122
	(0.56)	(1.57)	(0.24)	(0.91)
Many_OutDirLink × *OutDirLink*	0.083	-1.050	0.030	0.313
	(0.33)	(-0.89)	(0.18)	(1.57)
Many_OutDirLink × *CEO*	0.606**	0.533	0.312	0.213
	(2.11)	(0.37)	(0.73)	(0.47)
BlockDir	0.180	2.622***	0.439	0.830**
	(0.63)	(3.21)	(1.58)	(2.34)
Many_BlockDir	0.593**	-1.402	-0.003	0.424*
	(1.96)	(-1.48)	(-0.02)	(1.89)
Many_BlockDir × *CEO*	1.066***	3.045***	1.125**	1.200**
	(3.94)	(3.15)	(2.25)	(2.49)
Year06	-0.134	0.189	0.148**	-0.215***
	(-1.02)	(0.82)	(2.39)	(-2.94)
Constant	-3.876***	-5.883***	-2.083***	-4.110***
	(-5.93)	(-3.67)	(-6.42)	(-8.58)
N	11,833	4388	12,973	11,809
pseudo R^2	0.163	0.212	0.108	0.211

Note: t-statistics are in parentheses. All models use the base model in table 3 with the addition of interaction terms. We report only the coefficients for the additional interaction terms and associated variables. Where data are unavailable, ellipsis dots are inserted.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

The results for ISS indicate a substantial spillover effect of all three classifications of potentially suspect directors onto CEO. The presence of any type of suspect director nominee significantly increases the likelihood of an ISS withhold recommendation for the CEO. (In F-tests, *Many_Empl_Dir* + *Many_Empl_Dir* × *CEO*, *Many_OutDirLink* + *Many_OutDirLink* × *CEO*, and *Many_BlockDir* + *Many_BlockDir* × *CEO* are significant at the 1%, 5%, and 1% levels, respectively; *CEO* + *Empl_Dir* + *Many_Empl_Dir* × *CEO*, *CEO* + *Many_OutDirLink* +

Many_OutDirLink × *CEO*, and *CEO* + *Many_BlockDir* + *Many_BlockDir* × *CEO* are each significant at the 1% level.) In the absence of these spillover factors, CEOs do not have an increased likelihood of receiving a withhold recommendation (the *CEO* variable on its own is insignificant). Thus, the finding in our base regression that CEOs are significantly more likely to receive an ISS withhold recommendation is entirely explained by spillover effects. Our results are robust for various variations, such as excluding nominees from companies with classified boards, adding additional interaction variables, and using different variables to signify an excessive number of suspect directors. We also find evidence that the likelihood of a withhold recommendation for employee directors increases if there are at least two employee directors nominated to the board (in F-tests, *Many_Empl_Dir* + *Many_Empl_Dir* × *Empl_Dir* is significant at the 5% level).

We run similar regressions for the other proxy advisors. We find no evidence of any spillover effects for PG. For GL, we find weak evidence that the likelihood of a withhold recommendation for any nominee (other than the CEO) increases if there are at least two employee directors nominated to the board (*Many_Empl_Dir* is significant, but only at the 10% level). Furthermore, we find that, while CEOs are generally less likely to receive a withhold recommendation from GL, they are no less likely to receive a withhold recommendation if at least one block director is nominated to the board (*CEO* + *Many_BlockDir* + *Many_BlockDir* × *CEO* is insignificant). For EJ, we find that employee directors are significantly more likely to receive a withhold recommendation if and only if at least two such directors are nominated (*Empl_Dir* is insignificant, while *Empl_Dir* + *Many_Empl_Dir* + *Many_Empl_Dir* × *Empl_Dir* is significant at the 5% level); that outside linked directors are more likely (at the 5% level) to receive a withhold recommendation if at least two such directors are nominated; and that CEOs, who are ordinarily less likely to receive a withhold recommendation, are more likely (at the 10% level) to do so if at least one block director is nominated to the board.

The results of these analyses suggest that ISS (and to a lesser degree GL and EJ) considers the overall composition of the board as an important factor in issuing recommendations on specific directors. Combining this finding with the results of the previous sections indicates that proxy advisors may focus their evaluation of a particular nominee primarily within the context of a specific company.

VII. IMPLICATIONS AND CONCLUSIONS

Our analysis largely supports the conclusion that proxy advisors provide a valuable service to their investor clients. Significantly, advisor recommendations—at least with respect to uncontested director elections—appear to be based on the factors that should matter to investors: good governance, director attention, and performance. We find compelling evidence that withhold recommendations are made in response to identifiable issuer- and director-specific problems, including, among others, financial restatements, SEC investigations, excessive executive compensation, failure to attend board meetings, lack of independence, and failure to implement precatory proposals adopted by shareholders. By contrast, antitakeover devices, which are often the subject of precatory shareholder resolutions, appear to have no impact on recommendations in director elections.

We find mixed evidence (depending on the advisor and the issue) that advisors use withhold recommendations to target those board members who bear responsibility for the issuer-specific problems triggering the recommendations. Of particular interest may be our findings that only one proxy advisor (ISS) is more likely to issue a withhold recommendation for the CEO if the company's stock price persistently underperforms the market averages and that no advisor is less likely to issue a withhold recommendation for the CEO if the company's stock price consistently outperforms the market averages.

Among our most significant findings about proxy advisor recommendations is the heterogeneity among proxy advisors. Proxy advisors differ significantly from each other in their propensity to issue withhold recommendations, in the factors on which they base their recommendations, in the weight accorded to those factors, in their propensity to issue a greater number of withhold recommendations for persons nominated for multiple board seats, in their proclivity to issue group-based and spillover recommendations, and in their reasons for doing so.

This heterogeneity raises the initial issue of whether and to what extent the institutional investors who hire these proxy advisors are aware of the factors each advisor uses in making its recommendations. To the extent that investors are aware of those factors or will become so (as a result of this or similar studies), heterogeneity is desirable as it enables investors to subscribe to and follow the recommendations of those advisors that conform to the investor's assessment of value-maximizing corporate

governance. For example, an investor who believes that proper audit and disclosure is the most important board function may be best served by following the recommendations of GL, while an investor concerned with executive compensation may want to give serious weight to recommendations by PG. Moreover, public examination of the factors that result in withhold recommendations increases transparency and makes proxy advisors (and those institutional investors that follow their recommendations) more accountable to members of the public who hold shares through institutional investors and to corporate governance policymakers.

To the extent that investors are not aware of these factors, however, the fact that the different advisors employ substantially different methodologies in making recommendations suggests that investors may not accurately perceive the information content associated with a withhold recommendation. This could lead investors to follow blindly the recommendation of a proxy advisor, even when that recommendation is based on factors that the investors would not consider relevant. In that case, proxy advisors would not be serving the goal of facilitating an informed shareholder vote. The result would be to reduce the effectiveness of the shareholder franchise because shareholders would not be voting their true preferences. In such a scenario, proposals to expand the shareholder vote should be taken up with caution. Likewise, the criticism of proxy advisors—as powerful governance actors that lack proper incentives and accountability as to the content of their recommendations and have the ability to base these recommendations on their whim, to follow their own ideological agenda, or perhaps even to pursue their own conflicting business interests—would warrant serious attention.

APPENDIX. Variable Definitions

Variable	Definition
Age75	Indicator variable equal to 1 if the director is seventy-five years old or older and 0 otherwise.
Attendance	Indicator variable equal to 1 if the director attended less than 75 percent of the meetings (as tracked by the IRRC for the year prior to the annual meeting date) and 0 otherwise.
AuditMbr	Indicator variable equal to 1 if the director is a member of the audit committee and 0 otherwise.
BlockDir	Indicator variable equal to 1 if the director owns more than 20 percent of the outstanding shares of the company in question and 0 otherwise.
Bot5AbRet	Indicator variable equal to 1 if the abnormal return for the three-year period prior to the annual meeting date for the company in question is in the bottom 5 percent of the sample and 0 otherwise. The abnormal return is defined as the difference between the raw three-year holding period return for the company in question and the three-year holding period return for the CRSP value-weighted market index.
CEO	Indicator variable equal to 1 if the director is the CEO of the company in question and 0 otherwise.
Chairman Only	Indicator variable equal to 1 if the director is the chairman of the board of the company in question (but not an employee) and 0 otherwise.
ClassBd	Indicator variable equal to 1 if the director sits on a classified board for the company in question (as measured by the IRRC for the year prior to the annual meeting date) and 0 otherwise.
CompMbr	Indicator variable equal to 1 if the director is a member of the compensation committee and 0 otherwise.
CumVote	Indicator variable equal to 1 if the company in question uses cumulative voting to elect directors (as measured by the IRRC for the year prior to the annual meeting date) and 0 otherwise.
Empl_Dir	Indicator variable equal to 1 if the director is an employee of the company in question (but not the CEO) and 0 otherwise.

GP	Indicator variable equal to 1 if the company in question uses golden parachute agreements (as measured by the IRRC for the year prior to the annual meeting date) and 0 otherwise.
Interlock	Indicator variable equal to 1 if the director met the IRRC criteria for an interlocking director in the year prior to the annual meeting date and 0 otherwise. The IRRC defines an interlocking directorship as follows: a directorship "whereby a director and executive of the company ABC sits on a board of another company XYZ and a director and executive of company XYZ sits on the board of company ABC that has an executive and director who also sit[s] on the original company's board." Definitions for RiskMetrics' Directors Dataset, http://wrds.wharton.upenn.edu/ds/ riskmetrics/dir_doc.shtml (last visited Apr. 20, 2009).
IP No	Indicator variable equal to 1 if the company in question faced a proxy issue proposal that received a majority for vote and failed to implement the recommendations of the proxy issue proposal within the following year and 0 otherwise.
ManyBds	Indicator variable equal to 1 if the director is a member of at least three other "major" company boards (as followed by the IRRC for the year prior to the annual meeting date) and 0 otherwise.
New Director	Indicator variable equal to 1 if the director has been on the board for less than two years.
NomMbr	Indicator variable equal to 1 if the director is a member of the nominating committee and 0 otherwise.
OutDirLink	Indicator variable equal to 1 if the director is an outside director of the company in question with affiliated links with the company and 0 otherwise. The IRRC treats as a linked director: someone "who is a former employee; is an employee of or is a service provider, supplier, customer; is a recipient of charitable funds; is considered an interlocking or designated director; or is a family member of a director or executive." Definitions for RiskMetrics' Directors Dataset, http://wrds.wharton.upenn.edu/ ds/riskmetrics/dir_doc.shtml (last visited Apr. 20, 2009).
PPill	Indicator variable equal to 1 if a poison pill exists for the company in question (as measured by the IRRC for the year prior to the annual meeting date) and 0 otherwise.

Prior Restat Indicator variable equal to 1 if news relating to a financial restatement was first made public within two years prior to the meeting date (either in an SEC filing or through a public press release) and 0 otherwise.

Prior SEC Indicator variable equal to 1 if news relating to an SEC investigation or enforcement action was first made public within two years prior to the meeting date (either in an SEC filing or through a public press release) and 0 otherwise.

Sdret Standard deviation of returns for the company in question for the one-year period prior to the annual meeting date.

Top5AbComp Indicator variable equal to 1 if the total excess compensation for the CEO for the company in question is in the top 5 percent of the sample and 0 otherwise. We define Total Excess CEO Compensation as the difference between the Total CEO Compensation for the year prior to the meeting date (as provided by the Compustat Executive Compensation database) minus the Expected Total CEO Compensation. We calculate the Expected Total CEO Compensation by first estimating an OLS model as follows (following a model suggested to us by Martijn Cremers):

$$\ln(\text{Total CEO Compensation}) = \alpha + \beta_1 \ln(\text{market\_cap}) + \beta_2 \text{Three\_Year\_Abnormal\_Holding\_Period\_Return} + \beta_3 \text{Three\_Year\_Standard Dev. of Returns} + \beta_4 \text{Year\_2006} + \text{Industry Effects} + \varepsilon$$

We then use the predicted Total CEO Compensation based on this model as the Expected Total CEO Compensation. Industry effects were based on two-digit SIC codes. *Abnormal_Holding_Period_Return* is defined as the difference between the holding period return and the value-weighted CRSP market index for the same period.

Top5AbRet Indicator variable equal to 1 if the abnormal return for the three-year period prior to the annual meeting date for the company in question is in the top 5 percent of the sample and 0 otherwise. The abnormal return is defined as the difference between the raw three-year holding period return for the company in question and the three-year holding period return for the CRSP value-weighted market index.

VoteEJ Indicator variable equal to 1 if EJ recommends a Withhold vote for the director in question and 0 otherwise.

VoteGL	Indicator variable equal to 1 if GL recommends a Withhold vote for the director in question and 0 otherwise.
VoteISS	Indicator variable equal to 1 if ISS recommends a Withhold vote for the director in question and 0 otherwise.
VotePG	Indicator variable equal to 1 if PG recommends a Withhold vote for the director in question and 0 otherwise.
Year06	Indicator variable equal to 1 if the director recommendation is for 2006 and 0 otherwise (for 2005).

THE POWER OF PROXY ADVISORS: MYTH OR REALITY?

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ABSTRACT

Recent regulatory changes increasing shareholder voting authority have focused attention on the role of proxy advisors. In particular, greater shareholder empowerment raises the question of how much proxy advisors influence voting outcomes. This Article analyzes the significance of voting recommendations issued by four proxy advisory firms in connection with uncontested director elections. We find, consistent with press reports, that Institutional Shareholder Services (ISS) is the most powerful proxy advisor and that, of the others, only Glass, Lewis & Co. seems to have a meaningful impact on shareholder voting.

This Article also attempts to measure the impact of voting recommendations on voting outcomes. Unlike prior literature, it distinguishes correlation from causality by examining both the recommendation itself and the underlying factors that may influence a shareholder's vote. Using several different tests, we conclude that popular accounts substantially overstate the influence of ISS. Our findings reveal that the impact of an ISS recommendation is reduced greatly once company- and firm-specific factors important to investors are taken into consideration. Overall, we estimate that an ISS recommendation shifts 6%–10% of shareholder votes. We also

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determine that a major component of ISS's influence stems from its role as an information agent, aggregating factors that its subscribers consider important.

