SULLIVAN & CROMWELL LLP

July 12, 2018

2018 Proxy Season Review

Change in Landscape for Environmental/Social/Political Proposals—More Withdrawn Following Engagement; Those Going to a Vote Receive Higher Support and Pass More Frequently

Governance Proposals Receive Lower Support and Pass Less Frequently, Principally Due to Fewer Proxy Access Proposals Going to a Vote

Non-Responsiveness to a Prior Shareholder Vote Remains Most Common Basis for Low Director Support Levels in Uncontested Elections

Say-on-Pay Results Generally Remain Strong and Highlight Continued Importance of ISS Pay-for-Performance Model

EXECUTIVE SUMMARY

This publication summarizes significant developments relating to the 2018 U.S. annual meeting proxy season, including:

Rule 14a-8 Shareholder Proposals

- ***Environmental/social/political proposals gain traction.*** Although shareholders submitted a consistent level of environmental/social/political ("ESP") proposals as a percentage of all shareholder proposals submitted, there was a significant increase in the percentage withdrawn (for the first time surpassing the percentage going to a vote). This development appears primarily to reflect growing engagement by companies on a number of these issues, particularly anti-discrimination policies. Moreover, those going to a vote recorded a higher average percentage of votes cast in favor (more than 25% for the first time) and, notwithstanding the decline in the number of ESP proposals voted on, there was a marked increase in the number that passed (although still a low number). As in prior years, the vast majority of ESP proposals failed.
- ***Fewer gender pay equity, equal employment opportunity and board diversity proposals reach shareholder vote stage.*** The increase in ESP withdrawals related primarily to proposals addressing

corporate anti-discrimination policies (predominantly gender pay equity proposals), and the number of these proposals that ultimately went to a vote fell to less than half the number in 2017 (but those that went to a vote received meaningfully higher average support than they did last year). Similarly, although the total estimated number of board diversity proposals submitted this year was only slightly lower than the number in 2017, the number voted on fell below half the number in 2017. No proposal relating to anti-discrimination policies or board diversity passed in 2018.

- ***Overall pass rate for governance proposals declines significantly.*** After a consistent and significant downward trajectory from 2015 to 2017, the number of governance proposals that came to a vote in 2018 remained at levels comparable to 2017. However, a significantly lower number of governance proposals passed this year than in 2017, due in large part to a reduction in the relative number of proposals relating to proxy access, majority voting, board declassification and removal of supermajority vote proposals, each of which received average support of about 50% or more in both 2017 and 2018.
- ***Increased focus on proposals to reduce special meeting thresholds.*** There was a significant increase in proposals to lower the ownership percentage required for calling a special meeting, typically from 25% to 10%. These proposals almost always went to a vote and generally received substantial support from shareholders (average support of 40%). Although these proposals remained largely unsuccessful, the number that passed increased compared to 2017. The overall level of support is particularly notable in light of the lack of support from two or more of the largest institutional investors.
- ***Increased focus on proposals to adopt written consent.*** There was also a significant increase in proposals to adopt the right to act by written consent, which also almost always went to a vote and received average support of 42%, consistent with 2017. More of these proposals passed than last year, although representing a smaller proportion of the total number submitted.
- ***Substantial reduction in proxy access proposals, with few going to a vote.*** Proposals to adopt proxy access that came to a vote in 2018 declined to a negligible amount. Continuing a trend that began in 2017, most companies receiving such proposals opted to adopt a market-standard proxy access bylaw before a vote. Half of the proposals that did come to a vote did not pass (due to idiosyncratic reasons).
- ***Attempts to amend proxy access terms continue to be unsuccessful.*** All proposals that were voted on in 2018 to amend previously adopted proxy access bylaws, most often to remove or loosen restrictions on group size, failed.
- ***Continued focus on independent chair.*** Proposals for the board to have an independent chair remained common and, as in the past, generally received significant support from shareholders (25% to 40%). However, once again, none of these proposals passed, confirming that a consistent majority of shareholders generally are satisfied that a sufficiently empowered lead independent director is an appropriate alternative to mandatorily separating the CEO and chair roles.
- ***Despite recent scrutiny of dual class companies, number of proposals to eliminate dual class voting remains consistent with prior years.*** Between 2017 and 2018, major stock index compilers, such as the S&P Dow Jones Indices and FTSE Russell, have made policy changes that impact the eligibility of dual class companies for inclusion on their indices, and policy-makers also have issued several high-profile statements on the potential harms of dual class companies and the possibility of further regulatory scrutiny. However, the number of proposals in 2018 to eliminate supervoting shares (either by adopting a recapitalization plan for all equity securities to have one vote per share or by converting the supervoting shares into lower-vote shares) remained at a similar level and received a similar level of shareholder support (average support of 34%) as in 2017. As in prior years, none of these proposals passed.
- ***Compensation-related proposals remain limited.*** Once again, there were very few executive compensation-related shareholder proposals, continuing a trend that began once mandatory say-on-pay became the main focus of executive compensation concerns. However, this year shareholders submitted more than twice the number of proposals seeking to link compensation to social issues,

such as sustainability or social or environmental impact. The level of support remained consistent with 2017 (less than 20%), and none of these proposals passed.

Analysis of ISS Negative Recommendations Against Directors

- ***"Lack of responsiveness" continues to be most impactful recommendation.*** Our analysis of negative recommendations by Institutional Shareholder Services ("ISS") in uncontested director elections indicates that directors who were seen as insufficiently responsive to a prior shareholder vote were those that were the most likely to receive less-than-majority support (with average shareholder support of only 64%). The total number of directors who received a negative recommendation on this basis in 2018 increased substantially (by almost four times), although responsiveness did not rank among the top reasons for a negative recommendation. Lack of responsiveness to a low say-on-pay vote was the second-most impactful recommendation (with average shareholder support of 70%). In addition, poor attendance (particularly at S&P 500 companies) continued to have a significant impact.
- ***Independence issues remain most common basis but had limited impact.*** The most common basis for a negative ISS recommendation in 2018 related to independence issues. This rationale continued to have a limited impact, however, with directors in this category receiving average shareholder support of 88%.
- ***Directors at newly public companies with adverse governance provisions continue to be subject to negative recommendations.*** The second most common basis for a negative ISS recommendation in 2018 related to adverse governance provisions at "newly public" companies not subject to a sunset. The average support level for directors in this category was 86%, suggesting that directors at these companies do not face significant risk of less-than-majority support.
- ***New poison pill policy increases negative recommendations.*** New ISS policies regarding poison pill issues yielded many negative recommendations (the number of directors receiving a negative recommendation on this basis quadrupled from 2017). Directors in this category received average shareholder support of 77%, but only four received less-than-majority support (less than 4%).

Compensation-Related Matters

- ***Continued strength on say-on-pay.*** Public companies continued to perform strongly on say-on-pay, with support levels averaging over 90% and less than 3% of companies receiving less-than-majority support. Our analysis of ISS negative recommendations on say-on-pay suggests the continued importance of a pay-for-performance model, and that the most important factor under this pay-for-performance assessment is the alignment of CEO pay with Total Shareholder Return (or TSR) in relation to the ISS-determined peer group. The most important qualitative factor was performance standards that are not deemed sufficiently rigorous by ISS or clearly explained.
- ***Broad shareholder support for equity compensation plans.*** No Russell 3000 company failed to obtain shareholder approval for an equity compensation plan, and overall support levels continued to average over 90%.

* * *

The Rule 14a-8 shareholder proposals discussed in Section I below are those submitted to and/or voted on at annual meetings of the U.S. members of the S&P Composite 1500, which covers over 90% of U.S. market capitalization. The data discussed in Sections II, III and IV on negative ISS recommendations against directors in uncontested elections, say-on-pay votes and equity compensation approvals, respectively, are results from annual meetings of the U.S. members of the Russell 3000, which covers over 98% of U.S. market capitalization. For a discussion of U.S. proxy contests and other shareholder activist campaigns, see our publication, dated March 26, 2018, entitled "Review and Analysis of 2017 U.S. Shareholder Activism."

More generally, for a comprehensive discussion of U.S. public company governance, disclosure and compensation, see the *Public Company Deskbook: Complying with Federal Governance and Disclosure Requirements* (Practising Law Institute) by our colleagues Bob Buckholz, Marc Trevino and Glen Schleyer, available at 1-800-260-4754 (1-212-824-5700 from outside the United States) or http://www.pli.edu.

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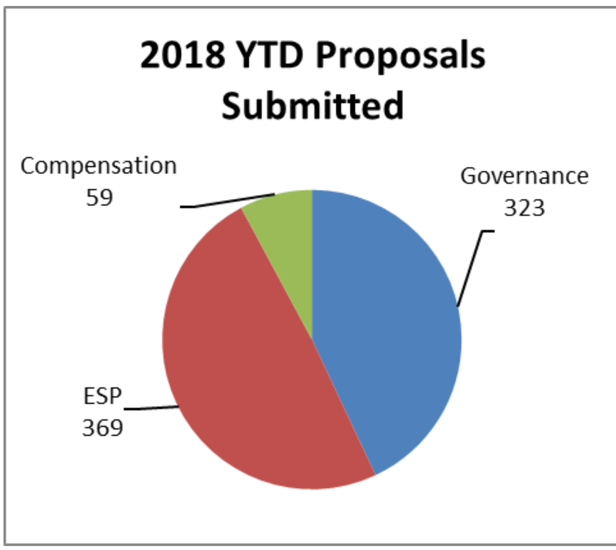
I. RULE 14A-8 SHAREHOLDER PROPOSALS

