
November 23, 2015

ISS and Glass Lewis Publish 2016 U.S. Voting Policies

As occurs every fall, the two largest U.S. proxy advisory firms, Institutional Shareholder Services (ISS) and Glass Lewis, have issued their respective voting policies for the upcoming year. This round of changes is not as extensive as in prior years, but nevertheless includes significant updates, including new policies related to director overboarding and defensive structures, such as classified boards, supermajority vote requirements and shareholders' ability to amend bylaws, even if implemented before a company's initial public offering. We summarize the key provisions below.

ISS U.S. Policy Updates

Unilateral Board Adoption of Bylaw or Charter Amendments

In 2014, ISS instituted a policy of recommending against directors if the board has amended a company's bylaws or charter, without shareholder approval, so as to materially diminish shareholder rights or adversely impact shareholders. Among several factors that ISS considers in making its recommendation is whether the amendment was made prior to or in connection with the company's IPO.

While this general policy remains in place, ISS now has a separate methodology for evaluating amendments adopted in the IPO context. The factors to be considered in the IPO context include the provision's impact on shareholders' ability to change the governance structure in the future (*e.g.*, limitations on shareholder's right, or supermajority vote requirements, to amend the bylaws or charter), whether there is a classified board and, perhaps most significantly, whether there is a public commitment to put the provision to a shareholder vote within three years of the IPO.

Importantly, ISS now explicitly states that it will continue to consider any such unilateral adoption of these materially adverse bylaws or charter amendments in making vote recommendations for director nominees (for both established and IPO companies) until the amendments are reversed or submitted to a binding shareholder vote.

Overboarded Directors

Starting with the 2017 proxy season, ISS will recommend against directors who sit on more than five public company boards (instead of six as under the current policy). For the upcoming 2016 proxy season, ISS will note in its analysis if the five-directorship cap is exceeded. Although comments were solicited on possible changes to its overboarding policy with respect to CEO-directors, no changes were made. Directors, who are public-company CEOs and sit on more than two public-company boards in addition to

their own board, will continue to receive negative recommendations at the boards of the public companies other than their own.

Proxy Access Nominees

Although companies had hoped for additional clarification from ISS on its views about proxy access bylaws, as of now, the only policy change on this topic clarifies that ISS may, in evaluating proxy access director nominees, consider factors different from those specified for directors in contested elections generally.

Other Amendments

ISS also (i) clarified its methodology for evaluating shareholder proposals that ask companies to adopt policies requiring senior executive officers to retain a portion of net shares acquired through compensation plans, (ii) amended its voting policies on issues related to animal welfare and pharmaceutical pricing, access to medicines and prescription drug reimportation and (iii) issued FAQs related to its equity plan scorecard.

For ISS' policy updates, see <http://www.issgovernance.com/policy-gateway/2016-policy-information/>

Glass Lewis U.S. Policy Updates

Conflicting Management Proposals

Rule 14a-8 under the Securities Exchange Act of 1934 allows shareholders meeting certain stock ownership and procedural requirements to submit proposals for inclusion in a company's proxy materials. Rule 14a-8 also includes certain substantive bases for the exclusion of shareholder proposals from a company's proxy materials. Among these substantive bases is Rule 14a-8(i)(9), which provides that a shareholder proposal that "directly conflicts" with a management proposal is excludable. After notable controversy last proxy season arising from an interpretation of Rule 14a-8(i)(9) by the Staff of the SEC's Division of Corporation Finance, which allowed Whole Foods to exclude a proxy access shareholder proposal in light of the company's intent to put forth its own proxy access proposal (albeit with materially different terms), the Staff has issued updated guidance of the Rule. Under Staff Legal Bulletin No. 14H, a shareholder proposal directly conflicts with a management proposal only if a reasonable shareholder could not logically vote in favor of both proposals (*i.e.*, a vote for one proposal must be tantamount to a vote against the other proposal). Even if a shareholder proposal and management proposal include materially different terms, the proposals may not conflict if they seek a similar objective. For example, under SLB No. 14H, a proxy access proposal with a 3% ownership threshold would not conflict with a

proxy access proposal with a 5% ownership threshold since a shareholder could logically vote in favor of both proposals.¹

Against this backdrop, Glass Lewis has outlined its approach to analyzing conflicting proposals, with considerations to include the following:

- The nature of the underlying issue;
- The benefit to shareholders from implementation of the proposal;
- The materiality of the differences between the shareholder and management proposals;
- The appropriateness of the provisions in the context of a company's shareholder base, corporate structure and other relevant circumstances; and
- A company's overall governance profile, including its responsiveness to shareholders as evidenced by a company's response to previous shareholder proposals and its adoption of progressive shareholder rights provisions.

Exclusive Forum Provisions

Glass Lewis will no longer automatically recommend against the chair of the nominating and governance committee when a company includes an exclusive forum provision in its IPO governance documents, but will consider the provision in light of others that may unduly limit shareholder rights, such as supermajority vote requirements, a classified board or a fee-shifting bylaw. Glass Lewis will continue to recommend against the chair of the nominating and governance committee if an established board adopts an exclusive forum provision without shareholder approval (other than in the spin-off or merger context).

Overboarded Directors

Beginning with the 2017 proxy season, Glass Lewis will recommend against directors who sit on more than a total of five public company boards (as opposed to the current six-board cap) and directors who are executives of a public company and sit on more than two total boards (as opposed to more than two other boards), but will note as a concern such directors starting this proxy season.

¹ SLB No. 14H also included clarification from the Staff of the Division of Corporation Finance with respect to the "ordinary business" exception under Rule 14a-8(i)(7). For SLB No. 14H, see <http://www.sec.gov/interp/leg/cfslb14h.htm>

Nominating and Governance Committee Performance

Glass Lewis has clarified that it will consider recommending against the chair of the nominating and governance committee if a board's failure to ensure that its members have relevant experience (*e.g.*, through periodic director assessments or board refreshment) has contributed to a company's poor performance.

Other Amendments

Glass Lewis also updated its policies to (i) clarify when it may consider recommending against directors for lapses in environmental and social risk management and (ii) highlight specific factors it will consider with respect to one-time and transitional compensation awards.

For the Glass Lewis policy updates, see <http://www.glasslewis.com/resource/guidelines/>

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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