INTRODUCTION

Proxy advisors—private firms that analyze corporate elections and advise investor clients on how to vote their shares—are recent and potentially powerful new players in the corporate governance world.[1] Institutional investors, which hold an increasing percentage of the shares of U.S. companies,[2] wield substantial voting power but often lack the appropriate incentives to cast informed ballots with respect to their portfolio companies.[3] Instead, many institutional investors employ the services of proxy advisors to assist them in exercising their voting rights.[4] The services of proxy advisors include providing research, helping investors develop voting guidelines, handling the mechanics of the voting process, and offering recommendations

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[1] *See* Albert Verdam, An Exploration of the Role of Proxy Advisors in Proxy Voting (Feb. 2007) (unpublished manuscript, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=978835) (describing the emergence of proxy advisors); *see also* U.S. GOV'T ACCOUNTABILITY OFFICE, CORPORATE SHAREHOLDER MEETINGS: ISSUES RELATING TO FIRMS THAT ADVISE INSTITUTIONAL INVESTORS ON PROXY VOTING 6–12 (2007) [hereinafter GAO, CORPORATE SHAREHOLDER], *available at* http://www.gao.gov/new.items/d07765.pdf (exploring competition and potential conflicts of interest in the proxy advisor market); Colin Diamond & Irina Yevmenenko, *Who Is Overseeing the Proxy Advisors?*, 3 BLOOMBERG CORP. L.J. 606, 608 (2008) (highlighting the proxy advisor market).

[2] Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987 (2010); *see also* Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 897 (2007) ("In 1965, institutional investors held 16% of U.S. equities; by 2001, institutional investors held 61%.").

[3] According to conventional wisdom, these institutional investors generally do not care enough about their votes to cast an informed ballot. They hold shares in too many companies, so any particular stake represents a small fraction of their portfolio, and how they vote is unlikely to affect the outcome and even if it did, the effect on the value of their portfolio would be minimal. Researching the issues on a company's annual meeting agenda is costly, and institutions may also lack the necessary expertise to evaluate these issues adequately. *See, e.g.*, Rose, *supra* note 2, at 897 ("Unless an institutional investor believes that it can conduct research for less, or that more expensive but discerning research will enable it to obtain better returns (after subtracting its own research costs), the investor may be better off outsourcing its corporate governance research."); Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 354 (2009) ("Institutional investors, despite having greater capacity to monitor and gather information, may have too small a stake in a company or too limited industry expertise to monitor it actively.").

[4] *See, e.g.*, GAO, CORPORATE SHAREHOLDER, *supra* note 1, at 13 (describing ISS's client base as consisting of an estimated 1,700 institutional investors).

on each issue on a company's agenda.[5] In some cases, institutional investors may even subcontract their voting decisions to proxy advisors.[6]

As a result of their capacity to influence voting, proxy advisors are regarded as very powerful.[7] The popular, business, and academic media describe ISS (Institutional Shareholder Services, a division of RiskMetrics), the proxy advisor with the largest client base,[8] and Glass, Lewis & Co., which has the second largest client base,[9] as "influential,"[10] "powerful,"[11] and having great "clout."[12] Commentators have claimed that ISS alone is able to influence shareholder votes by 19%,[13] 13.6 to 20.6%,[14] 30%,[15] and even "a third or more."[16] The collective power of proxy advisors arguably is even greater. As a result of this influence, management and shareholder activists alike frequently lobby ISS to endorse their respective positions. As related by Delaware's Vice-Chancellor Leo Strine:

> [P]owerful CEOs come on bended knee to Rockville, Maryland, where ISS resides, to persuade the managers of ISS of the merits of

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[5] *See, e.g.*, Glass, Lewis & Co., Proxy Paper: Proxy Research and Voting Recommendations on Global Proxies, http://www.glasslewis.com/solutions/proxypaper.php (last visited Aug. 11, 2009) (describing Glass Lewis's proxy research, voting recommendations, and voting platform for voting subscribers' shares); RiskMetrics Group, Custom Proxy Advisory, http://www.riskmetrics.com/custom_proxy_advisory (last visited Aug. 11, 2009) (describing how ISS works with clients to develop customized voting guidelines).

[6] RiskMetrics Group, Proxy Advisory Services, http://www.riskmetrics.com/proxy_advisory/options (last visited Aug. 11, 2009) (detailing the choice of ISS guidelines that subscribers can use and incorporate into "RiskMetrics' turnkey voting agency services").

[7] *See generally* GAO, CORPORATE SHAREHOLDER, *supra* note 1.

[8] *See id.* at 4.

[9] Stephen Davis, *White Knight Swoops in for Glass Lewis*, DIRECTORSHIP, Dec. 2007/Jan. 2008, at 7 ("Glass Lewis is the world's second biggest proxy adviser next to RiskMetrics . . . .").

[10] *See, e.g.*, Pallavi Gogoi, *Support for Bank of America CEO Wanes; Shareholders Meet Today, and Many Want Him Out*, USA TODAY, Apr. 29, 2009, at B1 (describing RiskMetrics as "[i]nfluential"); Robert D. Hershey Jr., *A Little Industry with a Lot of Sway on Proxy Votes*, N.Y. TIMES, June 18, 2006, § 3, at 6 (quoting David W. Smith, president of the Society of Corporate Secretaries and Governance Professionals, stating that "'[t]he influence [proxy] advisers wield is extraordinary'").

[11] *See, e.g.*, Matt O'Sullivan, *When Only a Corporate Jet Will Do*, SYDNEY MORNING HERALD, May 28, 2009, at 25 (describing RiskMetrics as "America's most powerful shareholder voting adviser").

[12] *See, e.g.*, Kim Clark, *Reading Proxies for Fun and Profit*, U.S. NEWS & WORLD REP., May 22, 2006, at EE10 (describing Glass Lewis's "growing clout"); Joann S. Lublin, *RiskMetrics's Head Faces His Day of Shareholder Judgment*, WALL ST. J., June 2, 2008, at C1 ("ISS Governance Services . . . exerts tremendous clout in advising institutional investors on proxy fights . . . .").

[13] Jie Cai, Jacqueline L. Garner & Ralph A. Walkling, *Electing Directors*, 64 J. FIN. 2389, 2404 (2009).

[14] Jennifer E. Bethel & Stuart L. Gillan, *The Impact of the Institutional and Regulatory Environment on Shareholder Voting*, FIN. MGMT, Winter 2002, at 29, 30.

[15] Posting of William J. Holstein to BNET: The Corner Office, http://blogs.bnet.com/ceo/?p=1100&tag=content;col1 (Feb. 7, 2008, 08:03).

[16] *See* Rose, *supra* note 2, at 889 (attributing this view to executives).

> their views about issues like proposed mergers, executive compensation, and poison pills. They do so because the CEOs recognize that some institutional investors will simply follow ISS's advice rather than do any thinking of their own. ISS has been so successful that it now has a California rival, Glass Lewis.[17]

Similarly, commentators have observed that "boards may do what they believe ISS wants them to in order to keep their seats, whether or not their belief is justified."[18]

This influence is troubling in light of the limited accountability of proxy advisors. Proxy advisors do not have a financial stake in the companies about which they provide voting advice; they owe no fiduciary duties to the shareholders of these companies;[19] and they are not subject to any meaningful regulation.[20] Moreover, it is not clear that the proxy advisory industry is sufficiently competitive and transparent to subject advisory firms—ISS in particular—to substantial market discipline.[21] Institutional investors, for the reasons outlined above, may lack sufficient interest in voting to scrutinize advisors' recommendations carefully. In addition, ISS has, until recently, enjoyed a near-monopoly position and still remains the dominant firm providing voting advice.[22]

The ability of proxy advisors to influence investor voting becomes particularly significant as the importance of shareholder voting increases. With respect to director elections, most U.S. companies have shifted in recent years from plurality to majority voting.[23] Under plurality voting, the nominees

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[17] Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 688 (2005).

[18] Diamond & Yevmenenko, *supra* note 1, at 617.

[19] Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1765 (2006) ("Unlike corporate managers, neither institutional investors as stockholders nor ISS as a voting advisor owe fiduciary duties to the corporations whose policies they seek to influence.").

[20] *See* GAO, CORPORATE SHAREHOLDER, *supra* note 1, at 8–9 (observing that, as pension consultants, ISS and Proxy Governance, Inc. (PGI) are registered with the SEC as investment advisors while Glass Lewis and Egan-Jones are not registered as investment advisors).

[21] *See id.* at 14 (acknowledging that "newer proxy advisory firms may face challenges attracting clients and establishing themselves in the industry").

[22] *Id.* at 7; Rose, *supra* note 2, at 899 ("ISS is the dominant firm in the corporate governance industry . . . .").

[23] In 2005, more than 90% of S&P 500 companies employed plurality voting. *See, e.g.*, Brooke A. Masters, *Shareholders Flex Muscles; Proxy Measures Pushing Corporate Accountability Gain Support*, WASH. POST, June 17, 2006, at D1 (stating that, as of the start of 2005, fewer than thirty S&P 500 companies

who win the most votes are elected, regardless of the number of votes that are "withheld."[24] Thus, in an uncontested election, a single vote in favor is enough to assure a nominee's election. By contrast, a majority standard requires a nominee to receive a majority of the votes cast.[25] Under this standard, shareholders can prevent the election of a nominee even without nominating a competing candidate; the voters simply must cast a sufficient number of "withhold" votes. As a consequence, the shift to a majority standard substantially increases the importance of shareholder voting in uncontested elections.

Over the same time period, a large number of companies dismantled their staggered boards.[26] The percentage of S&P 500 companies with staggered boards declined from 55% in 2005 to 40% in 2007.[27] In companies with staggered boards, typically only one-third of the board is up for election in any given year.[28] With a non-staggered board, the whole board is up for election. Dismantling the staggered board increases the number of directors up for election each year, thereby increasing the opportunity for shareholders to exercise their franchise. Indeed, the move from the typical three-year staggered board to non-staggered, annual elections triples the potential impact of the shareholder vote.

Finally, the New York Stock Exchange (NYSE) has adopted a rule that eliminates discretionary broker voting in uncontested director elections.[29]

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had majority voting or director resignation policies in place). By 2008, over 80% had moved away from plurality voting. Kahan & Rock, *supra* note 2, at 23.

[24] Under plurality voting, a shareholder in an uncontested election may cast a vote in favor of a director candidate or withhold voting authority but may not cast a vote "against" the nominees. *See, e.g.*, Jill E. Fisch, *The Transamerica Case*, *in* THE ICONIC CASES IN CORPORATE LAW 46, 68 (Jonathan R. Macey ed., 2008) (explaining the concept of "withheld" votes).

[25] *See id.* at 69 (explaining majority voting).

[26] Commentators have described effective staggered boards as the most powerful anti-takeover device and thus the most effective mechanism by which boards can insulate themselves from shareholder voice. *See, e.g.*, Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 889–91 (2002).

[27] Stephen Taub, *Revival of Classified Boards? Well, Maybe Not*, COMPLIANCE WK., Sept. 11, 2007, http://www.complianceweek.com/article/3647/revival-of-classified-boards-well-maybe-not.

[28] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(d) (2009); *see also* Gregory T. Carrott, *The Case for and Against Staggered Boards*, DIRECTORSHIP, Sept. 22, 2009, http://www.directorship.com/against-staggered-boards/ (explaining that, most often, staggered boards provide directors with three year terms).

[29] In October 2006, the New York Stock Exchange (NYSE) proposed to amend Rule 452 governing broker votes to redefine all director elections as "non-routine," which would eliminate the ability of brokers to cast discretionary votes. PROXY WORKING GROUP, REPORT AND RECOMMENDATIONS OF THE PROXY WORKING GROUP TO THE NEW YORK STOCK EXCHANGE 3 (2006), *available at* http://www.nyse.com/pdfs/PWG_REPORT.pdf. On July 1, 2009, the SEC finally approved the amendments, effectively ending broker

Historically, brokers who did not receive voting instructions from the beneficial owners of shares in their brokerage accounts were permitted to vote these shares in their discretion.[30] Brokers generally exercised their discretion to vote the shares in favor of the slate nominated by the company—the so-called management slate.[31] These discretionary broker votes are estimated to amount to about 19% of the votes cast at annual meetings.[32] Under the revised NYSE rules, companies will lose a sizeable block of automatic votes in favor of their nominees, shifting power to those shareholders who do vote.[33] The effect of broker voting is illustrated dramatically by the Citigroup 2009 annual meeting in which broker votes comprised 46% of votes cast.[34] Had the NYSE rule been in effect, two of the Citigroup nominees would not have won re-election.

As the Citigroup annual meeting demonstrates, the number of directors who receive a large percentage of withhold votes has increased. According to Georgeson, Inc., one of the leading proxy solicitation firms,[35] a record 612 directors at S&P 1500 companies received withhold votes in excess of 15% in the 2008 proxy season.[36] Thirty directors failed to receive a majority of the votes cast (up from fifteen in 2007).[37] Additionally, the number of contested elections, though still relatively small, continues to increase. For 2008,

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discretionary voting in director elections. Order Approving Proposed Rule Change, as Modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered Under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, Exchange Act Release No. 34-60215, 74 Fed. Reg. 33,293 (July 1, 2009).

30 NYSE, Inc., Rule 452 (Mar. 6, 2003).

31 Kahan & Rock, *supra* note 2.

32 *See* Posting of Ted Allen to RiskMetrics Group, http://blog.riskmetrics.com/gov/2007/05/sec-hears-testimony-on-broker-votessubmitted-by-ted-allen-director-of-publications.html (May 25, 2007, 10:58) (attributing this figure to Broadridge Financial).

33 *See* David A. Katz & Laura A. McIntosh, *A Seismic Shift in Mechanics of Electing Directors*, N.Y. L.J., July 27, 2006, at 5 ("If, in the aftermath of NYSE rule changes as proposed, issuers indeed are unable to contact or obtain voting instructions from large numbers of individual shareholders, the effect will be a massive shift of voting power from brokers to institutions, and, therefore, to proxy advisory services such as ISS, Glass, Lewis & Co., and Proxy Governance.").

34 Citigroup, Inc., First Quarter of 2009 (Form 10-Q), at 156–57 (May 11, 2009), *available at* http://www.citigroup.com/citi/fin/data/q0901c.pdf?ieNocache=643. (indicating broker votes of 1.732 billion shares).

35 For information on Georgeson, see http://www.georgeson.com/.

36 GEORGESON, ANNUAL CORPORATE GOVERNANCE REVIEW 7 (2008), *available at* http://www.georgeson.com/usa/download/acgr/acgr2008.pdf.

37 *Id.* at 7–8. In 2004, twelve directors failed to receive a majority of votes cast. Fisch, *supra* note 24, at 68.

Georgeson reported an all-time high of fifty-six contested solicitations, following a previous all-time high of forty-six contested solicitations in 2007.[38] In comparison, between 1995 and 1999, the number of contested solicitations averaged twenty-five per year.[39]

In addition to voting in director elections, shareholders vote on shareholder proposals introduced pursuant to Rule 14a-8 of the Securities Exchange Act.[40] As institutional activism increases, the character of these shareholder proposals has shifted from social policy issues[41] to proposals dealing with core economic and governance questions,[42] such as executive compensation,[43] shareholder nomination rights,[44] and other corporate governance matters.[45] These proposals are receiving increasing attention and support from shareholders. The number of proposals receiving majority shareholder support at S&P 1500 companies has increased from twenty-five in 2001 to eighty-six in 2008.[46] More importantly, boards have become more responsive to proposals receiving majority support. The number of implemented proposals rose from three in 2001 to forty-three in 2008.[47] As a result of these increases, shareholder power to introduce proposals is beginning to have a noticeable effect on the governance of U.S. corporations.