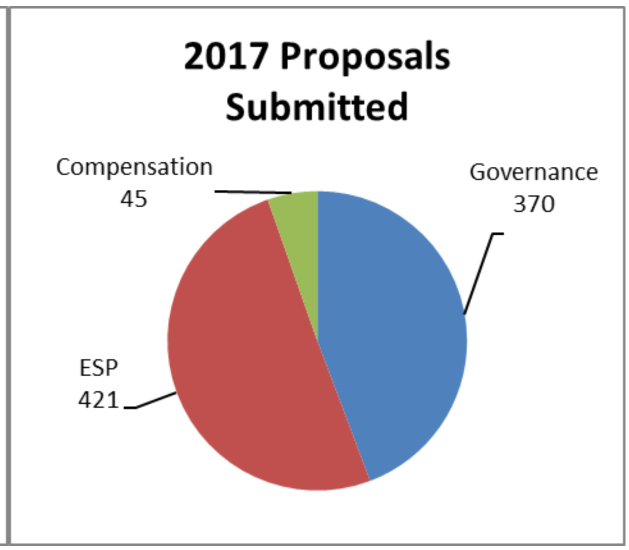
A. OVERVIEW OF SHAREHOLDER PROPOSALS

The following table and pie charts summarize, by general category, the Rule 14a-8 shareholder proposals submitted in 2017 (full year) and 2018 year-to-date, the number voted on and the rate at which they passed.*

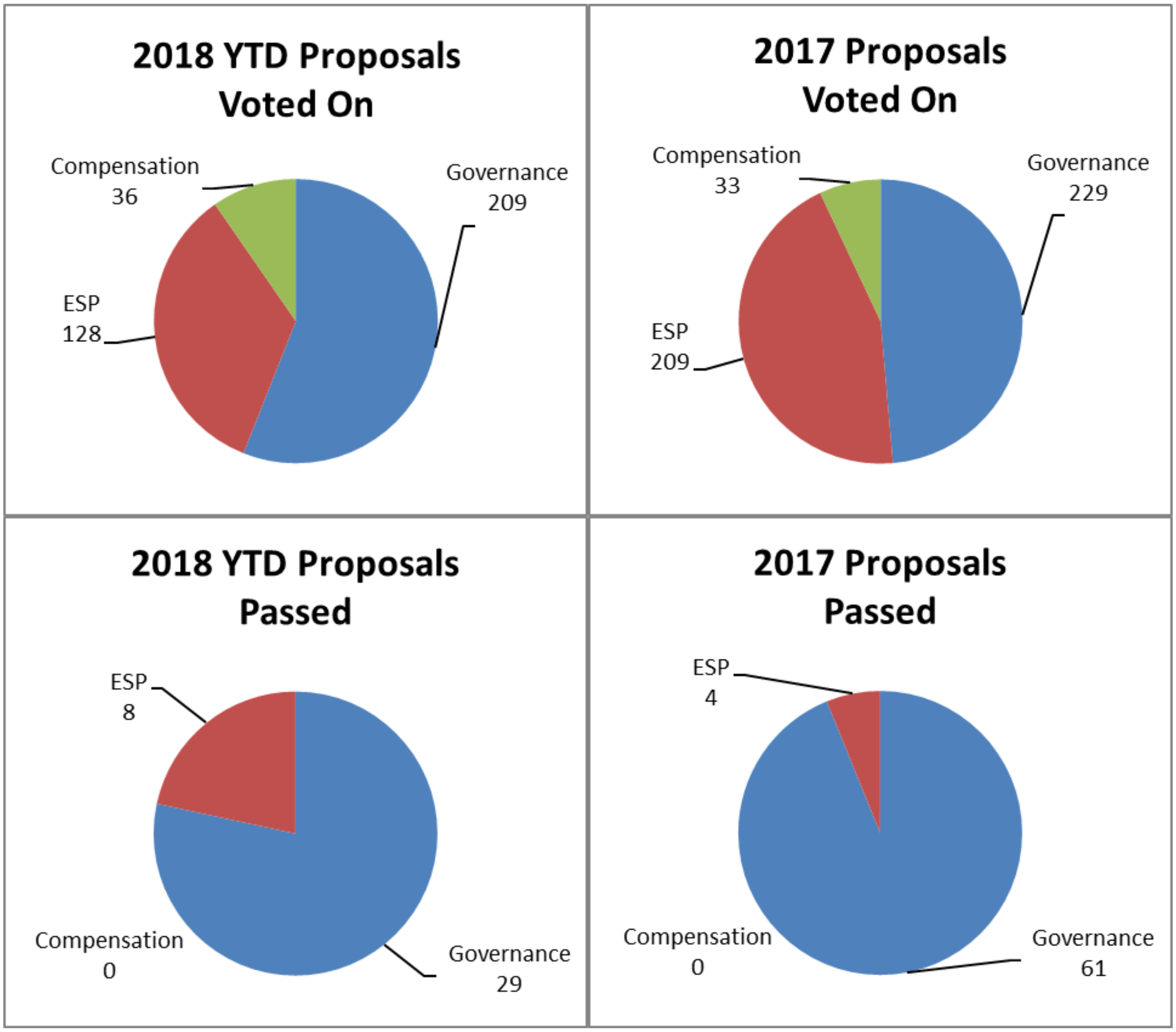
SUMMARY OF 2017-2018 SHAREHOLDER PROPOSALS

	Shareholder Proposals Submitted		*Shareholder Proposals Voted On*		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
Type of Proposal	*2018 YTD*	*2017*	*2018 YTD*	*2017*	*2018 YTD*	*2017*	*2018 YTD*	*2017*
ESP-related	***369***	421	***128***	209	***26%***	22%	***8***	4
Governance-related	***323***	370	***209***	229	***37%***	39%	***29***	61
Compensation-related	***59***	45	***36***	33	***23%***	22%	***0***	0
Total	***751***	836	***373***	471				





* The data in this publication incorporates proposals made at meetings held on or before June 30, 2018, unless otherwise specified. We estimate that around 90% of U.S. public companies held their 2018 annual meetings by that date. In this publication, when we refer to a proposal as "passing," we mean that it received the support of a majority of votes cast, regardless of whether this is the threshold for shareholder action under state law or the company's bylaws.



In 2018, more environmental, social and political ("ESP") proposals were submitted than any other type of shareholder proposal. However, as discussed further in Section I.D below, these proposals were withdrawn at a substantially higher rate, and less than a third reached the shareholder vote stage. Very few of the ESP proposals that reached a vote actually passed, although average shareholder support and pass rate both increased meaningfully compared to 2017. The most common topics continued to be environmental issues, political contributions and lobbying, gender and other discrimination, and human rights.

The number of governance-related proposals submitted was below the number of ESP proposals submitted again this year (continuing a trend that began in 2017), but governance-related proposals remained the most likely to reach a vote. As discussed further in Section I.E below, these proposals continued to represent the majority of proposals that actually passed, although the pass rate declined sharply to 14% from 26% in 2017. This decline resulted from a marked reduction in proposals that have received high shareholder support historically, such as adopt proxy access, eliminate supermajority thresholds, majority voting in uncontested elections and declassify the board proposals (each of which received average support of about 50% or more in both 2017 and 2018), and from an increase in written consent proposals and proposals to reduce special meeting thresholds, which generally do not pass (but do receive high average levels of shareholder support).

The number of compensation-related proposals remained at a negligible level, which is a continuation of a trend that began in 2011 when mandatory say-on-pay votes came into effect. No compensation-related proposals have passed in 2018. *See* Section I.F below for a further discussion.

The data on submitted, withdrawn and voted on shareholder proposals discussed in this section derives from ISS's voting analytics with respect to about 800 known shareholder proposals submitted this year to U.S. members of the S&P Composite 1500, which covers about 90% of U.S. market capitalization. We have supplemented the ISS data with information published by certain proponents on their websites and other independent research. The number of proposals submitted includes proposals that were withdrawn before or after being included in a company's proxy statement (usually following engagement with the company) or excluded from a company's proxy statement through the SEC no-action process. The data on submitted proposals understates the number of proposals submitted, as it generally does not include proposals that were submitted and then withdrawn unless either the proponent or the company voluntarily reported the proposal to ISS or, in the case of the major shareholder proponents discussed in Section I.B below, on their websites.[1] For purposes of our presentation, unless stated otherwise, we refer to proposals withdrawn by the proponent either before or after the mailing of a company's proxy materials, as well as proposals which are not presented by the proponent at the shareholder meeting, as "withdrawn." We refer to proposals that have been excluded through the SEC no-action process as "excluded."

B. WHO MAKES SHAREHOLDER PROPOSALS

The focus of a relatively concentrated group of individuals and entities tends to drive the voting agenda at U.S. public companies. The top 10 proponents account for more than half of shareholder proposals submitted to U.S. S&P Composite 1500 companies. The following table shows a breakdown of the types of proposals submitted by the top shareholder proponents in 2018.

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[1] As further described in Sections I.B and I.E.3, the discussion in this publication on proxy access proposals submitted by the Office of the New York City Comptroller takes into account information derived from independent research (in addition to data from ISS and the Comptroller's website), because the Comptroller has not yet published its annual list of proposals for 2018.

	Filers	ESP	Governance	Compensation	Total
1.	John Chevedden	4	109	0	113
2.	James McRitchie	2	42	2	46
3.	William Steiner	0	43	1	44
3.	NYS Common Retirement Fund	38	3	3	44
5.	NYC Comptroller	9	24	7	40
6.	As You Sow Foundation	33	0	4	37
7.	Trillium Asset Management	18	13	1	32
8.	Zevin Asset Management	20	0	9	29
9.	Walden Asset Management	18	6	0	24
10.	Arjuna Capital	23	0	0	23
11.	Mercy Investment Services	20	0	2	22
12.	AFL-CIO	5	5	6	16
13.	Calvert Investment Management	8	4	0	12
13.	The International Brotherhood of Teamsters General Fund	4	2	6	12
13.	Friends Fiduciary Corporation	12	0	0	12

- ***Individuals*.** The most prolific proponents, by far, were three individual investors who have been prominent for a number of years: John Chevedden, James McRitchie and William Steiner. Collectively, these individuals and their family members were responsible for the submission of over 200 proposals—representing over 40% of all proposals submitted, and the vast majority of governance-related proposals. In addition to governance-related proposals, these individuals also submitted a small number of proposals regarding political contributions and executive compensation.

- ***Public Pension Funds and Entities*.** Public sector pension funds and entities proposed more than 90 proposals to public companies for 2018 meetings. The most frequent proponents in this category were the New York State Comptroller, on behalf of the New York State Common Retirement Fund (with 44 proposals submitted, the vast majority of which were related to environmental issues (including climate change) and political contributions and lobbying), and the New York City Comptroller (with an estimate of 40 proposals submitted, almost half of which were proxy access proposals,[2] as described in Section I.E.3 below). Other topics commonly addressed by proposals from pension funds and other public sector entities include board diversity and gender pay equity.

- ***Labor Unions*.** Labor unions, such as the AFL-CIO, the Teamsters and the United Auto Workers and related entities, were the proponents of over 40 proposals, primarily relating to governance and compensation-related issues.

- ***Social Investment Entities*.** As further discussed in Section I.D below, the majority of proposals on ESP issues continued to come from asset management or advisory institutions that seek to make "socially responsible" investments and advance social causes. The entities that were most active in 2018 included As You Sow Foundation (37 proposals submitted), Trillium Asset Management (32), Zevin Asset Management (29), Walden Asset Management

[2] As of the date of this publication, the Office of the New York City Comptroller has not yet published its annual list of proposals for 2018. We have provided a rough estimate of the number of proposals submitted by the Comptroller based on a combination of ISS data and independent research. Due to the limited information available to us at this time, our estimates may not accurately depict actual patterns in the Comptroller's priorities.

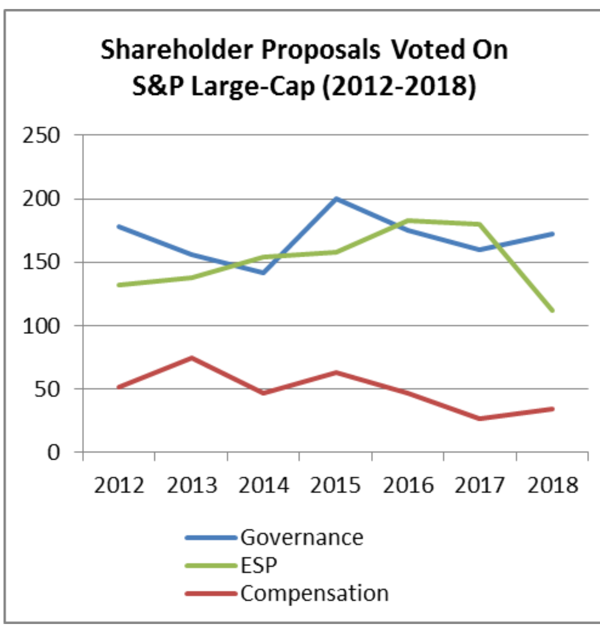
(24), Arjuna Capital (23), Mercy Investment Services (22) and Calvert Investment Management, Inc. (12).

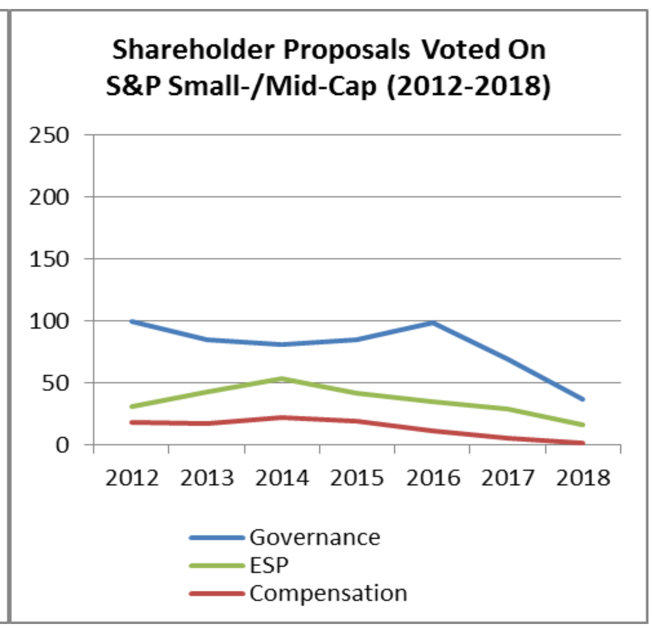
The ability of shareholders with a relatively small investment in the company ($2,000 of stock held for one year) to submit Rule 14a-8 proposals has been a subject of controversy and calls for change in recent years. For example, the Financial CHOICE Act of 2017, which was approved by the U.S. House of Representatives in June 2017, would have changed the threshold to at least 1% of the outstanding stock for three years. Although the Financial CHOICE Act was not brought to a vote in the Senate, legislative efforts toward change in this area have continued into 2018. Proponents of a higher threshold cite the relatively low success rate for many proposals brought by individuals and groups with minimal investments in companies.

C. TARGETS OF SHAREHOLDER PROPOSALS

Traditionally, large-cap companies have received the vast majority of shareholder proposals, a pattern that has intensified in recent years.[3] In 2018 so far, S&P 500 companies received nearly 80% of proposals voted on, marginally higher than in 2017 and higher than in each of the prior five years. The frequent shareholder proponents appear to prefer companies with the highest name recognition.

The following graphs show the frequency of proposals, by category, voted on at large-cap companies compared to small- and mid-cap companies. The higher numbers at large-cap companies are particularly notable given that the small-/mid-cap graph includes twice as many companies.

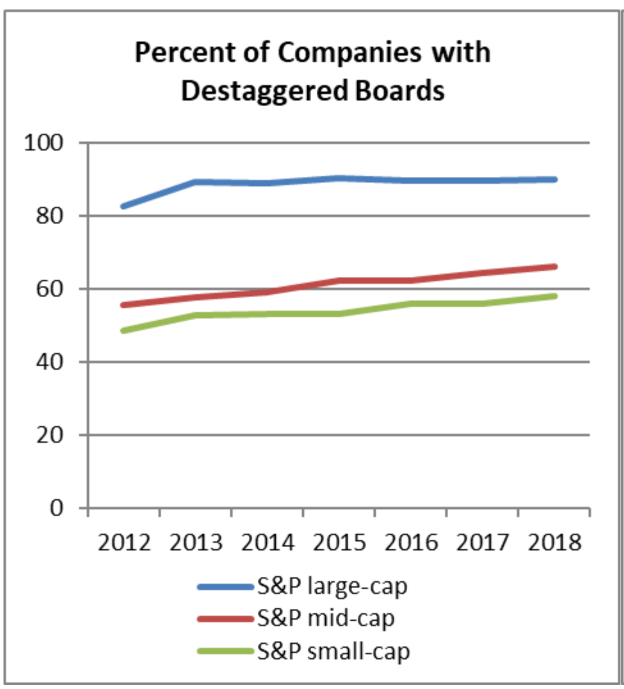


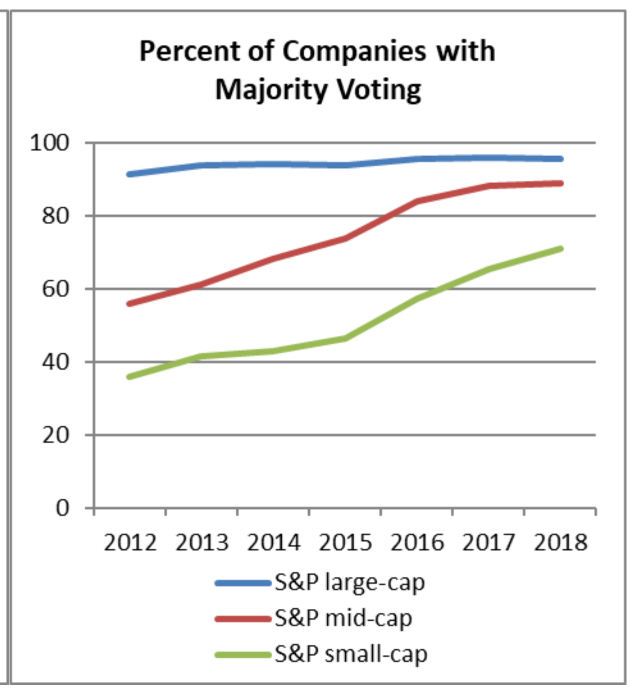


[3] In this publication, we use “large-cap” to mean U.S. S&P 500 companies, “mid-cap” to mean U.S. S&P 400 companies, and “small-cap” to mean U.S. S&P 600 companies.

As so-called shareholder-friendly governance features have become standard at S&P 500 companies, a number of governance proposals that previously have dominated proxy seasons and garnered high support from investors (*e.g.*, destaggered boards, majority election of directors, special meeting rights, simple majority vote thresholds and, more recently, proxy access) have become much less prevalent. There are simply fewer large-cap companies that have not already adopted these features, and those that have not adopted these features are often unappealing targets for governance proponents because many have structural hurdles that limit the efficacy of shareholder proposals.

Notwithstanding the lower frequency of governance proposals voted on and the approximately 50% reduction compared to 2016 levels, small- and mid-cap companies may nevertheless be experiencing heightened pressure as a consequence of developments in governance proposals and practices. First, the relatively small number of traditional governance proposals actually coming to a vote at smaller companies understates the effect of these proposals. In some cases, a proposal is made but does not come to a vote, because the receiving company, aware of the strong support levels these proposals have received, decides to adopt the proposal before a vote. In other cases, issuers decide unilaterally (*i.e.*, before a shareholder proposal is received) to migrate to what is perceived as the norm at larger companies. Second, when these proposals do come to a vote at smaller companies, they have similarly high support levels as (or, in some cases, even higher support levels than) they do at larger companies. Therefore, over time, the most popular governance practices have become somewhat more common (*e.g.*, destaggered boards) or much more common (*e.g.*, majority voting) at smaller companies, as demonstrated in the following charts.