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[38] GEORGESON, *supra* note 36, at 8.

[39] *Id.* at 46.

[40] Rules and Regulations Under the Securities Exchange Act of 1934: Solicitations of Proxies, 17 C.F.R. § 240.14a-8 (2008).

[41] *See, e.g.*, Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1152–55 (1993) (describing the rise in shareholder use of social policy proposals in the 1950s and 1960s).

[42] *See, e.g.*, A. A. Sommer, Jr., *Corporate Governance in the Nineties: Managers vs. Institutions*, 59 U. CIN. L. REV. 357, 371 (1990) (describing the shift from proposals "having a social dimension" to those dealing with corporate governance).

[43] *See, e.g.*, BNA, *Annual Meeting Voting Compels More Accountability*, 11 CORP. GOVERNANCE REP. 30 (2008) (listing "say on pay" executive compensation proposals as one of the top three issues on corporate ballots for 2008).

[44] *See, e.g.*, Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, 462 F.3d 121, 123 (2d Cir. 2006) (addressing a shareholder proposal on proxy access).

[45] *See* GEORGESON, *supra* note 36, at 14 fig.3 (detailing corporate governance proposals from 2004 to 2008).

[46] Kahan & Rock, *supra* note 2, at 27 tbl.4 (citing GEORGESON, CORPORATE GOVERNANCE: ANNUAL MEETING SEASON WRAP UP (2001), *available at* http://www.georgeson.com/usa/download/acgr/acgr2001.pdf; GEORGESON, *supra* note 36). Prior to 2001, Georgeson prepared a similar report, but it analyzed only corporate governance proposals made by institutional investors. GEORGESON, CORPORATE GOVERNANCE: ANNUAL MEETING SEASON WRAP UP (2000), *available at* http://www.georgeson.com/usa/download/acgr/acgr2000.pdf.

[47] Kahan & Rock, *supra* note 2.

Two regulatory initiatives have the potential to increase the significance of shareholder votes even more. Under the first initiative—so-called "proxy access"—shareholders are likely to gain some ability to introduce candidates for the board of directors in a company's proxy statement. Although shareholders have traditionally been able to mount an election contest by nominating competing candidates, a company is not required to include the challenger's nominees on the company proxy statement, and the challenge requires an independent (and costly) proxy solicitation. For many years shareholders have sought the power to compel the inclusion of their nominees on the company's proxy statement.[48] After several unsuccessful attempts to persuade the SEC to adopt a rule providing for proxy access, institutional investors began to seek proxy access by introducing amendments to individual companies' bylaws.[49] Although these efforts were upheld in court,[50] in 2007, the Republican-controlled SEC amended the proxy rules to prohibit shareholders from using SEC Rule 14a-8 to introduce such bylaw amendments.[51]

In 2009, proxy access received a dramatic boost when the Delaware legislature amended its corporation law to authorize proxy access bylaws explicitly.[52] Subsequently, the new Democratically-controlled SEC introduced a revised proxy access proposal which, if adopted, would require proxy access under specified conditions.[53] If the SEC adopts a proxy access rule, it would mean that for companies with majority voting, shareholders would not only have the power to reject a company's nominees to the board, but also the power to select nominees of their own choosing.

The second regulatory initiative—"say-on-pay"—enables shareholders to vote on executive compensation. Say-on-pay, which is modeled on a

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[48] Fisch, *supra* note 37, at 63–67 (reviewing the history of proxy access proposals); Kahan & Rock, *supra* note 2 (reviewing the history of proxy access proposals). The SEC first considered a proposed rule permitting proxy access in 1942. Fisch, *supra* note 37, at 63. In 2003, the SEC solicited comments on a complex proposal for proxy access; the proposal stalled due to opposition from corporations and lack of support from Republican commissioners. *Id.* at 65–66.

[49] Fisch, *supra* note 24, at 65–66.

[50] Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, 462 F.3d 121, 123 (2d Cir. 2006) (holding that shareholders can introduce proxy access proposals under Rule 14a-8).

[51] Rules and Regulations Under the Securities Exchange Act of 1934: Solicitations of Proxies, 17 C.F.R. § 240.14a-8 (2008).

[52] DEL. CODE ANN. tit. 8, § 112 (2009). The legislature also adopted a provision authorizing bylaws that provide for reimbursement of a shareholder's proxy solicitation expenses. DEL. CODE ANN. tit. 8, § 113(a) (2009).

[53] Facilitating Shareholder Director Nominations, 17 C.F.R. §§ 200, 232, 240, 249, 274 (2009).

procedure adopted in England in 2002, provides for an annual advisory shareholder vote on the compensation packages paid to top corporate executives.[54] Institutional investors have introduced shareholder proposals seeking say-on-pay at a substantial number of companies.[55] Some of these proposals have received majority support,[56] and several companies have already implemented say-on-pay.[57] Furthermore, Congress may implement some form of say-on-pay requirement, either directly through legislation or indirectly via an SEC rule.[58] The House approved a say-on-pay bill in 2007,[59] and President Obama has indicated his support for such legislation.[60] Similarly, the Emergency Economic Stabilization Act of 2008[61] required companies receiving financial assistance under the Troubled Asset Relief Program to permit a shareholder advisory vote on executive compensation.[62]

Viewed in the context of the increasing importance of the shareholder franchise, claims about proxy advisor power paint a frightening picture. A few entities with limited accountability and broad discretion control a huge portion of the shareholder vote. And the shareholder vote they control influences an ever-increasing range of issues.

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[54] Fisch, *supra* note 37, at 71 (describing say-on-pay).

[55] *See, e.g.*, Robert Kropp, *Shareowner Resolutions on Say on Pay Gain Widespread Support*, May 6, 2009, http://www.socialfunds.com/news/article.cgi?sfArticleId=2690 (reporting that seventy-nine say-on-pay resolutions were introduced in 2008, and more than one hundred have been filed in 2009).

[56] According to a preliminary count, as of May 2009, ten of the twenty-nine proposals that came up for a vote received majority support. Press Release, AFSCME, Say on Pay Shareholder Proposals Garner Record Support During Tumultuous Shareholder Season (May 4, 2009).

[57] *See, e.g.*, Editorial, *Stockholders Should Demand a Say on Executive Pay*, SEATTLE TIMES, May 14, 2009, *available at* http://seattletimes.nwsource.com/html/editorialsopinion/2009221158_editb15sayonpay.html (noting that resolutions had been approved by fifteen companies this year and that Hewlett-Packard and Occidental Petroleum had agreed to adopt say-on-pay without a shareholder vote); SmartPros.com, Say-On-Pay Is on the Way, http://accounting.smartpros.com/x65641/xml (last visited Feb. 7, 2010) (listing Occidental Petroleum, Intel, Hewlett-Packard, MBIA, Motorola, and Ingersoll-Rand as companies that have adopted say-on-pay).

[58] *See* Lawrence Bard et al, Morrison Foerster, *Administration Proposals on Compensation Committees and Say on Pay Would Affect All Public Companies*, July 30, 2009, http://www.mofo.com/news/updates/files/15793.html (describing the Treasury Department's draft legislation that would require the SEC to adopt rules mandating say-on-pay for all publicly traded companies).

[59] Shareholder Vote on Executive Compensation Act, H.R. 1257, 110th Cong. §2 (2007); Shareholder Vote on Executive Compensation Act, S. 1181, 110th Cong. §2 (2007).

[60] Stephen Taub, *Obama Pushes Say on Pay Legislation*, CFO.COM, Apr. 11, 2008, http://www.cfo.com/article.cfm/11037327/c_11036422 (reporting then-Senator Obama's support for say-on-pay).

[61] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110343, 122 Stat. 3765, 110th Cong. (2008).

[62] Shareholder Approval of Executive Compensation of TARP Recipients, Exchange Act Release No. 34-61335, 75 Fed. Reg. 2789 (Jan. 12, 2010) (describing requirement of Section 111(e) of the Emergency Economic Stabilization Act of 2008 and amending federal proxy rules to implement the requirement).

Yet, despite the assertions that proxy advisors are powerful, little systematic study of their actual influence on shareholder votes has been conducted. Only a handful of academic papers analyze ISS recommendations empirically. In one article, Jennifer Bethel and Stuart Gillian[63] examine votes on shareholder proposals during the 1998 proxy season. Bethel and Gillan conclude that a negative ISS recommendation was associated with 13.6% to 20.6% fewer shares voted in favor of management proposals.[64] Another recent paper analyzes the role of ISS recommendations in proxy contests.[65] The authors find that ISS recommendations have significant explanatory value for contest outcomes.[66] Finally, Jie Cai, Jacqueline Garner, and Ralph Walking examine the factors that determine the percentage of "for" votes cast in uncontested director elections.[67] After controlling for several other factors, they find that a negative ISS recommendation reduces the vote in favor of directors by 19%.[68]

These studies, as well as the other less systematic claims about the effect of proxy advisors, suffer in varying degrees from two problems. First, they focus only on ISS and do not consider the effect of other proxy advisors on shareholder voting. Second, and more importantly, they fail to deal with the issue of what is meant by the "power" or "influence" of proxy advisors. In particular, the studies do not distinguish between correlation and causation. Thus, although they demonstrate that proxy advisor recommendations are correlated with voting outcomes, they do not fully address the underlying factors—firm performance, director attendance, and the like—that are likely to influence both the recommendations and the ultimate vote.[69]

In this Article, we try to correct for these problems in two ways. First, we examine the relationship between shareholder votes and the recommendations of proxy advisors, including not merely ISS, but also Glass Lewis, Proxy Governance, and Egan Jones. (Glass Lewis is reputedly the second most influential proxy advisor; Proxy Governance and Egan Jones also provide

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63 Bethel & Gillan, *supra* note 14, at 29.

64 *Id.* at 46.

65 Cindy R. Alexander et al., *The Role of Advisory Services in Proxy Voting* (Nat'l Bureau of Econ. Research, Working Paper No. 15143, 2008), *available at* http://www.nber.org/paper/w15143.

66 *Id.* at 34–35.

67 *See* Cai et al., *supra* note 13.

68 *Id.* at 19.

69 The article by Cai and others partially examines other factors that may influence the vote. *See* Cai, et al., *supra* note 13.

proxy advice.)[70] Second, we try to disentangle the difference between correlation and causation both conceptually and empirically.[71]

Part I discusses the distinction between correlation and causation and posits four possible relationships between proxy advisor recommendations and the subsequent shareholder vote. Part II describes our dataset and provides summary statistics on advisor recommendations and voting outcomes. Part III incorporates factors that, we hypothesize, are likely to influence voting outcomes and, using multivariate regression analysis, analyzes the role these factors and advisor recommendations play in influencing voting outcomes. Part IV focuses on ISS in particular and introduces an alternative methodology for measuring ISS's power by distinguishing institutional voting behavior from that of individual retail investors.

I. CORRELATION AND CAUSATION: FOUR TYPES OF "POWER"

Proxy advisor recommendations may correlate with the shareholder vote for four conceptually distinct reasons. First, the same director nominee and company characteristics may independently influence both the proxy advisors' recommendation and the shareholder vote. Second, proxy advisors may gather information that investors use to make their voting decisions. Third, investors may select a proxy advisor based on their *ex ante* agreement with the bases upon which the advisor formulates its recommendations. Finally, investors may view the advisor's recommendation alone as a basis for deciding how to vote, independent of the underlying factors upon which that recommendation is based. It is only this last reason that can truly be characterized as causality.

There is reason to believe a substantial overlap exists between the factors that proxy advisors consider important and those that matter to voters. To start, there is extensive corporate governance literature examining board composition and effectiveness.[72] Although precise specifications of the

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[70] *See* GAO, CORPORATE SHAREHOLDER, *supra* note 1, at 7 (describing ISS, Glass Lewis, Proxy Governance, and Egan Jones as among the "five major firms" comprising the proxy advisory industry). The fifth firm included in the GAO report is Marco Consulting Group (MCG), which provides investment consulting services to Taft-Hartley funds and a number of public benefit plans but does not publicly issue voting recommendations. *See* Marco Consulting, Company History, http://www.marcoconsulting.com/1.2.html (last visited May 5, 2010) ("MCG only provides investment consulting and proxy voting services.").

[71] We explore the relationship between these factors and proxy advisor recommendations in a prior article. Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 650–51 (2009).

[72] *See, e.g.*, Laura Lin, *The Effectiveness of Outside Directors as a Corporate Governance Mechanism:*

characteristics that increase director effectiveness are difficult to identify, many commentators agree on baseline attributes.[73] In addition, while shareholders may be dissatisfied with a board of directors for many reasons, common reasons for concern include poor financial performance; corporate misconduct, such as securities fraud; excessive executive compensation; and a lack of responsiveness to shareholders.[74]

In an earlier article, we examined the relationship between these factors and proxy advisor recommendations in uncontested director elections.[75] In particular, we examined the effect on recommendations of twenty-three factors, including director-specific factors such as age and attendance, and firm-specific factors such as financial performance, the existence of antitakeover defenses, and the board's failure to implement a previously approved shareholder proposal. We found that the majority of our factors affected the likelihood that at least one proxy advisor would issue a withhold recommendation—although firm antitakeover defenses did not seem to play a significant role. Moreover, while all of the proxy advisors considered a few specific factors important—such as poor director attendance—on most issues there was substantial variation. For example, ISS was significantly more likely to issue a withhold recommendation when the company board had refused to

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Theories and Evidence, 90 NW. U. L. REV. 898, 921–39 (1996) (collecting empirical studies of board composition and effectiveness); *cf.* Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 263 (2002) (finding no correlation between director independence and long-term firm performance).

[73] These include director independence both from the company and the CEO, limited service on other corporate boards, and regular attendance at board meetings. *See, e.g.*, In the Matter of the Walt Disney Co., Exchange Act Release No. 50882 (Dec. 20, 2004) ("The independence of directors is a linchpin of sound corporate governance, and is crucial to the objective oversight of management."); PAUL W. MACAVOY & IRA M. MILLSTEIN, THE RECURRENT CRISIS IN CORPORATE GOVERNANCE 22–23 (2003) (stating that directors should act "independently of management"); Stephen P. Ferris et al., *Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments*, 58 J. FIN. 1087 (2003) (finding no evidence, contrary to popular wisdom, that multiple directors shirk their responsibilities); Renée B. Adams & Daniel Ferreira, *Regulatory Pressure and Bank Directors' Incentives to Attend Board Meetings* 304 (European Corporate Governance Inst. Working Paper Series, Working Paper No. 203/2008, 2008), *available at* http://ssrn.com/abstract=936261 (discussing various directives that directors attend board meetings regularly). The federal proxy rules require issuers to disclose whether any director has attended fewer than 75% of the board meetings held during the prior fiscal year. Schedule 14A. Information Required in Proxy Statement, 17 C.F.R. § 240.14a-101, Item 7(f) (2009). The rules also require disclosure of outside directorships. Schedule 14A. Information Required in Proxy Statement, 17 C.F.R. § 240.14a-101, Item 22(b) (2009).