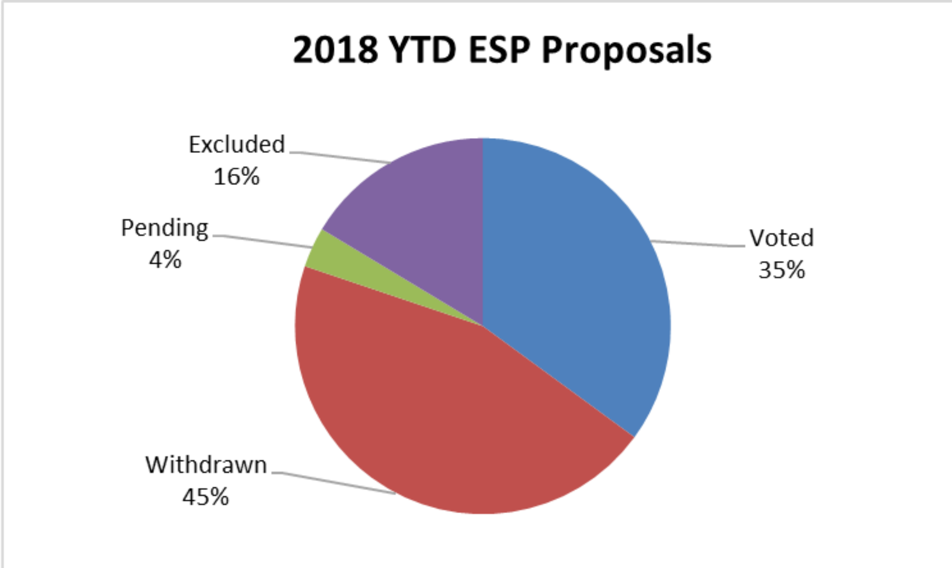


In comparison, proxy access and special meeting rights are less common among the S&P Composite 1500 at this time. Over 500 U.S. companies have adopted proxy access provisions at this point, which is concentrated at large-cap companies. (About two thirds of S&P 500 companies have adopted proxy access, versus 21% of the S&P 400 and only 7% of the S&P 600.) In contrast, there is a similar level of adoption of special meeting rights among large-cap and smaller-cap companies (nearly two thirds of the S&P 500, versus around 50% among each of the S&P 400 and S&P 600). This trend is partially attributable to the fact that many of the smaller companies are incorporated in states that have adopted the Model Business Corporation Act, which mandates the shareholder right to call special meetings (about 30% of S&P 400 companies and 25% of S&P 600 companies are incorporated in states that mandate the right, as compared to about 15% of S&P 500 companies).

D. SHAREHOLDER PROPOSALS ON ENVIRONMENTAL/SOCIAL/POLITICAL MATTERS

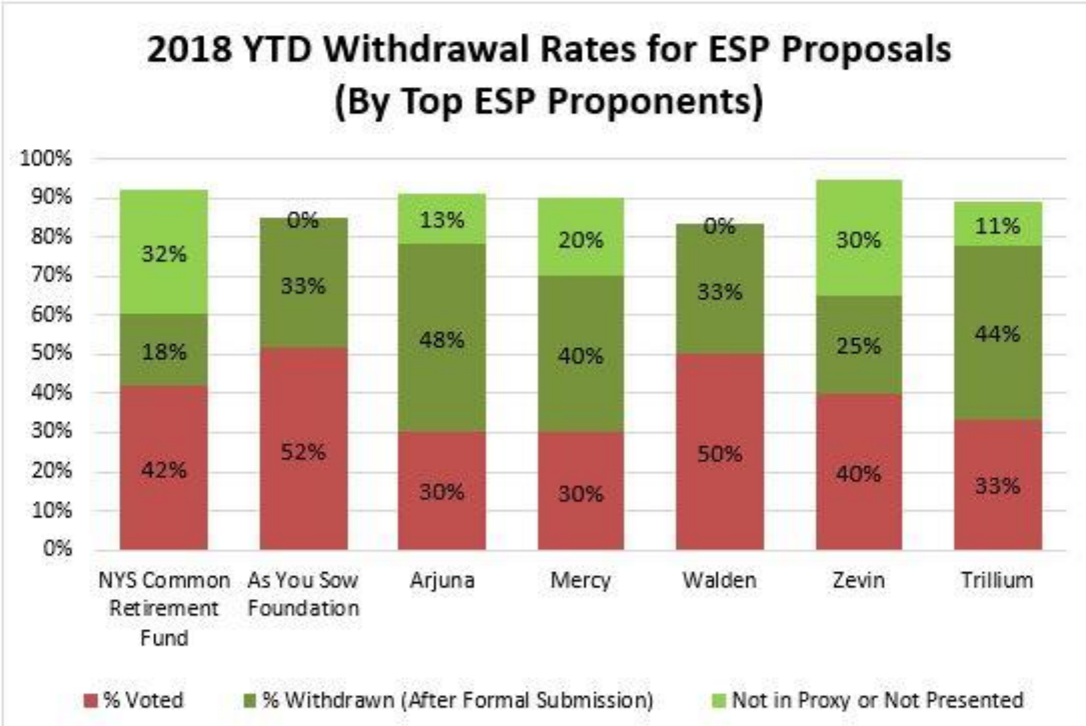
	ESP PROPOSALS							
	Shareholder Proposals Submitted		***Shareholder Proposals Voted On***		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
	2018 YTD	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***
Environmental issues	***107***	121	***31***	61	***31%***	29%	***5***	3
Political issues	***87***	89	***49***	64	***29%***	26%	***0***	0
Anti-discrimination	***58***	65	***11***	32	***29%***	16%	***0***	0
Human rights issues	***34***	43	***10***	24	***9%***	7%	***0***	0
Sustainability report	***18***	23	***7***	10	***34%***	29%	***1***	1
Health and safety	***8***	20	***3***	9	***17%***	17%	***0***	0
Animal rights	***7***	7	***1***	4	***3%***	10%	***0***	0
Other social policy issues	***50***	53	***16***	5	***17%***	4%	***2***	0

Although the level of ESP proposals submitted remained relatively consistent year-over-year (both as a percentage of all shareholder proposals submitted and across the different ESP categories), there was a significant decrease in the percentage that reached a vote. This year, there were more withdrawn ESP proposals than those going to a vote, as shown in the following chart, which underscores the robust engagement between issuers and shareholders on ESP topics. However, the withdrawal data in this publication generally excludes shareholder engagement prior to the receipt of a formal proposal, which may obscure actual trends in shareholder engagement with respect to at least some categories of ESP proposals.



The major shareholder proponents referenced in Section I.B submitted close to 60% of all ESP proposals received by U.S. S&P Composite 1500 companies. Among these proponents, the New York State Common Retirement Fund submitted the greatest number of ESP proposals (38), most of which related to environmental issues and political contributions and lobbying. Collectively, social investment entities, such as As You Sow Foundation (33 ESP proposals submitted), Arjuna Capital (23), Mercy Investment Services (20), Zevin Asset Management (20), Walden Asset Management (18) and Trillium Asset Management (18), submitted the bulk of the proposals and tended to focus on environmental issues and gender pay equity. As the following chart shows, almost all the top ESP proponents withdrew 50% or more of their proposals this year (either before or after a proposal was included in a company's proxy statement), likely following engagement with the company.[4]

[4] The chart does not show the percentage of excluded or pending ESP proposals submitted by each proponent.



The significantly lower number of ESP proposals that went to a vote this year reflects issuers' recognition of the growing importance of ESP issues to institutional investors. Proposals relating to discrimination (predominantly gender pay equity) had the highest withdrawal rate of any category this year (most likely following an issuer's commitment to make improvements in this area), with less than a fifth of all submitted proposals reaching a vote. The withdrawal rate is unsurprising given the impact of the #MeToo movement and the public attention on workplace culture this year. The most common subjects among ESP proposals that reached a vote continued to be environmental issues (including climate change) and political contributions and lobbying, correlating with the comparatively lower withdrawal rate among the major shareholder proponents that focused on these issues (*e.g.*, As You Sow Foundation).

The ESP proposals that went to a vote received higher shareholder support on average than in 2017 (more than 25% for the first time). In particular, average support for proposals relating to discrimination almost doubled this year (29% in 2018 compared to 16% in 2017). The number of ESP proposals that passed this year doubled, notwithstanding the decline in the total number of ESP proposals voted on. Whereas no political proposals passed in 2018, as was the case in 2017, the number of environmental proposals that passed increased to five in 2018 (all related to either climate change or emissions) from three in 2017.

This year, ISS supported an even higher percentage of ESP proposals voted on (74% in 2018 compared to 64% in 2017), including 94% of the political proposals and 87% of the environmental proposals. ISS supported 73% of anti-discrimination proposals this year, more than doubling the percentages from 2015 to 2017. Overall, shareholder support averaged 32% for ESP proposals where ISS recommended in favor, compared to 8% for proposals where ISS recommended against.

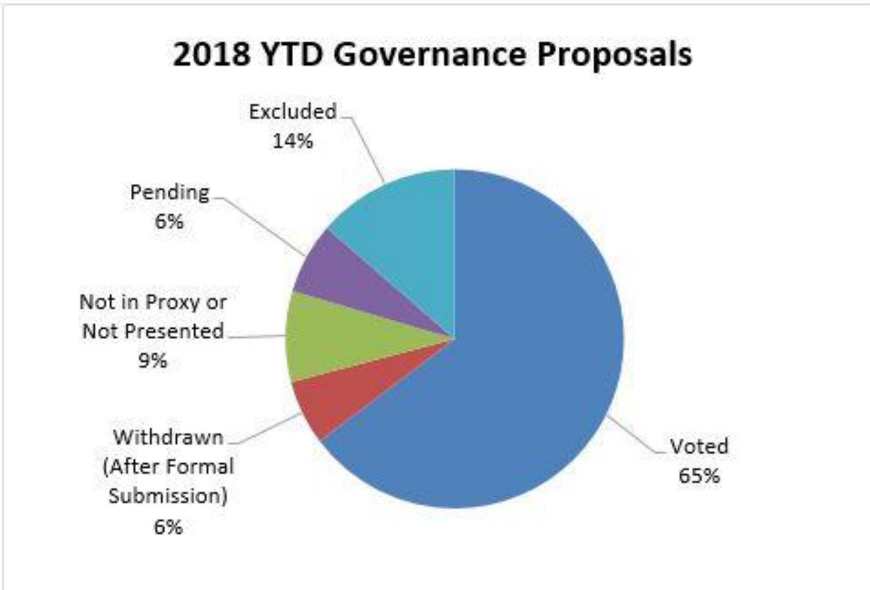
New types of ESP proposals submitted by shareholders this year included those relating to recent “hot button” political issues, such as gun safety (at Dicks Sporting Goods and Sturm, Ruger & Co) and social media “fake news” (at Alphabet, Facebook, Twitter, Comcast, Disney and Time Warner). The gun safety proposals were all submitted by religious organizations, and the only one that has been voted on passed with 69% of the votes cast. Facebook, Disney, Comcast and Time Warner obtained no-action relief from the SEC to exclude proposals seeking the adoption of anti-“fake news” policies. The other “fake news” proposals requested reports on major global content management controversies. All these proposals were submitted jointly by the New York State Common Retirement Fund and Arjuna Capital, and received very low support (8.5% on average).

E. SHAREHOLDER PROPOSALS ON GOVERNANCE MATTERS

After a consistent and significant downward trajectory from 2015 to 2017, the number of proposals on governance matters (board-related and anti-takeover concerns) that came to a vote in 2018 remained at levels comparable to 2017. There was a dramatic spike in the number of proposals to lower the ownership percentage required for calling a special meeting and to adopt written consent rights, offsetting the steep drop in adopt proxy access proposals as more companies adopt a market-standard provision. There are very few proposals coming to a vote at this point on the traditional governance topics of destaggering the board, adopting majority voting in uncontested director elections, and eliminating supermajority provisions. Few large companies have not already adopted these practices, and many of the smaller companies that receive these proposals decide to adopt the practices rather than letting the proposal come to a vote.

Average support for governance proposals in 2018 was 37% overall (slightly lower than the 2017 average of 39%), continuing the downward trend since 2013.

Unlike ESP proposals, when governance proposals failed to reach the shareholder vote stage, it was most often due to exclusion through the SEC no-action process, as shown in following chart. Instances where proponents did not present their proposals at shareholder meetings or withdrew before their proposals were included in a company's proxy statement and instances where an annual meeting is pending also contributed to the difference between the number of governance proposals that were submitted and those that went to a vote.



1. Shareholder Right to Call Special Meetings

	RIGHT TO CALL SPECIAL MEETINGS							
	Shareholder Proposals Submitted		Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
	2018 YTD	2017	2018 YTD	2017	2018 YTD	2017	2018 YTD	2017
Adopt new right	***15***	12	***8***	5	***39%***	45%	***1***	3
Lower % on existing right	***57***	19	***47***	19	***40%***	41%	***4***	1

Proxy advisory firms and many shareholders support the right of shareholders to call a special meeting, because it enables shareholders to act on matters that arise between annual meetings (such as the replacement of one or more directors, including in circumstances intended to permit an acquisition offer to proceed, or the amendment of bylaws). The right to call special meetings should be viewed in conjunction with the strong movement away from classified boards—in Delaware, directors of a non-classified board can generally be removed by shareholders without cause. Thus, given the trend of declassifying boards, the ability to act outside the annual meeting to remove directors without cause and elect their replacements can be viewed as the dismantling of an effective mechanism to provide directors with additional time to respond to shareholder activism or consider hostile takeover proposals. Nearly two thirds of S&P 500 companies (compared to about 60% last year) now provide shareholders with some right to call a special meeting, a development driven largely by shareholder proposals and shareholder support for the concept over the past decade.

a. Proposals to Introduce a Special Meeting Right

Almost half of the proposals that sought to introduce a special meeting right were excluded through the SEC no-action process. Of the eight that reached a vote, five called for a 10% threshold, two others for a 15% threshold, and one for an absent-good-cause standard. In four of the eight, the company included a counterproposal; two proposed a 25% threshold and two a 20% threshold. In each case where there was a company counterproposal, the company proposal won majority support. This year, one shareholder proposal passed; the company that received the proposal did not put up a counterproposal.

b. Proposals to Reduce Special Meeting Threshold

Proposals seeking to reduce the ownership threshold to call a special meeting became the most common type of governance-related proposal this year, both in terms of number submitted (57 in 2018 so far, compared to 19 in all of 2017) and number voted on (47 in 2018 so far, compared to 19 in 2017). The vast majority of these proposals (82%) went to a vote. Most of them were initiated by John Chevedden or James McRitchie.

All 47 such proposals that came to a vote in 2018 sought to reduce a 20% or 25% threshold (or higher in limited cases) to either 10% or 15%. These proposals continued to receive high shareholder support this year (averaging 40% in 2018 compared to 41% in 2017), with four managing to gain majority support. The significant level of support these proposals continue to receive suggests that some governance-focused shareholders are not satisfied with the 25% ownership threshold that has become the market standard at large companies.

c. Terms to Consider When Adopting or Amending a Special Meeting Provision

Issuers putting forth a new special meeting right or evaluating an existing right, either preemptively or in response to a proposal, may wish to consider the following terms:

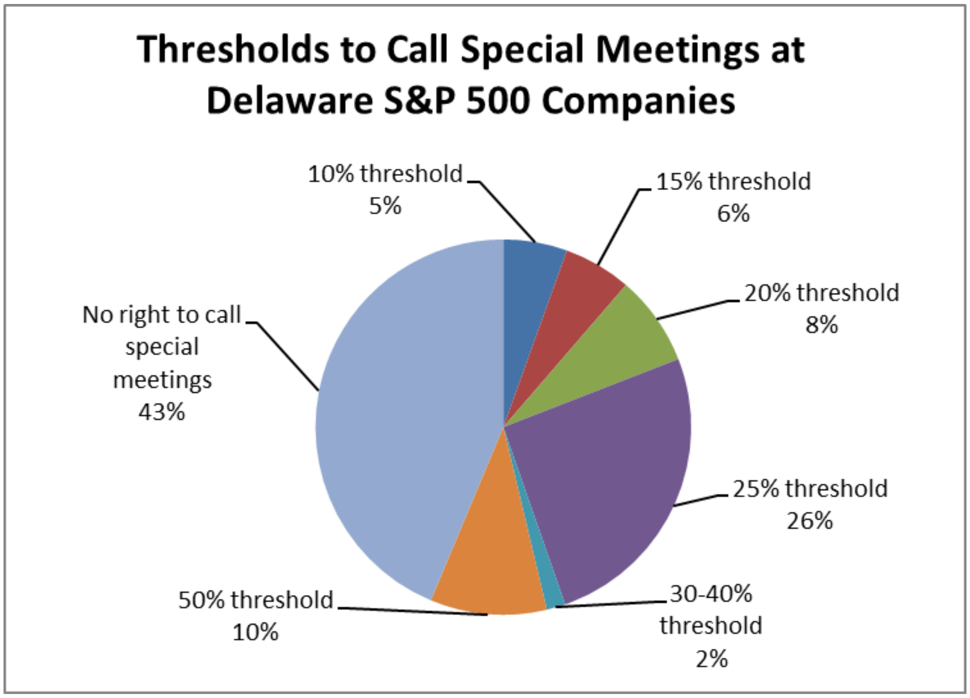
- ***Threshold*****.** Though practice varies, for a number of years 25% has been the most common threshold for special meeting rights at public companies, as reflected in the following chart showing the threshold for special meeting rights at Delaware companies among the S&P 500.[5] BlackRock's current policies indicate that it generally believes a threshold between 15%-25% is reasonable "in order to avoid the waste of corporate resources in addressing narrowly supported interests."[6] Similarly, State Street will only support a shareholder proposal

5 Based on data from FactSet Shark Repellent. We have limited this analysis to Delaware companies, because certain other states provide a statutory default special meeting right at 10%.

6 *See* BlackRock, Proxy voting guidelines for U.S. securities (Feb. 2018).

to amend existing special meeting rights if the threshold to exercise the existing right is over 25% and the shareholder proposal provides for at least a 10% threshold.[7]

However, companies with a 25% threshold should monitor and consider developments at peer companies on special meeting proposals and practices. Although some large institutional investors may continue to support a 25% threshold, the meaningful shareholder support for proposals to move from a 25% to a 10%-15% threshold indicates that a substantial portion of a company's other shareholders may be less concerned about making special meeting rights more accessible—this year, proposals passed at some companies despite the lack of support from two or more of the largest institutional investors.



- ***Definition of ownership.*** Many companies require "record" ownership of shares (as opposed to "beneficial" ownership), essentially requiring street name holders to work through their securities intermediaries to become a record holder. This eliminates uncertainty as to proof of ownership, but introduces an additional administrative step for shareholders seeking to use the right. In addition, a number of companies have introduced a "net long ownership" concept into their special meeting provision—essentially reducing the shareholders' actual ownership level by any short positions or other hedging of economic exposure to the shares. Companies that do not include a "net long" concept should nevertheless provide that the information required from the requesting shareholders must include details of any hedging transactions, so that the company and other shareholders can have a full picture of the requesting shareholders' economic stake in the company.
- ***Pre- and post-meeting blackout periods.*** In order to avoid duplicative or unnecessary meetings, many companies provide that no meeting request will be valid if it is received during a specified period (usually 90 days) before the annual meeting, or during a specified period (usually 90 or 120 days) after a meeting at which a similar matter was on the agenda.

[7] *See* State Street Global Advisors, 2018 Proxy Voting and Engagement Guidelines: North America (United States & Canada) (Mar. 16, 2018).

- ***Limitations of matters covered*.** Special meeting provisions typically provide that the special meeting request must specify the matter to be voted on, and that no meeting will be called if, among other things, the matter is not a proper subject for shareholder action. Generally, the only items that may be raised at the special meeting will be the items specified in the meeting request and any other matters that the board determines to include.
- ***Timing of meeting*.** Companies typically provide that the board must set the meeting for a date within 90 days from the receipt of a valid request by the requisite percentage of shareholders. Often, the special meeting provisions provide that, in lieu of calling a special meeting, the company may include the specified item in a meeting called by the company within that same time period.
- ***Holding period*.** A few companies require the requesting shareholders to have held the requisite number of shares for a specified period of time prior to the request.
- ***Inclusion in charter versus bylaws*.** Companies should consider whether to include the special meeting provisions in the charter, the bylaws or a combination. In some cases, companies include the critical provisions (such as ownership threshold) in the charter so that shareholders cannot unilaterally amend them, but provide the details and mechanics in the bylaws, so that they can be adjusted by the board without a shareholder vote.

d. Management Counterproposals

If a shareholder proposal is made, there is a potential advantage in putting forward a management counterproposal (*e.g.*, a counterproposal to ratify the existing threshold or adopt a reduced threshold that is higher than the shareholder's proposed ownership percentage) rather than letting the shareholder proposal come to a vote with no management alternative. If a 10% special meeting shareholder proposal comes to a vote and passes, the adoption of a provision with any higher threshold may be perceived as unresponsive by proxy advisory firms assessing director recommendations in the following year, even if the company adopts a provision that otherwise relaxes the requirements for exercising special meeting rights.[8]

On the basis of a conflicting management proposal, several companies have been able to exclude shareholder proposals to reduce special meeting thresholds. Notably, this season, the SEC granted "no-action" relief to both AES and Capital One under Rule 14a-8(i)(9), allowing the companies to exclude proposals from John Chevedden seeking a reduction of the existing ownership threshold from 25% to 10% in each case. In these no-action letters, the SEC concurred with the companies that the Chevedden

[8] ISS's FAQs indicate that a threshold above 10% will be deemed responsive only if the company finds through investor outreach that a different threshold is acceptable to its shareholders, and the company discloses these results in its proxy statement, along with the board's rationale for the threshold chosen. *See* ISS, U.S. Proxy Voting Procedures & Policies (Excluding Compensation-Related) FAQs, *available at* https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf/, at Question 40. Even then, ISS's analysis is on a case-by-case basis.