[74] *See, e.g.*, Mark Anderson, *Eli Lilly Heads CalPERS' 'Underperforming' List*, SACRAMENTO BUS. J., Mar. 19, 2009, http://sacramento.bizjournals.com/sacramento/stories/2009/03/16/daily56.html (describing CalPERS's (the California Public Employees' Retirement System) watch list as targeting companies with corporate governance defects that also "show weakness with profitability, transparency and/or management").

[75] *See* Choi, Fisch & Kahan, *supra* note 71, at 650–51.

implement a shareholder resolution that had received majority shareholder support. Glass Lewis was significantly more likely to issue a withhold recommendation if the nominee was an inside director (other than the CEO). Egan Jones was significantly more likely to issue a withhold recommendation if the nominee was a board member at three or more other major companies. Proxy Governance was significantly more likely to issue a withhold recommendation if the company CEO received abnormally high compensation.[76]

We found a substantial correlation between proxy advisor recommendations and the factors that academics, policy makers, and the media have identified as important. This correlation challenges the view that ISS and the other proxy advisors are causally significant in determining the shareholder vote because shareholders may themselves directly consider these factors important. To the extent that the same factors independently affect both shareholders' voting behavior and the proxy advisor's recommendation, shareholder votes and recommendations will be correlated. However, the recommendation will not be the cause of the shareholder vote. Any power or influence inferred from such a correlation would be illusory.[77]

Of course, proxy advisors may be the source of the information underlying shareholder voting decisions. When proxy advisors issue recommendations, they provide more than a bottom line—more than a mere vote "for" or "withhold." Proxy advisors also provide additional information about the basis for their recommendation.[78] For example, a proxy advisor may explain that it issued a withhold recommendation because the director is a member of a board that failed to implement a shareholder resolution adopted with majority shareholder support. Thus, a shareholder who cares about responsiveness to such resolutions, but has neither the time nor the interest to research whether the resolution won majority support and, if so, whether it has been implemented, may obtain that information from the proxy advisor's report. The relevant underlying information is generally available to the public, but as long as the shareholder is not willing to conduct the requisite research, the proxy advisor's report is likely to become the exclusive source of information relevant to shareholder voting decisions. Under this circumstance, had the

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[76] *Id.* at 664–70.

[77] Paul W. Holland, *Statistics and Causal Inference*, 81 J. AM. STAT. ASS'N 945, 945 (1986).

[78] *See, e.g.*, ISS Governance Services, Proxy Alert, Citigroup Inc. 18 (Apr. 10, 2009) (stating that ISS recommends shareholders withhold their votes for board nominee Anne Mulcahy because she may be overextended as she sits on more than three boards and serves as CEO of Xerox Corporation).

shareholder not subscribed to the services of the advisor, the shareholder would not have learned of the information.

In such a case, the proxy advisor may well be the "but for" cause of the shareholder vote. Nonetheless, it still may be inappropriate to attribute the shareholder's voting decision to the "power" of the proxy advisor. The advisor is acting as a mere information agent. The underlying information provided by the proxy advisor—not the bottom-line conclusion—is what affects the shareholder vote.

The proxy advisor nonetheless exercises power as an information agent by selecting, in its discretion, which information to report. For example, a proxy advisor could, as a general matter, choose not to provide any information on whether a board failed to implement a shareholder proposal, or it could provide this information selectively.[79] In either case, assuming that shareholders do not otherwise obtain the underlying information, the proxy advisor is exercising some power over the shareholder vote. In sum, to the extent that the information provided by a proxy advisor affects the shareholder vote, the proxy advisor has some limited influence, but inferring from this correlation that the advisor has power over the shareholder vote is an overstatement.

Alternatively, some institutional investors may just look at the bottom line of the proxy advisor and vote accordingly. That is, shareholders may rely on the proxy advisor's assessment of the underlying information, rather than evaluating that information themselves.[80] Even in such cases, however, the extent of the proxy advisor's power may be overstated. At least some

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[79] For example, the proxy advisor could provide information on the board's failure to implement a shareholder proposal only when the advisor was recommending a withhold vote and not when the advisor was recommending a vote in favor of the nominees. In theory, proxy advisors could also misreport information. The ability of advisors to exercise power consistently by misreporting is quite limited, however. In addition to the market competition provided by other advisors, the company itself has a strong incentive to correct inaccuracies, and the media is likely to report any substantial errors. Thus proxy advisors have incentives to avoid recommendations that can be described as erroneous. Indeed, ISS received substantial adverse media attention for its recommendation that shareholders withhold their votes from Warren Buffett, a nominee to the Coca-Cola board, because of business relationships between Coca-Cola and some Berkshire Hathaway subsidiaries. *See, e.g.*, Donald E. Graham, *The Gray Lady's Virtue*, WALL ST. J., Apr. 23, 2007, at A17, *available at* http://online.wsj.com/article/SB117728391033378436.html (describing ISS's recommendation as "perhaps the single silliest recommendation ever made to shareholders").

[80] The proxy voting guidelines of the Nathan Cummings Foundation, for example, reflect this role for the proxy advisor, indicating that the Foundation will vote for a director nominee if the company does not have a staggered board, if the company is not recommending against an issue proposal supported by the Foundation, and if RiskMetrics supports the nominee. Proxy Voting Practices, The Nathan Cummings Foundation, *available at* http://www.nathancummings.org/shareholders/pvgandvr/VotingGuidelines.pdf.

investors will have substantial information about proxy advisors' recommendations and the bases on which they are issued, and they may choose to follow the recommendations of an advisor because they have concluded that they usually agree with the proxy advisor's decisions. Proxy advisors prepare and distribute annual explanations of their voting policies to their clients, identifying the factors that they consider important.[81] Recognizing that different institutions potentially have different objectives (primarily with respect to shareholder resolutions), ISS in fact now offers different guidelines tailored to the needs of union pension funds, public pension funds, and socially responsible institutional investors.[82] For most of these institutional investors, many of which hold securities in hundreds or even thousands of issuers, the most efficient way of deciding how to vote is to determine which proxy advisor has a voting policy they most agree with and then to follow its recommendations.

Anecdotal evidence also suggests that institutions sometimes choose to follow an advisor that has adopted certain voting policies to further their business interests. For example, according to the SEC, INTECH, an investment advisor, switched to ISS's union fund voting guidelines in an effort to generate more advisory business from union funds.[83] While this may reflect a conflict of interest between INTECH and its clients,[84] it also indicates that the choice of advisor is correlated with the advisor's voting policies.

To the extent that an institutional investor chooses a proxy advisor based on its voting policies, the proxy advisor exercises a degree of power, but this power is contingent in two respects. First, the power derives from an *ex ante* assessment by the advisor's client that it is in general agreement with the way the proxy advisor makes the recommendations. Second, to the extent that the client ceases to be in agreement—because the client's view (or its business

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[81] *See, e.g.*, ISS GOVERNANCE SERVICES, 2008 U.S. PROXY VOTING GUIDELINES SUMMARY (2007), *available at* http://www.riskmetrics.com/sites/default/files/2008PolicyUSSummaryGuidelines.pdf.

[82] RiskMetrics, Proxy Advisory Services, http://www.riskmetrics.com/proxy_advisory/options (last visited Aug. 11, 2009) (describing different voting guideline options).

[83] *See* Thompson Hine, *SEC Enters Order Against Adviser Related to Proxy Voting*, May 22, 2009, http://www.thompsonhine.com/publications/publication1818.html (describing SEC action); Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Investment Adviser for Proxy Voting Rule Violations (May 8, 2009), *available at* http://www.sec.gov/news/press/2009/2009-105.htm.

[84] The SEC noted that the INTECH decision created a potential conflict of interest in that "not all clients would agree with votes made pursuant to the ISS-PVS Guidelines and that voting proxies pursuant to the ISS-PVS Guidelines would benefit INTECH in obtaining and retaining union-affiliated clients." Thompson Hine, *supra* note 83.

objective) has changed, because the advisor's methodology has changed, or because the client believes that there is a different advisor whose recommendations coincide with the client's views more closely—the client may switch to another proxy advisor.

The degree of contingent power held by a proxy advisor depends on the nature of competition in the market for proxy advisory services. An increase in the number of proxy advisory firms, the extent to which the recommendations of different advisors vary, and the transparency of the bases of these recommendations will each increase the ability of an institution to achieve a closer match between its voting preferences and the recommendations of an advisor.[85] To the extent the market for proxy advisory services is sufficiently competitive, market forces will discipline proxy advisors to make recommendations that conform to the preferences of current and potential clients. Indeed, this analysis suggests that those proxy advisors who *appear to* exercise the most power—i.e., those whose recommendations are followed most often by shareholders—may have this apparent power not because they exercise discretion in making voting recommendations, but rather because they base their recommendations on criteria important to their clients. To the extent this conclusion is correct, the criticism of proxy advisors as being both powerful and unaccountable to shareholders would be substantially muted.

Lastly, some shareholders may not care about how they vote their shares. They may lack the resources, time, or expertise to evaluate voting decisions, or they may engage in an investment strategy in which the outcome of shareholder voting is irrelevant. Although some such investors simply refrain from voting,[86] others are legally required to make an informed vote.[87] Subscribing to a proxy advisor and, in some cases, delegating complete voting authority to that advisor,[88] may be the most cost effective way of complying

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[85] *See* GAO, CORPORATE SHAREHOLDER, *supra* note 1, at 13–14 (describing the market for proxy advisory services).

[86] William Baue, *Report Urges Foundations to Vote Their Proxies*, SOCIAL FUNDS, Mar. 4, 2004, http://www.socialfunds.com/news/article.cgi/1358.html (describing the low level of proxy voting by foundations and suggesting purchasing proxy voting service from ISS as a superior and reasonably priced alternative to refraining from voting).

[87] *See* Rose, *supra* note 16, at 897–98 (noting Department of Labor and SEC regulations).

[88] *See* Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 324 (2008) (reporting that 20% of public pension funds surveyed reported delegating complete voting authority to ISS or a similar organization).

with that requirement.[89] To the extent that the choice of the proxy advisor is unrelated to the voting recommendations it issues, a proxy advisor may have absolute power. The advisor may base its recommendations on factors that it (or its staff) considers important and would face no short- or long-term pressure to modify these factors because they do not mesh with the interests of its clients. The causal power of proxy advisors to affect a shareholder vote is strongest in this last form of proxy advisor influence. Note, however, that even this absolute power is limited as long as a proxy advisor has *other* clients who will periodically review its recommendations to determine whether they coincide with their interests, and the advisor issues the same recommendation to both sets of clients.

II. ADVISOR RECOMMENDATIONS AND THE SHAREHOLDER VOTE

We now proceed to examine the power of proxy advisors empirically. Our dataset examines uncontested director elections in 2005 and 2006. We focus only on director elections for companies listed in the S&P 1500 as of June 30 for the year prior to the director election (June 30, 2004 and June 30, 2005, respectively). For each director in our sample of S&P 1500 companies, we collected information about whether the director received a "for" or withhold recommendation (or no recommendation) from ISS, Glass Lewis, Egan Jones, and Proxy Governance.[90]

Table 1, Panel A presents some summary statistics on the coverage rates and recommendations of the four proxy advisors. ISS, Glass Lewis, and Egan Jones provided extensive coverage, issuing recommendations on 88% to 99% of the director nominees in the sample. Proxy Governance, by contrast, provided much more limited coverage—issuing recommendations on only 34% of the director nominees in the sample.

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[89] The SEC has specifically stated that investment advisors can comply with their fiduciary obligations by using a '"predetermined voting policy,' such as a third-party proxy voting service's platform, to vote proxies provided that the predetermined policy is 'designed to further the interests of clients rather than the adviser.'" INTECH Inv. Mgmt. LLC, Investment Advisers Act Rel. No. 2872, at 5 (May 7, 2009) (quoting Final Rule: Proxy Voting by Investment Managers, Investment Advisers Act Rel. No. 2106 (Jan. 31, 2003)), *available at* http://www.sec.gov/litigation/admin/2009/ia-2872.pdf.

[90] Institutional Shareholder Services recommendations were obtained through LEXIS. Glass Lewis, Egan Jones, and Proxy Governance provided us with their recommendations for the period in question. All of the companies in our sample that conducted a director election in 2005 had a proxy advisor recommendation for at least one of their directors.

The advisors also differed significantly in their proclivity to issue a withhold recommendation. Institutional Shareholder Services issued such recommendations for only 6.8% of the directors it covered, and Proxy Governance issued even fewer withholds at 3.7% of its recommendations. By contrast, Glass Lewis's withholds accounted for 18.8% of its recommendations, and for Egan Jones, withholds accounted for 11%. Panel B presents a correlation matrix of the recommendations made by the proxy advisors. The correlation is uniformly positive, but low, indicating that advisors make different decisions about whether to issue a withhold recommendation.

These findings—together with the findings in our prior article that proxy advisors base their recommendations on different factors[91]—highlight that institutional investors have a real choice in selecting proxy advisors. They can pick among advisors that differ both in how critical they are of board nominees (as demonstrated by the overall rate of their withhold recommendations) and in the criteria they use to assess those nominees. As a result, even institutions that do not want to examine the bases for recommendations on a case-by-case basis can nonetheless choose an advisor, or combination of advisors, to match their preferences.

Table 1, Panels C and D, explore the general correlation between withhold recommendations and the subsequent shareholder vote by providing data on the relationship between the recommendations and the vote outcome. Panel C shows the average percentage of "for" votes[92] when a proxy advisor has issued a "for" and a "withhold" recommendation. The last column of that table displays the difference in these percentages as the marginal impact of a withhold recommendation. As Panel C shows, an ISS withhold recommendation is associated with a 20.3% drop in the "for" vote. This drop reflects a far higher percentage than for any of the other advisors. For Glass Lewis, the drop is 6.2%, and for Egan Jones and Proxy Governance, it is 4.7% and 3.5% respectively. The data in this table are consistent with the press characterizations of ISS as the most powerful and Glass Lewis as the second most powerful proxy advisor,[93] and the marginal impact is within the range of

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[91] *See* Choi, Fisch & Kahan, *supra* note 71, at 649.

[92] Percentage "for" vote is defined as the "for" votes as a percentage of the sum of "for" and withhold votes.