In addition, ISS takes a limited view of the permissible restrictions on the special meeting right, including the view that restrictions on agenda items are generally seen as negating the right to call a special meeting.

proposals conflicted with management counterproposals to ratify the existing 25% threshold, since a reasonable shareholder could not logically vote in favor of both.[9] These no-action letters appear to limit meaningfully the effect of Staff Legal Bulletin No. 14H (CF) ("SLB 14H"), which was issued in 2015 and narrowed the application of conflicting proposal exclusion by redefining the meaning of "direct conflict."

Companies seeking similar no-action relief in the future should be aware that this approach has attracted considerable criticism from ISS and the Council of Institutional Investors ("CII"). ISS issued a negative recommendation against the chair of the governance committee at AES, citing its belief that management created its counterproposal for the purpose of preventing the shareholder proposal from reaching a vote (AES's governance committee chair achieved only 67% shareholder support, whereas other nominees received at least 96%). In a January 31, 2018 letter to the SEC, CII expressed its disagreement with the grant of no-action relief to AES, arguing that the shareholder proposal to reduce the company's special meeting threshold had the potential to garner significant support or even pass, and that AES's approach was "exactly the kind of game-playing that prompted the SEC review that led to [SLB 14H] as the appropriate guidance for determining the proper scope of Rule 14a-8(i)(9)."[10] Whether or not in response to these objections, for Capital One and a number of other issuers requesting no-action relief on the basis of a conflicting management proposal, the SEC has conditioned relief on disclosure requirements, including the addition of statements to the effect that the company has omitted a shareholder proposal to adopt a lower threshold and that a vote for ratification is effectively a vote against a lower threshold. The SEC also required these companies to describe their plans in the event that shareholder ratification is not received, including any potential impact on the special meeting threshold.

2. Shareholder Right to Act by Written Consent

RIGHT TO ACT BY WRITTEN CONSENT							
Shareholder Proposals Submitted		***Shareholder Proposals Voted On***		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
2018 YTD	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***
39	16	***35***	15	***42%***	46%	***6***	3

After significant decreases in 2015, 2016 and 2017, the number of proposals requesting that the company grant shareholders the right to act by written consent increased significantly in 2018 as shareholder proponents shifted their attention away from proxy access. The vast majority of these proposals (90%) went to a vote. ISS recommended in favor of about 86% of the written consent proposals voted on in 2018, and the proposals, as usual, received relatively strong support levels. In 2018, six proposals (17%

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9 *See* the SEC's no-action letters to AES Corporation (Dec. 19, 2017) and Capital One (Feb. 21, 2018).

10 *See* CII's letter to the SEC, dated January 31, 2018, *available at* https://www.cii.org/files/issues_and_advocacy/correspondence/2018/January%202018%2014a-8(i)(9)%20FINAL.pdf.

of the total) have passed so far, compared to three (21% of the total) in all of 2017, although there was a decline in the level of overall support for these proposals.

The corporate laws of most states provide that shareholders may act by written consent in lieu of a meeting unless the company's certificate of incorporation provides otherwise. Commonly, public companies provide in their charters that shareholders may not act by written consent, or that they may act by written consent only if the consent is unanimous. The concern that companies have about giving shareholders the right to act by written consent is that the written consent process can frustrate the orderly and transparent debate on the merits that would occur if the proposed action were raised at a shareholder meeting.

In 2018, all the companies that had written consent proposals up for a vote already provided shareholders with the right to call a special meeting. Most stressed in their opposition statements that adopting a written consent provision would be unnecessary, and potentially detrimental to shareholder interests, in light of existing corporate governance structures and practices. The relatively low success rate of written consent proposals in both 2018 and 2017 seems to reflect continuing agreement by a majority of shareholders that special meeting rights adequately address this concern and render written consent rights unnecessary. When companies do implement a written consent right today, the right is often subject to a number of the same terms contained in market standard special meeting provisions, such as defined waiting periods, disclosure requirements (including disclosures to shareholders who are not solicited), holding requirements, and black-outs.

3. Proxy Access Proposals

	PROXY ACCESS							
	Shareholder Proposals Submitted[11]		***Shareholder Proposals Voted On***		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
	2018 YTD	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***
Adopt new right	***25***	61	***6***	28	***49%***	59%	***3***	18
Amend existing right	***29***	52	***25***	25	***28%***	28%	***0***	0

There was a dramatic decrease in the number of proxy access proposals voted on in 2018 compared to 2016 and 2017, when proxy access was the most common governance subject voted on. At this point, over 500 U.S. companies have adopted proxy access provisions, including 87% of S&P 100 companies and approximately two thirds of S&P 500 companies. Given the widespread and continued adoption of proxy access bylaws at larger companies, it is unsurprising that shareholders submitted significantly fewer proposals for the adoption of a new proxy access right this year.

[11] As further discussed below, the submission data discussed in this subsection includes our rough estimate of such proposals submitted by the New York City Comptroller, which is based on our independent research in addition to ISS data.

Over the past three years, there has been significant convergence in the terms of proxy access provisions adopted by companies, with the market standard now being a so-called 3/3/20/20 bylaw—that is, a threshold of 3% ownership for three years, a director cap of 20% of the board but no less than two, and a group limit of 20 shareholders. Continuing a trend that began in 2017, most companies receiving a proposal to adopt proxy access opted to adopt the market-standard bylaw before a vote, resulting in a near elimination of such proposals that reached a shareholder meeting in 2018 (six total, compared to 28 in 2017). The pass rate of these proposals decreased in 2018 (50%) compared to 2017 (64%). Once again, the proposals that did not receive majority support appear to have failed to due to idiosyncratic reasons.[12]

As more companies implement proxy access, some have expected to see a rise in shareholder proposals to amend existing proxy access rights. However, none of these proposals passed in 2017, and the number submitted this year decreased significantly (29 in 2018 compared to 52 in all of 2017). Over half of these proposals failed to reach a vote last year, but this year nearly 90% reached a vote. (Consequently, the number voted on so far this year was the same as the number for all of 2017.) As was the case last year, none of these proposals passed. These proposals did receive meaningful average support levels (28% in both 2018 and 2017), and ISS supported all of them. They generally sought to increase the director cap from 20% of the board to 25%, to remove or increase limits on the size of shareholder groups, and/or to remove various other limitations on the use of proxy access.

a. No-Action Requests

In appropriate cases, Rule 14a-8(i)(10) is available to exclude shareholder proposals to adopt or amend a proxy access bylaw as "substantially implemented." Throughout 2016 and 2017, the SEC generally allowed the exclusion of shareholder proposals for a new proxy access right if a company adopts a 3/3/20/20 provision, even if the company's bylaw contains terms that are different from the shareholder's proposal (for example, imposing a lower group size limit, so long as the ownership percentage and duration thresholds matched those proposed by the shareholder) or imposes additional requirements on proxy access (such as a "net long" definition of ownership or qualification requirements for nominees). With respect to proposals to amend a proxy access bylaw, the SEC has granted no-action relief on the basis of substantial implementation even where the company has not taken any action in response to the shareholder proposal, provided that the company can adequately demonstrate that the requested change would not significantly impact the company's provisions.

12 All three failed proposals were at companies with concentrated stock ownership. At one of the companies, the directors and executive officers controlled nearly 87% of the voting power, while at the other two companies, a single shareholder beneficially owned 62% and 25%, respectively, of the outstanding common stock.

Based on SEC correspondence made public to date, the number of companies seeking no-action relief on proxy access proposals seems to have declined since last year. James McRitchie, who contributed to a sizeable portion of the proxy access proposals submitted over the years, has commented that companies generally reached resolution with shareholder proponents this year "off the field" rather than filing a formal no-action request.[13]

Besides the sheer momentum that proxy access has gained over the last few years, one reason that a company may be less willing to rely on no-action requests this year could be a heightened sense of uncertainty after the SEC declined to grant no-action relief to H&R Block in both 2016 and 2017. After the SEC's July 2016 letter declining H&R Block's no-action request to exclude a shareholder proposal seeking elimination of the group size limit, some predicted that it would become more difficult to exclude shareholder proposals on the basis of substantial implementation as proposals increasingly shift from requests to adopt a new right to those seeking an amendment of an existing right. Shareholder proponents submitted a string of proposals through early 2017 to raise the group size limits specified under existing proxy access bylaws from 20 to 40 or 50 shareholders. The SEC had mixed responses to the first round of no-action requests to exclude these proposals, but beginning in March 2017, generally granted relief to companies that used shareholder composition data to demonstrate that the requested increase would not significantly change the availability of proxy access to shareholders.

H&R Block incorporated this line of reasoning into its no-action request when it faced another proposal to remove the group size limit in 2017. However, the SEC rejected H&R Block's request again.[14] Since then, some companies facing similar proposals, including Alaska Air, BorgWarner, Celgene and Raytheon, were denied no-action relief, while others, including Delta Air Lines, HCA Healthcare, JetBlue Airways and Northern Trust Corporation, obtained relief. Among those that obtained no-action relief, a few provided shareholder composition data to support their arguments,[15] while others simply cited the favorable no-action letters issued between 2016 and 2017 and/or the 20-shareholder group provisions adopted by the publicly traded parents of major institutional investors (*i.e.*, BlackRock, T. Rowe Price Group, Inc. and State Street Corporation).