[93] *See supra* text accompanying notes 9–12.

votes—albeit at the lower end—that media and prior academic reports have claimed ISS controls.[94]

Note, however, that Panel C measures correlation, not causation. This correlation reflects the combined effect of all of the relationships between the shareholder vote and the ISS recommendation detailed in Part I above. Thus, the 20% effect of an ISS recommendation may be due to a combination of the following: (1) some shareholders conducting an independent analysis and voting the way that ISS recommends without considering (or even knowing about) the ISS recommendation; (2) some shareholders learning information from ISS that affected their own assessment as well as the ISS recommendation; (3) some shareholders following ISS based on their general assessment of ISS's voting policies;[95] (who may switch if they find that ISS's voting policies in fact do not match their preferences); and (4) some shareholders following ISS recommendations without regard to (or without having) their own views on the issues.

In Panel D, we consider the combined effect of recommendations by multiple proxy advisors. For ISS, the marginal impact of a recommendation is pretty stable, regardless of what the other proxy advisors do—ranging from 17.6% to 21.4% depending upon whether another advisor (and which advisor) has issued a "for" or a withhold recommendation. By contrast, the impact of the other advisors seems to decline when the ISS recommendation is taken into account. Thus, holding the ISS recommendation constant, withhold recommendations by Egan Jones and Proxy Governance affect less than 2% of the vote. A withhold recommendation by Glass Lewis retains its earlier effect (6.2% in Panel C compared to 6.5% in Panel D) when ISS also issued a withhold recommendation. But the marginal impact of a Glass Lewis withhold recommendation is only 3.6% of the vote when ISS issues a "for" recommendation. In sum, when we combine the recommendations, the ISS effect clearly dominates those of the other advisors. Although not conclusive, these data suggest either that ISS's recommendations are more closely aligned with shareholders' preferences, that other proxy advisors are far less influential than ISS, or both.

Table 1, Panel E presents data on the distribution of shareholder votes. In 2005 and 2006, most directors were elected with a very high vote margin—an

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[94] *See supra* text accompanying notes 12–16.

[95] These shareholders may switch if they find that ISS's voting policies in fact do not match their preferences.

unsurprising outcome given that we examined uncontested elections during an economic bubble in a period when broker discretionary voting was permitted.[96] For 72% of the nominees, the margin is 95% or more of the vote, and for 89% of the nominees, the margin exceeds 90%. Only 4% of the nominees received a "for" vote of less than 80%. It is important to remember that, in uncontested elections, shareholders make a significant statement simply by withholding a higher percentage of votes than normal. Thus, given that the average "for" vote is 95%, a "for" vote of 80% could be considered a rebuff or an embarrassment to a director.[97] Indeed, issuers have become increasingly responsive to substantial (but less than majority) withhold votes, even though such votes have no direct impact on the composition of the board.[98]

III. INDEPENDENT FACTORS AFFECTING THE SHAREHOLDER VOTE

We now probe further into the effect of underlying firm and director factors and advisor recommendations on vote outcomes. As in our prior research, we collected information about various publicly available factors that, based on corporate governance literature, we posit may influence the shareholder vote. We obtained data regarding the characteristics of both individual director nominees and the company for which the director was being nominated. With respect to individual directors, we obtained data[99] on: (1) whether the director was the CEO (CEO), a non-executive chairman (Chairman Only), an employee of the company other than the CEO (Empl_Dir), an outside director with certain links to the company (OutDirLink), or a new Director (New Director); (2) whether the director was a member of the audit committee (AuditMbr), the compensation committee (CompMbr), or the nominating committee

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[96] *See infra* text accompanying note 135. Since 2006, the number of directors with high withhold votes has increased. *See* GEORGESON, *supra* note 36, at 7 (describing the increase in the number of high withhold votes).

[97] GEORGESON, *supra* note 36, at 7 (charting the number of directors who received a withhold vote of 20% or more).

[98] *See* Cai et al., *supra* note 13, at 2390; Diane Del Guercio et al., *Do Boards Pay Attention When Institutional Investor Activists "Just Vote No"?*, 90 J. FIN. ECON. 84 (2008) (finding operating performance improvement and increased CEO turnover in response to successful "vote no" campaigns).

[99] These data were obtained from the RiskMetrics-Investor Responsibility Research Center (IRRC) director database, available to subscribers of Wharton Research Data Services. The IRRC dataset consists of data on individual board directors from 1996 to 2006. The data include "a range of variables related to individual board directors (e.g., name, age, tenure, gender, committee memberships, independence classification, primary employer and title, number of other public company boards serving on, shares owned, etc.)." *See* RiskMetrics-Directors Legacy Data Request, Wharton Research Data Services (on file with authors).

(NomMbr); and (3) whether the director was a member of at least three other "major" company boards during the year prior to the annual meeting date (ManyBds),[100] whether the director attended less than 75% of the director meetings (Attendance), whether the director held at least 20% of the company's stock (BlockDir), whether the director was an interlocking director (Interlock), and whether the director was 75 years or older (Age75).

For each company in our sample, we obtained data[101] on (1) whether the first public report of a restatement to the company's financial statement occurred within two years prior to the annual meeting (Prior Restat), whether the first public statement of an SEC investigation or enforcement action occurred within two years prior to the annual meeting (Prior SEC), and whether the company rejected an issue proposal that had received majority shareholder support in the last year (IP No); (2) whether the company had a classified board (ClassBd), a poison pill (PPill), cumulative voting (CumVote), or golden parachutes (GP); (3) whether the company was in the top or bottom 5% of the companies ranked based on the abnormal holding period return for the three-year period prior to the meeting date for the year of the recommendation (Top5AbRet, Bot5Abret);[102] and (4) whether the CEO for the company was in the top 5% for total excess compensation (Top5AbComp).[103]

We hypothesize that all factors other than new director, CEO, non-executive chairman, and top 5% abnormal return are associated with a decline in "for" votes for a particular director. As most shareholders typically vote for a company's nominees in an uncontested election,[104] it is likely that withhold votes are triggered by specific problems with a particular director or the

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[100] We use the IRRC data on other "major" company boards held by directors for the year prior to the annual meeting.

[101] These data were obtained from SEC filings, press releases, the IRRC Governance database, the Georgeson Annual Corporate Governance Reviews, and the Center for Research in Security Prices (CRSP). All of the data are publicly available or based on publicly available sources.

[102] The abnormal return is defined as the difference between the raw three-year holding period return for the company in question and the three-year holding period return for the CRSP value weighted market index.

[103] Top5AbComp is an indicator variable defined as equal to 1 if the total excess compensation for the CEO for the company in question is in the top 5% of the sample and 0 otherwise. We define total excess CEO compensation as the difference between the total CEO compensation for the year prior to the meeting date (as provided by the Compustat Executive Compensation database) minus the expected total CEO compensation. We calculate the expected total CEO compensation by (1) estimating an Ordinary Least Squares (OLS) model for: $\ln(\text{Total CEO compensation}) = \alpha + \beta_1 \ln(\text{Market\_Capitalization}) + \beta_2 \text{One\_Year\_Abnormal\_Holding\_Period\_Return} + \beta_3 \text{Year\_2006} + \varepsilon$ and (2) using the predicted Total CEO compensation based on this model as the expected Total CEO compensation.

[104] *See, e.g.*, GEORGESON, *supra* note 36, at 8 (reporting that, in 2008, only thirty directors at S&P 1500 companies failed to receive a majority of "for" votes, compared to fifteen directors in 2007).

company as a whole. Directors who may not perform their duties as effectively as other directors (due to low attendance, posts on multiple boards, or old age) may receive a greater proportion of withhold votes. Shareholders may look negatively on directors who lack independence or have conflicts of interest (including employee directors other than the CEO, outside directors with linked affiliations with the company, directors with substantial block shareholdings, and directors that have interlocking board relationships with the company). Company problems such as poor performance, a restatement, or an SEC investigation may trigger a withhold vote, as may a lack of board responsiveness to investors, indicated by the failure to adopt a shareholder-approved issue proposal. Shareholders, particularly institutional investors, may also view the presence of antitakeover mechanisms as a lack of board responsiveness.

We also hypothesize that shareholders tailor their voting to hold directors who sit on key committees more responsible for certain problems. Thus shareholders may be more likely to hold members of audit committees responsible for audit-related problems, or they may be more likely to withhold votes from members of the compensation committee if a company overpays its CEO.

We view shareholder voting for a CEO-director as categorically different. A significant withhold vote on the CEO may both send a strong signal of dissatisfaction (because the CEO, in many ways, personifies the current management policy of the company), but it may also entail greater costs (leading to the CEO's resignation, possibly without a successor in place). We hypothesize a decreased likelihood of a withhold recommendation for new directors because shareholders are not likely to hold them responsible for prior problems. We also hypothesize a decreased likelihood of a withhold recommendation for non-executive chairmen because they are likely both to reflect company responsiveness to shareholder demands and to be selected for factors valued by shareholders such as expertise and independence. For obvious reasons, we similarly hypothesize a decreased likelihood of withhold recommendations for directors of companies that rank in the top 5% of abnormal return.

In Table 2, we present some summary statistics about the distribution of these variables as well as a univariate analysis of the relationship between these variables and the voting outcome. For the variables for which we had a prediction, all but five yield a statistically significant difference in the vote

outcome in the predicted direction. The remaining five variables (audit committee membership, chairman only, cumulative vote, golden parachute, and top abnormal returns) do not yield a statistically significant difference.

The results of the univariate analysis, however, should be viewed with care. This is especially true for the variables associated with board or employment status (CEO; membership on the audit, compensation, or nominating committee; chairman only; employee director; and outside-linked director) because these variables are negatively correlated with each other. For example, a CEO cannot also be a chairman-only, an employee director, or an outside-linked director. As the key committees tend to consist only of independent directors, a CEO or an employee director will generally not be on the audit, compensation, or nominating committee.[105] Additionally, given some notion of fair distribution of work among outside directors, a director generally does not serve on more than one of these committees at the same time.

We also hypothesize interactions between these variables. Specifically, we hypothesize: (1) that the presence of audit and disclosure-related problems (prior audits or restatements) may have a particularly strong adverse impact on members of the audit committee;[106] (2) that the presence of compensation-related problems (abnormally high compensation) may have a particularly strong adverse impact on members of the compensation committee;[107] (3) that an abnormal positive or negative return may have a particularly strong impact

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[105] *See, e.g.*, NYSE, Inc., Listed Company Manual §§ 303A.03, 303A.07(b) (2009); NASDAQ, Inc., Stock Market Equity Rules § 5605 (Mar. 12, 2009) (describing the composition of the audit committee (5605(c)(2)), independent director executive compensation (5605(d)), and independent director oversight of director nominations (5605(d))), *available at* http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp_1_1_4_2&manual=%2Fnasdaq%2Fmain%2Fnasdaq-equityrules%2F.

[106] Studies have demonstrated relationships between audit committee composition and audit-related problems. *See, e.g.*, Bradley Pomeroy & Daniel B. Thornton, *Meta-Analysis and the Accounting Literature: The Case of Audit Committee Independence and Financial Reporting Quality*, 17 EUR. ACCT. REV. 305, 310–11 (2008) (summarizing twenty-seven empirical studies examining the relationship between audit committee independence and financial reporting quality); Joseph V. Carcello et al., *Audit Committee Financial Expertise, Competing Corporate Governance Mechanisms, and Earnings Management* (Working paper, 2006), *available at* http://ssrn.com/abstract=887512 (finding that "independent audit committee members with financial expertise are most effective in mitigating earnings management").

[107] *See, e.g.*, Ronald C. Anderson & John M. Bizjak, *An Empirical Examination of the Role of the CEO and the Compensation Committee in Structuring Executive Pay*, 27 J. BANKING & FIN. 1323, 1332–36 (2003) (discussing compensation committee independence and CEO presence on the compensation committee as mechanisms for dealing with potential agency issues in setting CEO pay).

on the CEO;[108] and (4) that membership on many boards may have a different impact on the CEO than on other board members. (This impact could be more positive because it serves as a signal of quality or more negative because of concerns that the CEO is spending excess time on non-company business.) Table 2.1 reports that the "for" vote outcome correlates significantly with three of these interaction terms (Prior Restat x AuditMbr, Prior SEC x AuditMbr, and Top5AbComp x CompMbr).

We will refer to variables and interacted variables other than the vote recommendations as "underlying factors." Our prior research demonstrates that most of these variables (other than those related to takeovers)[109] are significantly related to a withhold recommendation by at least one proxy advisor.[110] As at least some proxy advisors base their recommendations on these variables, it is plausible that shareholders may give independent weight to these factors in determining their votes—either because they have independent information about these underlying factors or because they obtain this information through the proxy advisor's analysis. Finally, even though takeover-related factors do not appear to affect the recommendations of proxy advisors, we nevertheless include them in our analysis because these factors are often identified as important indicators of governance quality,[111] may affect firm value,[112] and are within the control of the board.[113]

We next examine (in Table 3) the relationship between the "for" vote outcome and our identified, publicly available underlying factors in a multivariate model. We first estimate a regression with a log odds

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[108] *See, e.g.*, Michael S. Weisbach, *Outside Directors and CEO Turnover*, 20 J. FIN. ECON. 431, 453–54 (1988) (finding that firms with independent boards are more likely to remove the CEO on the basis of poor stock performance).

[109] We regard ClassBd, PPill, CumVote, and GP as takeover-related factors.

[110] *See* Choi, Fisch & Kahan, *supra* note 71, at 649.

[111] *See* Paul Gompers et al., *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107 (2003).

[112] *See id.* (finding a relationship between equity prices and various corporate governance variables).

[113] Boards generally can adopt poison pills and golden parachutes without shareholder approval. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346, 1351 (Del. 1985) (holding that the board of directors has the power to adopt a poison pill under Delaware law); *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–54 (Del. 1985) (outlining a board's broad powers to act unilaterally). In contrast, addition or removal of a classified board (otherwise known as a staggered board) or a cumulative voting structure typically requires both board and shareholder approval. *See, e.g.*, Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 894 (2002) ("[D]ismantling [a staggered board] that is in the charter requires both a shareholder vote and a board vote . . . ."); Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 161 (1994) ("[T]he elimination of cumulative voting in a specific firm ordinarily requires shareholder approval . . . .").

transformation of the "for" vote outcome as a dependent variable.[114] For independent variables we use publicly available factors with the following additions: We add interaction variables for Prior Restat x AuditMbr, Prior SEC x AuditMbr, Top5AbComp x CompMbr, Bot5AbRet x CEO, Top5AbRet x CEO, and ManyBds x CEO. As further controls, we add variables for the percentage of shares held by institutional investors (InstHold); the percentage of the vote held by all board members (Tot_Dir_Shs); firm size (lmktcap, the log of the firm's market capitalization); risk (sdret, the standard deviation of the company's returns for the one-year period prior to the annual meeting date). We also add a dummy variable for whether the election took place in 2005 or 2006 (Year06).

For the base model (reported as Model 1 in Table 3), we do not include any proxy advisor recommendations. In the base model, virtually every underlying factor significantly affects the shareholder vote, either on its own or as part of an interaction variable. As predicted, the following are associated with a reduced "for" vote: membership on audit, compensation, or nominating committees; status as outside-linked or employee director; poor attendance; age 75 years or older; a prior SEC investigation; a prior restatement (for audit committee members only); payment of abnormally high compensation (for compensation committee members only); membership on many boards (for non-CEOs); ignoring a shareholder proposal; and abnormally low stock returns. Status as a new director and abnormally high stock returns are each associated with an increased "for" vote. In addition, we find that CEOs get a lower percentage of "for" votes than other directors. With regard to the takeover-related factors, only the presence of a classified board is associated

[114] While the vote outcome for any director election is continuous, the vote outcome is bounded by zero and one. Estimating an ordinary least squares model on a bounded dependent variable results in biased coefficients. We employ a log odds transformation of the vote outcome to generate an unbounded, continuous variable allowing for ordinary least squares estimation of the relationship between the vote outcome and our independent variables of interest. We compute the log odds of the vote outcome as follows: For the dependent variable for a particular proxy advisor, we compute a term $X = 0.5/n$, where n is the number of data points where "for" vote data exists for directors with a recommendation from the particular proxy advisor in question. We then use the $log((VOTE + X)/(1-VOTE + X))$ as the dependent variable (to avoid division by zero problems when the "for" vote fraction is equal to 1).

To control for the possibility that errors for directors in the same company may be correlated we use standard errors clustered by company in the models of Table 3. Unreported, we re-estimate the base model (Model 1 of Table 3) using non-clustered, robust standard errors and obtain similar qualitative results, except that both PPill and CumVote are now significant (at the <1% and 10% levels respectively), and Bot5AbRet x CEO is insignificant.

with a significant decrease in the "for" vote. No underlying factor is significant in the opposite of the predicted direction.

As with the analysis in Part II, however, the associations in the base regressions between the underlying factor variables and the shareholder vote reflect correlation, not causation. Significantly, the impact of these variables may be mediated because they affect proxy advisor recommendations rather than directly influencing shareholder votes. We address this issue in Model 2 by adding an indicator variable for the ISS recommendation (VoteISS): assigning a value of 1 if ISS issued a withhold recommendation and 0 if ISS issued a "for" recommendation. In Models 3, 4, and 5, we do the same for recommendations by Glass Lewis, Egan Jones, and Proxy Governance.

Having both the ISS recommendation and the underlying factors in the same regression permits us, to some extent, to separate the effects of the two types of variables on the election results. To the extent that the underlying factors affect the vote outcome independently of the ISS recommendation—either because voters pay direct attention to these factors or because voters pay attention to other proxy advisors who pay attention to these factors—the effect should persist even after controlling for the ISS recommendation. Indeed, when we add the variable for the ISS recommendation, there is almost no qualitative distinction between Models 1 and 2 in the significance levels of the underlying factors. All variables retain their statistical significance with the exception that one variable (Interlock) that was not significant in the base model is now significant at the 10% level (in the predicted direction) in Model 2. The levels of significance change from Model 1 to Model 2 for only Prior Restat x AuditMbr (which decreases from a 5% to a 10% level) and Bot5AbRet x CEO (which increases from a 10% to a 5% level). To test the continuing importance of the underlying factors even with the ISS recommendation, we perform an F-test of the joint hypothesis that no independent variable except the ISS recommendation variable is significantly different from zero. The p-value of the F-test is 0.0000, which indicates that the other independent variables add significance to the explanatory power of the "for" vote ordinary least squares model.

The variable for the ISS recommendation in Model 2 is also highly significant. This provides compelling evidence that the ISS recommendation has independent significance—that vote outcome is not driven exclusively by the underlying factors included in our regression. In addition, the magnitude of the ISS recommendation variable is higher than any other single variable,

and inclusion of the ISS recommendation greatly increases the predictive power of the regression (the adjusted R-squared increases from .109 to .185). In short, ISS's recommendation matters.

A. The Impact of an ISS Recommendation

Finding that the ISS recommendation matters leads to the next question: How much does it matter? To get a better sense of the quantitative impact of the ISS withhold recommendation on the "for" vote percentage, we calculate the predicted change in the "for" vote outcome—depending on whether ISS makes a "for" or withhold recommendation. We find that this effect varies depending on the overall level of the vote in favor of the director candidate. Thus Table 4 reports the effect at various points along the log-odds "for" vote distribution. For example, calculations show that the ISS withhold recommendation reduces the predicted "for" vote by 13.1% (from 98.1% to 85.4%) at the fiftieth percentile of the log-odds "for" vote distribution.[115] At the twenty-fifth percentile, an ISS withhold recommendation has a stronger impact, reducing the predicted "for" vote by 17.0%. On the other hand, at the seventy-fifth percentile, an ISS withhold recommendation has a weaker impact, reducing the predicted "for" vote by 10.1%.

The quantitative impact of the ISS variable reflected in Table 4 likely overstates the actual impact of the ISS recommendation. One of the challenges of the multivariate regression models in Table 3 (used to compute the marginal impacts reported in Table 4) is that they are incomplete. Although we have endeavored to identify many of the publicly available factors that may influence the shareholder vote, it is likely that we have failed to identify and control for all such factors.[116] This reflects the standard omitted variable

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[115] These percentiles were calculated using the actual distribution of all independent variables except the variable for the ISS vote recommendation, which was set to zero (the baseline "for" recommendation).

[116] Research indicates, for example, that shareholders affiliated with the AFL-CIO may consider the interests of union workers when voting in director elections. *See, e.g.*, Ashwini K. Agrawal, *Corporate Governance Objectives of Labor Union Shareholders: Evidence from Proxy Voting* 30 (N.Y.U. Stern Working Paper Series, No. FIN-08-006, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1285084 (finding evidence that labor relations affect the voting behavior of some union shareholders). Considerations of corporate social responsibility may influence other shareholders. *See* Thomas W. Joo, *Corporate Hierarchy and Racial Justice*, 79 ST. JOHN'S L. REV. 955, 956–57 (2005) (describing the potential role of shareholder power in increasing racial justice and social responsibility). Shareholders may care about the board's position on current as well as previously submitted shareholder proposals. *See* NATHAN CUMMINGS FOUND., *supra* note 80, at 1 (indicating that the Foundation will vote for company nominees if, *inter alia*, "[t]he board does not recommend a vote AGAINST a shareholder proposal that the Foundation supports").

problem in regression analyses. As long as we do not control for these factors, the ISS variable will include both the direct effect of the variable and the effect of these omitted factors—thus potentially overstating the importance of the ISS recommendation in explaining the "for" vote outcome. The coefficient estimates for the VoteISS dummy variable represent the upper bound of any direct effect of the ISS recommendation, but the true effect of the ISS recommendation may be lower, even much lower.

The extent to which our model overstates the significance of the ISS recommendation depends on how many underlying factors we have omitted from the regression, the importance of these factors, and their correlation with the ISS recommendation. In this regard, it is important to keep in mind that some of the variables we have identified and used in the regressions are imprecise proxies for an actual problem with a director or company. This is true specifically for the variables for CEO status and for membership on the audit, compensation, or nominating committee. For example, shareholders are not automatically going to vote against a director because the director is a member of the compensation committee (nor is ISS more likely to recommend a withhold vote against such a director because of his or her committee membership). Rather, membership on the audit, compensation, or nominating committee may result in a withhold vote or withhold recommendation because voters or ISS hold the committee responsible for problems under its purview. In our regression, we control for only a few potential problems: high CEO compensation for compensation committee members; restatements and SEC investigations for audit committee members; and performance and membership on other boards for CEOs.

In addition to being underinclusive, our proxies are overinclusive—not every restatement reflects adversely on the current audit committee. More generally, given the nature of our empirical analysis and the size of our data set, we can include only the factors that are easily available, quantifiable, and generalizable across a large number of firms and directors. Neither proxy advisors (which have a sizeable full-time staff) nor shareholders are confined in this manner. We thus expect that our regressions fail to include a large number of important underlying factors that presumably also affect the ISS recommendation.

B. Contingent Versus Absolute Power

We did not find any variable that was both (i) associated with an increased likelihood of an ISS withhold recommendation as reported in our earlier article[117] and (ii) associated with a reduced "for" vote in the regressions reported in Table 3. Similarly, we did not find any variable that was both (i) associated with a reduced likelihood of an ISS withhold recommendation and (ii) associated with an increased "for" vote in the regressions reported in Table 3. This is true whether or not we control for the ISS recommendation. Thus, we have not identified any factor that ISS views as negative but shareholders view as positive (or vice versa). This, incidentally, is not true for Glass Lewis. In our earlier article, we found that Glass Lewis is less likely to issue withhold recommendations for CEOs,[118] but here we find that CEOs receive a significantly higher withhold vote from shareholders than do non-CEOs for all the models reported in Table 3.

Moreover, most of the factors that we identified in our earlier article as having a statistically significant impact on the ISS recommendation[119] remain significant in explaining the voting outcome even after controlling for the ISS recommendation in Model 2 of Table 3. Specifically, the following factors are associated with a lower likelihood of a "for" recommendation by ISS and, after controlling for the ISS recommendation, with a lower "for" shareholder vote percentage: CEO status, membership on the compensation committee, abnormal compensation (for compensation committee members), lack of attendance, membership on multiple boards (for non-CEOs), membership on the nominating committee, status as an employee or outside-linked director, ignoring a shareholder proposal, and having a classified board. New director status is associated with a higher likelihood of a "for" recommendation by ISS (as identified in our earlier article) and, after controlling for the ISS recommendation, a higher "for" vote percentage in Model 2 of Table 3.[120] Furthermore, the four most important factors affecting an ISS recommendation—ignoring a shareholder proposal, poor attendance at board meetings, status as outside-linked director, and status as employee

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117 Choi, Fisch & Kahan, *supra* note 71, at 665.

118 *Id.* at 695.

119 *Id.* at 665.

120 Only two factors that were significant for the ISS recommendation—status as non-executive chairman and golden parachutes, both of which reduced the likelihood of a withhold recommendation—are not significant in the vote regressions. *Compare id.* at 665, *with id.* at 671–72.

director[121]—were also among the six most important factors (together with the ISS recommendation itself and status as CEO) affecting the vote outcome. Institutional Shareholder Services is the only advisor for which CEO status is associated with an increased likelihood of a withhold recommendation as reported in our earlier article, and it is associated with a reduction in the "for" vote percentage in Model 2 of Table 3. The relationship between the factors that independently affect the ISS recommendations and the vote outcome suggests that ISS is in sync with the sentiments of shareholders. In essence, ISS generally gives the same directional weight to company and director attributes in making its voting recommendation as do shareholders in making their voting decisions.[122]

The results for the separate regressions involving the other proxy advisors (reported in Table 3 as Models 3, 4, and 5) follow the same basic pattern as the results for ISS. Specifically, for each advisor, the dummy variable for a withhold recommendation is negative and significant, and most attribute variables that were significant in the base regression remain so. The marginal effect of a withhold recommendation by the advisors, calculated in the same manner as discussed above for ISS, is reported in Table 4. In each case, the upper-bound estimate of the direct effect is significantly smaller than the respective estimate for ISS. Glass Lewis has a larger upper-bound effect, and the estimates for Proxy Governance and Egan Jones are similar to each other.[123]

The results further suggest that these advisors are less in sync with shareholders than ISS. For example, the four most important factors affecting the recommendations of Egan Jones and Proxy Governance do not correspond

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[121] *Id.* at 671–72.

[122] This alignment is unlikely to be coincidental. Institutional Shareholder Services explicitly seeks shareholder input in formulating its voting policies, surveying institutional investors on a yearly basis. *See* RISKMETRICS GROUP, 2009–2010 RISKMETRICS POLICY SURVEY 4 (2009) (describing how feedback from both institutional investors and issuers is part of RiskMetrics's annual policy-formulation process).

[123] As a robustness test, we re-estimated the "for" vote outcomes for Proxy Governance (PGI), Glass Lewis (GL), and Egan Jones (EJ) recommendations using a Tobit model. Unreported, the coefficients on VotePGI (-0.025), VoteGL (-0.052), and VoteEJ (-0.037) are all significantly different from zero. Note that the upper bounds of influence for PGI (2.5 percentage points), GL (5.2 percentage points), and EJ (3.7 percentage points) are again smaller than for ISS. We also re-estimated the "for" vote outcomes for PGI, GL, and EJ recommendations using an OLS model with the untransformed "for" vote outcome as the dependent variable. Unreported, the coefficients on VotePGI (-0.023), VoteGL (-0.050), and VoteEJ (-0.035) are all significantly different from zero. Note that the upper bounds of influence for PGI (2.3 percentage points), GL (5.0 percentage points), and EJ (3.5 percentage points) are again smaller than for ISS.

closely to the factors affecting the shareholder vote.[124] Although ignoring a shareholder proposal is an important factor in explaining the shareholder vote in all the regressions of Table 3, it is not a significant factor in explaining recommendations by Egan Jones and Proxy Governance.[125] As to Glass Lewis and ISS, the regressions of Table 3 show a significant overlap in the most important factors affecting the recommendation.[126] But Glass Lewis gives strong positive weight to CEO status (i.e., CEOs are *less* likely to receive a withhold recommendation),[127] whereas CEO status is associated with a lower "for" vote.

These findings have two implications: First, they suggest that the effect of an ISS recommendation, as reflected in our measurements, may include a fair degree of contingent power. Our results indicate that shareholders are basing their votes on considerations similar to those that ISS uses in making its recommendations, whether shareholders are following ISS's recommendation or not. Most of the factors we identified as affecting the ISS recommendation also independently affect the shareholder vote, and both ISS and shareholders consider the same factors as most important. This allows us to infer that many institutions that follow ISS's recommendations do so because they generally agree with the basis for ISS's voting recommendations. Second, the findings suggest that ISS's market position, and to a lesser extent Glass Lewis's market position, may be due, at least in part, to the fact that their recommendations reflect client views better than those of the other proxy advisors. While catering to clients' views may explain ISS's market dominance, it also suggests the limits of such dominance—if ISS were to shift its recommendations away from the views of its clients, it would likely lose those clients to competing advisory firms.

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[124] The most important factors affecting Egan Jones's recommendation are attendance, membership on multiple boards, outside-linked status, and membership on the nominating committee. The most important factors for Proxy Governance's recommendation are attendance, high compensation, membership on the compensation committee, and age. Choi, Fisch & Kahan, *supra* note 71, at 671–72.

[125] *Id.* at 672.

[126] The four most important factors affecting the ISS recommendation were also among the five most important factors accounting for a withhold recommendation for Glass Lewis. *Id.* at 671–72. The fifth Glass Lewis factor significantly associated with a withhold recommendation, board interlock, was present only in 25% of the sample.

[127] *Id.* at 671.