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[13] *See* Bloomberg—Big Law Business, *Shareholder Proposals in 2018: Something Old, Something New*, *available at* https://biglawbusiness.com/shareholder-proposals-in-2018-something-old-something-new/ (Mar. 26, 2018).

[14] *See* the SEC's letter to H&R Block (July 21, 2017).

[15] Specifically, these companies provided data on share ownership by their institutional and other large investors to show that there are a number of ways for a combination of 20 shareholders to meet the ownership requirements for using the existing proxy access right.

b. NYC Comptroller Shifts Emphasis from Proxy Access Proposals

Another key driver of the drop-off in proxy access proposals this year was a shift in the priorities of the New York City Comptroller, the primary sponsor of proxy access proposals from 2015 to 2017. Last year, when proxy access was the most common type of proposal among major shareholder proponents, the New York City Comptroller, acting on behalf of pension funds for city employees, was the leader with proxy access proposals submitted to over 70 companies. This year, based on ISS data and other information we have examined, we estimate that the New York City Comptroller has submitted proxy access proposals to approximately 17 companies.[16]

Proxy access proposals have constituted the focal point of the corporate governance efforts of the New York City Comptroller since he launched the Boardroom Accountability Project in 2014. However, after announcing that the nationwide campaign to implement proxy access had achieved critical mass, the Boardroom Accountability Project transitioned to its second phase in September 2017.[17] The focus of this next phase is on increasing diversity, independence and competence on climate-related issues at the board level, especially among larger companies. On September 8, 2017, the Comptroller sent letters to 151 portfolio companies (80% of which are in the S&P 500) asking them to publish standardized annual disclosures on their board diversity (including in terms of skills, race and gender) and board refreshment process. All of the letter recipients had a proxy access provision or were expected to adopt one in response to a majority-supported proposal in 2017. The Comptroller has emphasized that the requested disclosures are intended to help shareholders "identify boards that are ill-suited to protect their investments due to a lack of diversity or relevant expertise," and will allow shareholders to more effectively exercise their new proxy access rights by recommending qualified, diverse and independent candidates.[18]

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[16] As of the date of this publication, the Office of the New York City Comptroller has not yet published its annual list of proposals for 2018. In the absence of the Comptroller's list, we have supplemented ISS data with independent research in order to provide a rough estimate of the number of proposals submitted by the Comptroller. In addition to the six companies identified by the ISS, we have identified 11 companies that likely received a proxy access proposal from the Comptroller during the 2018 proxy season based on a review of recently adopted proxy access bylaws. However, due to the limited information available to us at this time, our estimates may obscure actual patterns in the Comptroller's priorities.

[17] *See* New York City Comptroller, *Comptroller Stringer, NYC Funds: Boardroom Accountability Enters Next Phase As Campaign Achieves Critical Mass*, *available at* https://comptroller.nyc.gov/newsroom/comptroller-stringer-nyc-funds-boardroom-accountability-enters-next-phase-as-campaign-achieves-critical-mass/ (Apr. 26, 2016).

[18] *See* New York City Comptroller, *Comptroller Stringer, NYC Pension Funds Launch National Boardroom Accountability Project Campaign — Version 2.0*, *available at* https://comptroller.nyc.gov/newsroom/press-releases/comptroller-stringer-nyc-pension-funds-launch-national-boardroom-accountability-project-campaign-version-2-0/ (Sept. 8, 2017).

According to ISS data, the second phase of the Boardroom Accountability Project has resulted in only one formal proposal to disclose a board diversity and qualifications matrix so far. The proposal, which went to a vote of Exxon Mobile's shareholders on May 30, 2018, failed to pass, gaining only 17% of votes cast. While it remains to be seen whether the impact of the second phase of the Comptroller's campaign will be as widely felt as the first, it is possible that proxy access may become an important tool for the Comptroller and other shareholders to advance board composition issues such as director diversity and expertise on climate change and other matters that contribute to corporate sustainability.

c. Terms to Consider When Adopting or Amending a Proxy Access Provision

Issuers putting forth a new proxy access right or evaluating an existing right, either preemptively or in response to a proposal, may wish to consider the following terms:

- ***Market Standard Bylaw.*** As discussed above, the 3/3/20/20 bylaw has become the widely-adopted and well-established market standard for proxy access. Since 2017, shareholders have become increasingly focused on challenging certain aspects of the 3/3/20/20 bylaw, specifically, the total number of directors that may be nominated by proxy access and the limit on the number of shareholders that can aggregate their holdings to meet the three percent ownership threshold. The results of the 2018 proxy season indicate that a 3/3/20/20 proxy access provision continues to be resilient against proposals to amend it, and it is unclear whether the individual proponents that have advanced these amendment proposals will continue to do so, given the failure of any to pass in 2018 to date. It is possible that a company with perceived governance and board composition problems could see an amendment proposal pass in the future, and management should continue to monitor (and update the board as appropriate) on proxy access developments at peer companies and the views of the company's significant shareholders on proxy access, as well as governance and social responsibility topics in general.
- ***Group size limit.*** Among the "core" provisions of the 3/3/20/20 bylaw, the 20-shareholder group size limit may warrant the greatest attention. As discussed above, although proposals to increase or eliminate a market-standard group size limit appear unlikely to pass, proponents have continued to exert pressure on companies to increase, eliminate, or disclose additional shareholder composition data through the SEC no-action process. Issuers should stay up-to-date on trends in the SEC's no-action letters relating to proxy access proposals in general, as well as proposals relating to group size limits in particular. Issuers should also monitor its shareholder base on an ongoing basis, making sure that the drafting around the group size limit is appropriate in light of the company's particular circumstances and shareholder composition (for example, it is typical that related funds count as one shareholder for purposes of the group size limit).
- ***Minimum level of support for renomination.*** Many companies provide that a proxy access nominee will not be eligible to be renominated in subsequent years if he or she does not obtain a minimum level of shareholder support, typically between 10% and 25% of votes. These provisions are intended to reduce a waste of corporate resources on nominees who have proven themselves to be unpopular with shareholders.
- ***Proxy access creep.*** In order to ameliorate the risk of "proxy access creep," many companies provide that nominees who were recently elected via proxy access are counted towards the proxy access director cap when renominated by the board. In addition or as an alternative, companies may also impose a "cooling off" period on nominating shareholders after their nominees are elected via proxy access.
- ***Concurrent proxy contest.*** Most proxy access bylaws also include provisions that address the possibility of a shareholder (or group) engaging in the proxy access process and a proxy

contest at the same time to maximize the number of seats it could obtain. These provisions either prohibit a shareholder (or group) from exercising proxy access rights when it is engaging in a concurrent proxy context, or reduce the number of proxy access nominees that the shareholder (or group) may nominate for a particular annual meeting by the number of advance notice nominees submitted for the same meeting.

4. Independent Chair Proposals

INDEPENDENT CHAIR							
Shareholder Proposals Submitted		***Shareholder Proposals Voted On***		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
2018 YTD	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***
51	48	***44***	42	***32%***	30%	***0***	0

Once again, proposals requesting that companies separate the roles of CEO and chair, or that the chair be an independent director, were among the most common types of governance proposals submitted. Large companies have regularly received these proposals since the mid-2000s, and the slight year-over-year increase in the number of proposals on this topic reflects that certain shareholders still believe that having the CEO or another executive serve as chairperson may undermine the independence of the board as a whole. These proposals tend to receive significant shareholder support (generally 25% to 40%), but rarely pass. Only a handful each year managed to win majority support between 2012 and 2015, and none have passed since.

The continued low pass rate for these proposals is consistent with the view of many investors that having a lead independent director with suitably broad powers and responsibilities is an appropriate alternative to mandatorily separating the CEO and chair roles. Notwithstanding this background, ISS recommended in favor of about three quarters of proposals (up from about half in 2014). ISS support, however, has only limited impact on the voting results of these proposals at this point, suggesting that the strong overall market performance may have dampened some of the shareholder sentiment for change. In 2018, these proposals received 34% of votes cast on average with ISS support and 24% without it. In contrast to ISS, shareholders seem to take a more nuanced approach, basing their support for this proposal on company-specific issues, including the company's performance, other governance issues, and the merits of the individuals serving in the CEO, chair and/or lead director roles.

5. Majority Voting in Uncontested Elections, Elimination of Supermajority Thresholds and Board Declassification

	MOST SUCCESSFUL GOVERNANCE PROPOSALS							
	Shareholder Proposals Submitted		***Shareholder Proposals Voted On***		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
	2018 YTD	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***
Majority Voting in Uncontested Elections	***11***	22	***9***	15	***61%***	67%	***6***	10
Eliminate Supermajority Thresholds	***16***	14	***5***	14	***73%***	74%	***5***	13
Declassify Board	***8***	10	***4***	7	***80%***	68%	***4***	5

In previous years, the only common shareholder proposals that passed on a consistent basis have been proxy access and the three other governance proposals that have been widely adopted at large companies—majority voting in uncontested director elections (rather than plurality voting), elimination of supermajority voting thresholds to effect certain corporate actions (such as charter or bylaw changes or the removal of directors), and declassification of boards. Although proxy access proposals (which, as noted, mostly involved amendments) rarely passed this year, the three other types of governance proposals still managed to pass at almost every company where they reached a vote.