C. ISS and Glass Lewis

The data in Table 1, Panels A and B, suggest that the marginal impact of Glass Lewis's recommendations may be affected by the recommendation made by ISS. In Table 5, Panel A, we start with the base model (reported as Model 1 in Table 3) and include separate indicator variables for the recommendations of ISS and Glass Lewis as well as an interacted indicator variable taking the value of 1 if both ISS and Glass Lewis issued a withhold recommendation. In this regression, the indicator variable for the ISS recommendation (VoteISS) measures the impact of an ISS withhold recommendation on the "for" vote outcome when Glass Lewis has issued a "for" recommendation. Similarly, the indicator variable for Glass Lewis (VoteGL) measures the impact of a Glass Lewis withhold recommendation on the "for" vote outcome when ISS has issued a "for" recommendation. The sum of the indicator variable for ISS (VoteISS) and the interacted indicator variable (VoteISS x VoteGL) measures the impact of an ISS withhold recommendation when Glass Lewis has also issued a withhold recommendation. The sum of the indicator variable for Glass Lewis (VoteGL) plus the interacted indicator variable (VoteISS x VoteGL) measures the impact of a Glass Lewis withhold recommendation when ISS has also issued a withhold recommendation.

In Table 5, Panel A, the variables for both the ISS and Glass Lewis recommendations are negative and significant, indicating that a withhold recommendation by either advisor reduces the "for" vote percentage. At the median of the log-odds "for" vote distribution, assuming that Glass Lewis has issued a "for" recommendation, the predicted change in the "for" vote outcome is -14.5 percentage points when ISS issues a withhold recommendation. In contrast, assuming ISS has issued a "for" recommendation, the predicted change in the "for" vote outcome is -3.1 percentage points when Glass Lewis issues a withhold recommendation. If ISS issues a withhold recommendation, the predicted marginal effect of Glass Lewis also issuing a withhold recommendation (the sum of VoteGL and VoteISS x VoteGL) is insignificant. However, if Glass Lewis issues a withhold recommendation, the predicted marginal effect of ISS also issuing a withhold recommendation (the sum of VoteISS and VoteISS x VoteGL) is negative and significant; the predicted change in the "for" vote outcome (measured at the mean level of the other control variables) is -13.2 percentage points.[128]

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[128] *See infra* tbl.5, Panel B.

These results are consistent with those in the univariate analysis (Table 2) and suggest that a Glass Lewis withhold recommendation has a greater impact on the vote if ISS has issued a "for" recommendation than if ISS has issued a withhold recommendation. This suggests the possibility that some institutional investors automatically will vote in favor of the board's nominees if both ISS and Glass Lewis issue "for" recommendations, but not if one of them issues a withhold recommendation. Alternatively, it may indicate that there are some underlying factors that both Glass Lewis and shareholders (but not ISS) consider relevant when voting. The recommendations by the other two proxy advisors have only a small, if any, effect on the vote outcome.

IV. INSTITUTIONAL VERSUS INDIVIDUAL TEST

Proxy advisors provide recommendations and supporting research to their subscribers, which include mutual funds, pension funds, foundations, and other institutional investors.[129] Individual shareholders generally do not employ the services of these advisors, and advisors typically do not provide public access to their recommendations and underlying research.[130] In some high profile elections such as those involving a proxy contest[131] or merger,[132] interested parties may issue a press release disclosing a proxy advisor's recommendation. It is thus likely that recommendations directly affect only the vote of institutional investors (some of which are clients of these advisors), not the vote of individual investors (who are not clients).

We therefore construct a test designed to measure the power of ISS by capturing the differential in voting between individual investors and institutional investors. We estimate the base regression (Model 1 of Table 3)

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129 GAO, CORPORATE SHAREHOLDER, *supra* note 1, at 9–10.

130 *See* Alexander, et al., *supra* note 65, at 8 ("The core business of ISS and other proxy advisors is to supply institutional investors with vote recommendations on a subscription basis."). Institutional Shareholder Services's recommendations and reports are now available on LEXIS and are also available on Westlaw through a premium subscription.

131 *See, e.g.*, Press Release, Starboard Value and Opportunity Master Fund Ltd. and Ramius Capital Group LLC, Institutional Shareholder Services (ISS), A Leading Independent Proxy Advisory Firm, Supports Ramius' Independent Nominees for Election to the A. Schulman Board of Directors (Jan. 7, 2008), *available at* http://www.euroinvestor.co.uk/news/story.aspx?id=9692387&bw=20080107005892 (reporting that ISS and Glass Lewis supported the appointment of dissident nominees to the A. Schulman Board of Directors). Media reports typically are a response to a press release, and press releases are most common in contested elections.

132 *See, e.g.*, Press Release, Arris, ISS and Glass Lewis Each Recommend Merger of ARRIS and C-COR (Dec. 6, 2007), *available at* http://www.arrisi.com/press_events/press_releases/pressdetail.asp?id=389 (reporting ISS and Glass Lewis recommendations in favor of proposed merger).

by substituting a dummy variable for the recommendation with two interaction variables. First, we multiply a dummy variable for the recommendation (VoteISS taking a value of 1 if the ISS recommendation is withhold and 0 if the ISS recommendation is "for") by the fraction of shares held by institutional investors (Insthold). Second, we multiply a dummy variable for the recommendation by the fraction of shares held neither by institutional investors nor by board members as a proxy for holdings by individual investors (Indivhold).[133] Given the assumption that individuals do not directly receive the ISS recommendation, we posit that any relationship between an ISS withhold recommendation and votes by individual investors (Indivhold x VoteISS) must be the result of individuals responding to some other observable factor that is not directly included in our regressions,[134] but for which the ISS recommendation in our model acts as a proxy. We then use the differential between Insthold x VoteISS and Indivhold x VoteISS to estimate the effect of ISS's influence on the proxy vote.

Table 6 reports the results of the regression with the Insthold x VoteISS and Indivhold x VoteISS interaction variables. The coefficients for the Insthold x VoteISS interaction terms are more negative than the coefficients for the Indivhold x VoteISS interaction terms. In unreported F-tests, the difference in coefficients is significant at the <1% level. These results are consistent with the hypothesis that an ISS withhold recommendation has a greater impact on voting by institutions than by individuals.

The results also enable us to estimate the effect of an ISS recommendation. We start by making the following three assumptions: First, a recommendation affects the vote of some institutional—but not any individual—investors. Second, if they did not follow ISS, institutional investors would base their votes on the same underlying factors as individual investors. Third, ISS does not provide to its clients any additional information about these underlying factors that is not known to individual investors.

Under these assumptions, the voting record of individual investors is a perfect proxy for how institutional investors would vote if ISS did not exist. This is so because the votes by individual investors are not themselves affected by ISS (first assumption) and because institutions would vote the same way as

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[133] "Insthold" is defined as the fraction of outstanding shares of the company in question in the hands of institutional investors, measured using Form 13-F data obtained from Thomson Financial for the time period immediately prior to the annual meeting date. "Indivhold" is defined as *1 – InstHold – Tot_Dir_Shs*.

[134] *See* discussion of potentially omitted variables *supra* Part III.A.

individuals but for ISS (second assumption). Moreover, any influence of ISS is entirely due to its bottom-line recommendation, not to any information and analysis accompanying its recommendation (third assumption). The power of ISS thus can be measured by the difference in the coefficients for the interaction term with institutional holdings and the interaction term with individual holdings (for example, a difference of -1.889 for ISS). This variable will measure any absolute power by ISS as well as any contingent power, but only to the extent that ISS clients would have voted differently had they not followed ISS.

Because our dependent variable is the log odds of the "for" vote, we use the following methodology to quantify ISS's power. We start with the overall marginal impact of 13.1 percentage points from an ISS withhold recommendation on the base "for" vote model measured at the median of the log-odds "for" vote distribution (as reported in Table 4). We then apportion the overall marginal impact of an ISS withhold recommendation between the effect on institutional and individual holdings. For our entire sample, the mean fraction of institutional ownership is 0.60, and the mean fraction of individual holdings is 0.35. In the model, the coefficient estimate for Insthold x ISS is -3.137, and for Indivhold x ISS it is -1.248. Therefore, we calculate the relative contribution of the Insthold x ISS variable on the overall marginal impact of an ISS withhold recommendation as (3.137*0.60)/(3.137*0.60 + 1.248*0.35) = 81.2%. Stated differently, the marginal impact of an ISS withhold recommendation is 10.6 points of the 13.1 overall marginal impact. The relative contribution of the Indivhold x ISS variable is 18.8% (or 2.5 percentage points of the 13.1 overall marginal impact). This suggests that an ISS withhold recommendation reduces the "for" vote of institutional holders by 17.7% (10.6/60) and the "for" vote by individual holders by 7.0 % (2.5/35). If, as assumed, the relationship between the ISS recommendation and the vote is due to other factors correlated with the ISS recommendation, not the recommendation itself, and these factors have the same impact on the institutional vote, then the real effect of an ISS withhold recommendation is to reduce the institutional "for" vote by 10.7 percentage points of the institutional vote. Multiplying ISS's relatively greater influence with institutional investors (the 10.7 percentage points) by the fraction of votes held on average by institutional investors (60% of the votes) yields 6.4 % of the overall vote.

Note that this result is critically dependent on our foundational assumptions. To the extent that the first assumption is incorrect, and some individual investors follow the ISS recommendations (or some institutional

investors are misclassified in our data as individuals), our result would understate the magnitude of ISS's power. We think this is unlikely because ISS recommendations are rarely publicized in uncontested elections and because individual investors are unlikely to automate their voting decisions. Thus, they would only learn of an ISS recommendation through independent research.

To the extent that the second assumption is incorrect and institutional investors who follow ISS vote differently from individuals, our result would *overstate* ISS's power to the degree that institutional investors that follow ISS pay more attention to the factors that affect an ISS recommendation than do individual investors. It would also *understate* ISS's power to the extent that institutional investors that follow ISS would pay less attention to the factors that affect an ISS recommendation than do individual investors.

There are two reasons to believe that the second assumption is at least partially incorrect and that it biases our results towards overstating ISS's power. First, a significant portion of the votes attributed to individuals in our methodology are actually brokers' discretionary votes.[135] According to one estimate, an average of 19% of all votes cast are broker discretionary votes.[136] Traditionally, brokers exercised their discretionary voting authority in accordance with management recommendations, that is, for the board nominees.[137] Although a few brokers have adopted other voting measures and either abstain from voting or vote uninstructed shares in the same proportion as shares for which they have obtained voting instructions,[138] generally broker votes are more favorable to management than shares voted by their beneficial owners.[139] If one divides the shareholdings of individuals into broker votes—which are automatically votes "for" each nominee—and remaining shares, the

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[135] *See* discussion of discretionary broker voting in director elections, *supra* text accompanying notes 29–34.

[136] *See* Allen, *supra* note 32.

[137] *See* Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1269 (2008) ("[B]rokers tend to vote in accordance with management recommendations . . . .").

[138] *See* Kahan & Rock, *supra* note 2, at 30 (discussing the shift in some brokers' voting strategies). We are not aware of any information to suggest that brokers vote the shares of their clients for which they received no voting instructions in accordance with ISS recommendations. Charles Schwab policy dictates that it votes securities held in its customers' brokerage accounts, for which it has not received voting instructions, in proportion to "all instructed shares held by Schwab." N.Y. STOCK EXCH., REPORT AND RECOMMENDATIONS OF THE PROXY WORKING GROUP TO THE NEW YORK STOCK EXCHANGE 16 (2006) (describing Schwab's adoption of proportional voting in 2005).

[139] *See* N.Y. STOCK EXCH., *supra* note 138, at 13 (describing the anticipated effect on uncontested director elections of eliminating broker discretionary voting).

coefficient estimate for the interaction between the ISS recommendation and the individual shareholdings *not* part of such broker votes would be higher than the coefficient estimate in Table 6. Therefore, the estimate of the difference between that coefficient and the coefficient for Insthold x VoteISS—the measure of ISS's power—would be lower.

Second, institutional investors who follow ISS have made an affirmative choice to do so. While some institutions may have followed the ISS recommendation as an easy way to satisfy their duty to cast an informed vote, others may have done so because they are in overall philosophical agreement with the way in which ISS makes voting recommendations. Even institutions that for practical reasons want to follow the recommendations of some advisor can choose which advisor to follow. Thus, it is likely that those institutions that choose to follow ISS differ in their voting preferences from—and are closer to the voting preference of ISS than—those shareholders who have made no such choice.

Finally, to the extent that our third assumption is incorrect and ISS provides additional information to its subscribers that individual investors do not have, our estimate of ISS's power would also include the following two components. First, it would include the votes by clients for which ISS acts as a pure information agent. Votes by these investors, as discussed in Part II, are not based on the bottom-line ISS recommendation, but rather on the information provided by ISS. Second, our estimate would include the votes by ISS clients who base their votes on the ISS recommendation (but not on the information provided by ISS), but who *would have* voted the same way ISS recommended if they had known of the additional information provided by ISS.

CONCLUSION

In this paper we analyze the significance of voting recommendations issued by proxy advisors. Our examination includes four advisory firms: ISS, Glass Lewis, Egan Jones, and Proxy Governance. We find, consistent with press reports, that ISS is the most powerful proxy advisor. Of the others, only Glass Lewis seems to have a meaningful impact on the shareholder voting.

We conduct several tests to quantify the impact of an ISS recommendation. Although superficial analyses suggest that an ISS recommendation can have a marginal impact of as much as 20%, and press reports state that ISS has the power to shift 20% to 30% of the shareholder vote, we conclude that these

numbers are substantially overstated. In particular, our findings reveal that although an ISS recommendation has independent value, this value is greatly reduced once we take into account the company- and firm-specific factors that are important to investors. Depending on the test, we find that the impact of an ISS recommendation ranges from 6% to 13% for the median company. Overall, we consider it likely that an ISS recommendation shifts 6% to 10% of shareholder votes—a material percentage but far less than commonly attributed to ISS.

Furthermore, we find evidence that ISS's power is partially due to the fact that ISS (to a greater extent than other advisors) bases its recommendations on factors that shareholders consider important. This fact and competition among proxy advisors place upper bounds on ISS's power. Institutional Shareholder Services cannot issue recommendations arbitrarily if it wants to retain its market position. Doing so would lead institutional investors to seek the services of other proxy advisory firms. Thus, ISS is not so much a Pied Piper followed blindly by institutional investors as it is an information agent and guide, helping investors to identify voting decisions that are consistent with their existing preferences.

Table 1

Panel A: Coverage and Withhold Rates

	N	Coverage Rate	Number of Withhold Recs.	Number of "For" Recs.	Withhold Rate
All	16038	1.00			
ISS	15823	0.99	1073	14750	0.068
GL	15722	0.98	2956	12766	0.188
EJ	14147	0.88	1551	12596	0.110
PGI	5437	0.34	202	5235	0.037

Panel B: Correlation Matrix of Recommendations

	VoteISS	VoteGL	VoteEJ	VotePGI
VoteISS	1			
VoteGL	0.1683	1		
VoteEJ	0.1803	0.1425	1	
VotePGI	0.1057	0.0736	0.0548	1

VoteISS equals 1 if ISS gives a Withhold recommendation and 0 if ISS gives a "for" recommendation. VoteGL, VoteEJ, and VotePGI are defined similarly**.**

Panel C: Recommendation and Percentage "For" Vote—Single Advisor

	Percentage of "For" Votes (mean)	Percentage of "For" Votes where Advisor Rec. = For (mean)	Percentage of "For" Votes where Advisor Rec. = Withhold (mean)	Marginal Impact
Total	95.12%			
ISS		96.44%	76.14%	20.3%
GL		96.25%	90.05%	6.2%
EJ		95.75%	91.02%	4.73%
PGI		95.39%	91.90%	3.49%

Panel D: Recommendation and Percentage "For" Vote—ISS and Other Advisor

	ISS Withhold Rec.			ISS For Rec.			Marginal ISS impact	
ISS Alone	76.14%			96.44%			20.30%	
	ISS Withhold Rec. & Other Withhold Rec.	**ISS Withhold Rec. & Other For Rec.**	**Marginal Impact of Other Rec. when ISS=Withhold**	**ISS For Rec. & Other Withhold Rec.**	**ISS For Rec. & Other For Rec.**	**Marginal Impact of Other Rec. when ISS=For Rec.**	**Marginal ISS impact when Other Withhold Rec.**	**Marginal ISS impact when Other For Rec.**
+ GL	72.08%	78.58%	6.50%	93.43%	97.04%	3.61%	21.35%	18.46%
+ EJ	74.87%	76.49%	1.62%	95.45%	96.66%	1.21%	20.58%	20.17%
+ PGI	77.13%	75.38%	- 1.65%	94.75%	96.49%	1.74%	17.62%	21.11%

Panel E

	Sample	Percentage of Directors
All	16038	100.00
Vote>95%	11501	71.71
Vote 90<x<95	2837	17.69
Vote 85<x<90	742	4.63
Vote 80<x<85	283	1.76
Vote 75<x<80	218	1.36
Vote <75	457	2.85

Table 2

Variable	=0		=1			
	N	ForVote	N	ForVote	% Difference	p-value
CEO	12566	95.0	1471	95.9	0.9	0.0000
New Director	13050	94.9	2232	96.6	1.7	0.0000
AuditMbr	8389	95.0	5564	95.4	0.4	0.0009
Prior Restat	13441	95.2	1841	94.4	-0.8	0.0000
Prior SEC	14210	95.2	1072	94.4	-0.8	0.0008
CompMbr	8585	95.5	5368	94.5	-1.0	0.0000
Top5AbComp	13870	95.2	707	94.4	-0.8	0.0033
Attendance	13820	95.2	93	79.3	-15.9	0.0000
ManyBds	12107	95.2	1280	94.2	-1.0	0.0000
ManyBds x CEO	13334	95.2	53	96.7	1.6	0.0977
Age75	13488	95.2	1794	94.9	-0.3	0.0967
NomMbr	8460	95.4	5493	94.7	-0.7	0.0000
Empl_Dir	13065	95.1	888	94.7	-0.4	0.0495
OutDirLink	12489	95.6	1464	90.7	-4.9	0.0000
Interlock	13916	95.1	37	92.7	-2.4	0.0366
Chairman_ Only	13719	95.1	318	94.9	-0.2	0.5173
IP No	15136	95.2	146	82.8	-12.4	0.0000
ClassBd	9459	95.3	5516	94.8	-0.5	0.0000
PPill	7242	95.4	7733	94.9	-0.6	0.0000
CumVote	13345	95.1	1630	95.1	0.0	0.8105
GP	3700	94.9	11275	95.2	0.3	0.0710
Top5AbRet	14505	95.1	755	95.0	-0.1	0.6463
Bot5AbRet	14536	95.2	724	93.3	-1.9	0.0000

Table 2.1

Interaction Variable	=0 N	ForVote	=1 N	ForVote	% Difference	p-value
Prior Restat x AuditMbr	13305	95.2	648	94.3	-0.8	0.0025
Prior SEC x AuditMbr	13607	95.1	346	94.4	-0.7	0.0490
Top5AbComp x CompMbr	13083	95.2	241	92.9	-2.3	0.0000
Top5AbRet x CEO	13947	95.1	85	95.6	0.5	0.5169
Bot5AbRet x CEO	13963	95.1	69	94.5	-0.6	0.4434

The =1 group is where the variable in question is equal to 1 (For example, Prior Restat x AuditMbr=1 means the director is a member of the audit committee, and the company experienced a first public announcement of an accounting restatement within the two years prior to the annual meeting.). The =0 group is where the variable in question is equal to 0.

The p-value is from a two-sided t-test of the difference in the mean ForVote between the =0 and =1 groups for each in the interaction variables.

Table 3: "For" Vote Outcome

Variable	Model 1 No Advisor	Model 2 ISS	Model 3 GL	Model 4 EJ	Model 5 PGI
CEO	-0.714**	-0.648**	-0.777**	-0.709**	-0.574**
	(-9.84)	(-9.20)	(-10.73)	(-9.54)	(-5.93)
New Director	0.335**	0.278**	0.218**	0.295**	0.321**
	(6.61)	(5.61)	(4.34)	(5.91)	(5.11)
AuditMbr	-0.251**	-0.264**	-0.193**	-0.201**	-0.126*
	(-5.29)	(-5.70)	(-4.26)	(-4.40)	(-1.97)
Prior Restat	-0.0961	-0.125	-0.0722	-0.137	-0.226
	(-0.68)	(-0.93)	(-0.53)	(-0.94)	(-1.46)
Prior SEC	-0.282**	-0.260**	-0.234*	-0.287**	0.0536
	(-2.83)	(-2.71)	(-2.57)	(-2.92)	(0.36)
Prior Restat x AuditMbr	-0.235*	-0.192+	-0.126	-0.250*	-0.119
	(-2.06)	(-1.73)	(-1.20)	(-2.25)	(-0.99)
Prior SEC x AuditMbr	-0.0959	-0.0914	-0.103	-0.0788	-0.381*
	(-1.08)	(-1.13)	(-1.25)	(-0.92)	(-2.39)
CompMbr	-0.381**	-0.334**	-0.329**	-0.354**	-0.265**
	(-8.24)	(-7.38)	(-7.35)	(-7.31)	(-4.40)
Top5AbComp	-0.105	-0.0690	-0.109	-0.0733	0.00164
	(-0.66)	(-0.51)	(-0.69)	(-0.46)	(0.01)
Top5AbComp x CompMbr	-0.462**	-0.376**	-0.310+	-0.463**	-0.493
	(-2.78)	(-3.10)	(-1.85)	(-2.79)	(-1.52)
Attendance	-1.907**	-1.188**	-1.272**	-1.512**	-1.801**
	(-10.64)	(-9.27)	(-8.33)	(-8.26)	(-8.84)
ManyBds	-0.394**	-0.266**	-0.298**	-0.164**	-0.287**
	(-7.14)	(-5.47)	(-5.56)	(-2.77)	(-3.81)
ManyBds x CEO	0.264	0.0428	0.231	0.177	0.239
	(1.56)	(0.26)	(1.36)	(1.09)	(1.03)

Age75	-0.351**	-0.341**	-0.306**	-0.355**	-0.199
	(-3.05)	(-3.02)	(-2.75)	(-2.89)	(-1.01)
NomMbr	-0.168**	-0.126**	-0.108**	-0.134**	-0.113*
	(-4.22)	(-3.29)	(-2.77)	(-3.24)	(-2.06)
Empl_Dir	-1.030**	-0.848**	-0.885**	-0.957**	-0.943**
	(-11.04)	(-10.05)	(-9.89)	(-10.09)	(-7.30)
OutDirLink	-1.303**	-0.967**	-1.022**	-1.156**	-1.245**
	(-18.24)	(-14.72)	(-14.96)	(-15.41)	(-10.82)
Tot_Dir_Shs	1.183**	1.424**	1.246**	1.172*	1.855*
	(2.60)	(2.95)	(2.68)	(2.50)	(2.43)
Interlock	-0.110	-0.306+	0.334+	-0.127	0.121
	(-0.61)	(-1.77)	(1.92)	(-0.78)	(0.42)
Chairman_ Only	0.0349	-0.0803	-0.102	-0.00752	-0.0894
	(0.31)	(-0.80)	(-0.91)	(-0.06)	(-0.50)
IP No	-1.507**	-0.631**	-1.360**	-1.381**	-1.893**
	(-5.10)	(-4.54)	(-5.14)	(-4.83)	(-9.00)
ClassBd	-0.263**	-0.208**	-0.252**	-0.277**	-0.146
	(-3.44)	(-2.89)	(-3.37)	(-3.53)	(-1.32)
PPill	-0.0929	-0.0770	-0.0950	-0.121	-0.179
	(-1.10)	(-0.97)	(-1.14)	(-1.37)	(-1.42)
CumVote	-0.0859	-0.0157	-0.100	-0.0711	0.113
	(-0.64)	(-0.12)	(-0.76)	(-0.50)	(0.69)
GP	-0.0592	-0.126	-0.0638	-0.0536	-0.0110
	(-0.61)	(-1.37)	(-0.67)	(-0.53)	(-0.07)
Top5AbRet	0.445*	0.414*	0.394*	0.385*	0.475*
	(2.57)	(2.44)	(2.31)	(2.25)	(2.18)
Bot5AbRet	-0.484**	-0.438**	-0.391**	-0.563**	-0.677**
	(-3.47)	(-3.22)	(-2.94)	(-3.15)	(-3.82)

Top5AbRet x CEO	-0.134 (-0.66)	-0.109 (-0.55)	-0.0603 (-0.30)	-0.0317 (-0.16)	-0.232 (-1.26)
Bot5AbRet x CEO	0.310^{+} (1.92)	0.318* (2.05)	0.177 (1.09)	0.212 (1.59)	0.119 (0.49)
Sdret	-31.62** (-4.48)	-26.91** (-3.91)	-28.99** (-4.14)	-29.53** (-3.82)	-17.93^{+} (-1.81)
ln(Market Capitalization)	-0.126** (-3.93)	-0.125** (-4.17)	-0.132** (-4.16)	-0.131** (-3.69)	-0.119* (-2.55)
InstHold	0.465 (1.42)	0.460 (1.48)	0.474 (1.46)	0.363 (1.04)	0.486 (1.05)
Year06	0.0197 (0.30)	0.00358 (0.06)	0.0420 (0.65)	0.00388 (0.06)	0.0910 (1.05)
VoteISS		-2.216** (-25.54)			
VoteGL			-1.182** (-21.52)		
VoteEJ				-0.595** (-9.22)	
VotePG					-0.559** (-3.22)
Constant	6.003** (11.80)	5.946** (12.34)	6.084** (11.96)	6.078** (10.84)	5.309** (7.60)
N	12644	12605	12563	11447	4624
adj. R^2	0.109	0.185	0.163	0.119	0.143

t statistics in parentheses: $^{+}$ $p < 0.10$, * $p < 0.05$, ** $p < 0.01$

Table 4: Marginal Impact of a Withhold Recommendation at Varying Points on "For" Vote Distribution (Calculated Using a "For" Recommendation)

"For" Vote Distribution	ISS Withhold	GL Withhold	EJ Withhold	PGI Withhold
5%	0.2547	0.0859	0.0403	0.0437
10%	0.2171	0.0692	0.0312	0.0340
25%	0.1699	0.0505	0.0216	0.0221
50%	0.1310	0.0368	0.0154	0.0157
75%	0.1015	0.0273	0.0113	0.0117
90%	0.0780	0.0209	0.0085	0.0087
95%	0.0660	0.0180	0.0071	0.0074

Table 5

Panel A: "For" Vote Outcome

Variable	Model
CEO	-0.709**
	(-10.07)
New Director	0.173**
	(3.51)
AuditMbr	-0.210**
	(-4.72)
Prior Restat	-0.104
	(-0.80)
Prior SEC	-0.229**
	(-2.62)
Prior Restat x AuditMbr	-0.0837
	(-0.83)
Prior SEC x AuditMbr	-0.0901
	(-1.20)
CompMbr	-0.290**
	(-6.62)
Top5AbComp	-0.0718
	(-0.52)
Top5AbComp x CompMbr	-0.251*
	(-2.04)
Attendance	-0.850**
	(-6.98)
ManyBds	-0.190**
	(-4.00)
ManyBds x CEO	0.0192
	(0.12)
Age75	-0.296**
	(-2.71)
NomMbr	-0.0838*
	(-2.24)

Empl_Dir	-0.724**
	(-9.01)
OutDirLink	-0.763**
	(-11.93)
Tot_Dir_Shs	1.499**
	(3.03)
Interlock	0.116
	(0.68)
Chairman_Only	-0.188+
	(-1.90)
IP No	-0.557**
	(-4.11)
ClassBd	-0.200**
	(-2.83)
PPill	-0.0809
	(-1.03)
CumVote	-0.0394
	(-0.31)
GP	-0.126
	(-1.40)
Top5AbRet	0.369*
	(2.21)
Bot5AbRet	-0.350**
	(-2.74)
Top5AbRet x CEO	-0.0444
	(-0.22)
Bot5AbRet x CEO	0.211
	(1.35)
Sdret	-24.60**
	(-3.61)
ln(Market Capitalization)	-0.131**
	(-4.39)
InstHold	0.470
	(1.51)

Year06	0.0344
	(0.54)
VoteISS	-2.473**
	(-26.62)
VoteGL	-1.123**
	(-21.94)
VoteISS x VoteGL	0.995**
	(6.74)
Constant	6.024**
	(12.51)
N	12524
adj. R^2	0.230

t statistics in parentheses: + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$.

Panel B: Expected and Marginal "For" Votes

	ISS "For" Rec.	ISS Withhold Rec.	Marginal Impact of ISS Withhold Rec.
Glass Lewis "For" Rec.	98.4%	83.9%	-14.5%
Glass Lewis Withhold Rec.	95.3%	82.1%	-13.2%
Marginal Impact of Glass Lewis Withhold Rec.	-3.1%	-1.8%	

All expected and marginal "For" votes are calculated at the median of the log odds for vote distribution.

Table 6: Institutional v. Non-Institutional Investor Model

Variable	Model
Tot_Dir_Shs	1.290**
	(2.77)
InstHold	0.583+
	(1.81)
InstHold x VoteISS	-3.137**
	(-15.29)
IndivHold x VoteISS	-1.248**
	(-4.52)
Constant	5.895**
	(12.21)
N	12605
adj. R^2	0.187

t statistics in parentheses: + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. Unreported, the models all include the same independent variables as in the base log-odds for vote model (reported above as Model 1 of Table 3).