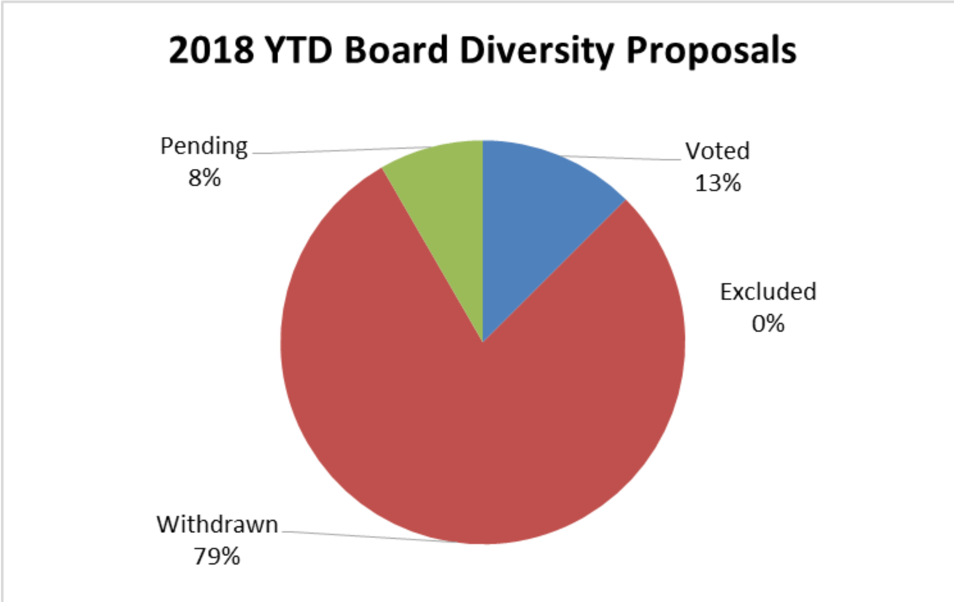
Around half of the proposals on these topics have been at non-S&P 500 companies this year. As shown in the charts in Section I.B, these governance reforms are common among large-cap companies, and have been steadily advancing at smaller companies as well (particularly majority voting). The widespread adoption of these practices has led to a sharp decrease in these proposals in recent years at both large- and smaller-cap companies. This year, the total number of these proposals continued to fall, and a lower percentage of each type of proposal reached a vote.

6. Proposals on Board Composition

a. Increase Board Diversity

INCREASE BOARD DIVERSITY							
Shareholder Proposals Submitted		***Shareholder Proposals Voted On***		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
2018 YTD	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***	***2018 YTD***	***2017***
24	26	***3***	8	***17%***	31%	***0***	2

So far in 2018, shareholders have submitted a comparable number of board diversity proposals (24) as they did in all of 2017 (26). As shown in the following chart, the vast majority of these proposals were withdrawn this year, consistent with 2017 (22 for both 2018 year-to-date and all of 2017). As a result, only three board diversity proposals reached a vote in 2018. None of the proposals passed, and the average vote result was significantly lower than last year. ISS supported one of the proposals. The results suggest that company-specific factors drove results in these cases.



The topic of gender diversity on boards has been a continuing and well-publicized focus of institutional investors and others. For example:

- State Street Global Advisors stated in its 2018 proxy voting and engagement guidelines that it expects boards to include at least one female director. If the board is all male, then State Street Global Advisors may vote against the chair of the board's nominating or governance committees.[19]
- BlackRock's 2018 proxy voting guidelines for U.S. securities state that BlackRock normally expects to see at least two women directors on every board.[20] In February 2018, BlackRock sent letters to all Russell 1000 companies with fewer than two female directors asking the companies to justify how their board diversity aligns with their long-term strategies.
- On August 31, 2017, Vanguard Group posted an open letter to directors of public companies worldwide stating that it expects boards to focus on gender diversity. The open letter praises the effects of gender diversity on board performance and states further that demonstration of meaningful progress on gender diversity over time will inform Vanguard Group's engagement and voting going forward.[21]
- Glass Lewis announced in its 2018 proxy guidelines that, beginning in 2019, it will recommend against the nominating chair of Russell 3000 companies with all-male boards.[22]
- A number of social investment entities, governance activists and other interested parties have formed advocacy groups, most notably the Thirty Percent Coalition, to engage with corporations and the public to advance the cause of board diversity.[23]

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19 *See* State Street Global Advisors, 2018 Proxy Voting and Engagement Guidelines: North America (United States & Canada) (Mar. 16, 2018).

20 *See* BlackRock, Proxy voting guidelines for U.S. securities (Feb. 2018).

21 *See* Vanguard Group's open letter to directors of public companies worldwide.

22 *See* 2018 Proxy Paper, Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice, *available at* http://www.glasslewis.com/wp-content/uploads/2018/01/2018_Guidelines_United_States.pdf.

Moreover, multiple state legislatures, including those of Massachusetts, California, Illinois, and Pennsylvania, have passed non-binding resolutions to encourage companies doing business within their states to increase gender diversity on boards, and other state legislatures are considering doing the same.

- ***California Senate Resolution No. 62***

Date adopted:	September 20, 2013
Companies covered:	Publicly held corporations in California
Target minimum # of women:	1 if board size is less than 5 2 if board size is 5-8 3 if board size is 9 or more
Target compliance date:	December 2016

- ***Illinois House Resolution HR0439***

Date adopted:	May 30, 2015
Companies covered:	Publicly held corporations in Illinois
Target minimum # of women:	1 if board size is less than 5 2 if board size is 5-8 3 if board size is 9 or more
Target compliance date:	May 2018

- ***Massachusetts Senate Resolution No. 1007***

Date adopted:	January 15, 2015
Companies covered:	All public and private companies doing business in Massachusetts
Target minimum # of women:	2 if board size is less than 9 3 if board size is 9 or more
Target compliance date:	December 31, 2018
Other actions that should be taken:	Adopt policies and practices designed to increase the gender diversity in their boards of directors and senior management groups and set goals by which to measure their progress Publicly disclose the number of women and total number of individuals on their boards Measure progress toward a goal of equal representation of men and women in leadership positions on an annual basis

- ***Pennsylvania House Resolution No. 273***

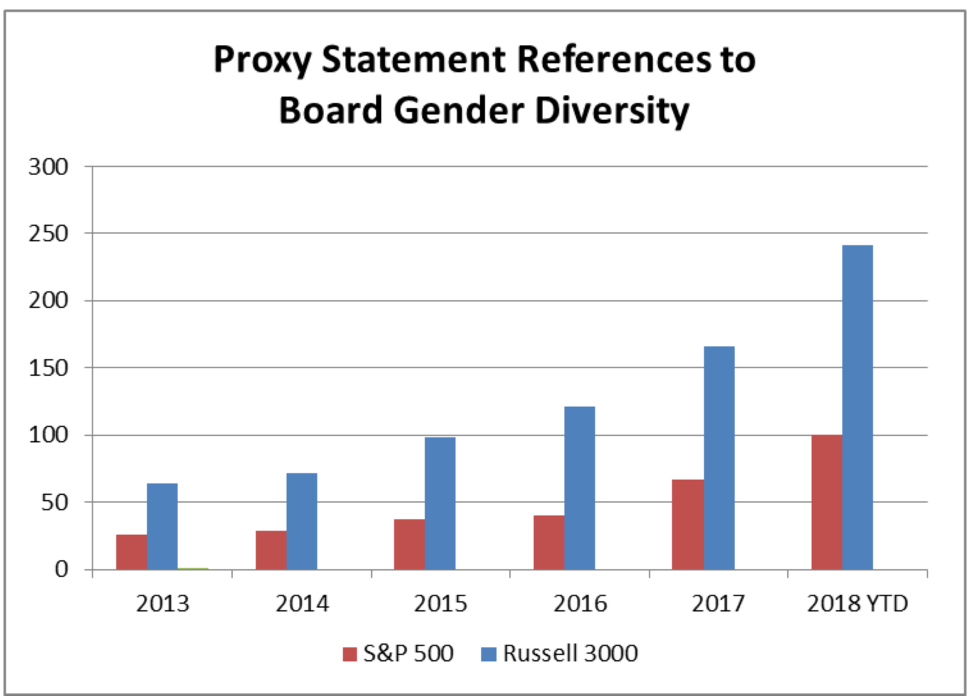
Date adopted:	April 25, 2017
Companies covered:	All nonprofit, privately held and publicly traded institutions and companies doing business in Pennsylvania

[23] The name of the Thirty Percent Coalition comes from its commitment to the goal of having women hold 30% of board seats across public companies. Information about the Coalition is available at https://www.30percentcoalition.org/.

Target minimum # of women:	30% of board
Target compliance date:	December 31, 2020
Other actions that should be taken:	Undertake a commitment to increase the gender diversity on their boards of directors and in senior management positions and set goals by which to measure their progress Measure progress toward a goal of equal representation of men and women in leadership positions on an annual basis

In addition to the non-binding resolutions noted above, on January 3, 2018, California Senators Hannah-Beth Jackson and Toni Atkins introduced California Senate Bill No. 826, which would require publicly held corporations with their principal place of business located in California to have one female director if their boards have fewer than five members, two female directors if their boards have five members, and three female directors if their boards have six or more members. The bill, which would be the first law of its kind in any U.S. state if enacted, passed the California Senate on May 31, 2018 on a 22-11 vote and is now before the California Assembly.

Gender diversity in particular has become an increasingly common topic for both large- and smaller-cap companies to address in their proxy statements, as they seek to respond to the greater focus on these issues by investors. The following chart, which presents the number of proxy statements that include the phrases "women on the board," "gender diversity" or "female directors," presents a partial picture of trends in proxy disclosures with respect to board gender diversity.



Female representation on boards has, in fact, been increasing in recent years, particularly at larger companies. In a May 2018 report, ISS noted that the percentage of new directors who are female was approximately 35% in the Russell 3000 and 39% in the S&P 500, reaching an all-time high.[24] However, smaller companies still lag behind in gender diversity. Approximately 90% of S&P 500 companies have two or more female directors compared to 58% of Russell 3000 companies.

The small number of shareholder proposals concerning board diversity that came to a vote in 2018, as well as the high withdrawal rate of these proposals, suggest that companies are making board gender diversity a priority in response to many of the above developments, eliminating the perceived need by shareholders to push for a vote on a specific proposal. In light of the current interest in this topic, companies should be prepared to engage with investors on diversity issues and, in particular, to articulate the principles by which the board considers gender, racial and other types of diversity in choosing a slate, the steps taken to ensure a diverse pool of potential nominees is considered, and how the board is considering this issue for the upcoming meeting.

b. Director Qualifications

DIRECTOR QUALIFICATIONS							
Shareholder Proposals Submitted		*Shareholder Proposals Voted On*		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
2018 YTD	*2017*	*2018 YTD*	*2017*	*2018 YTD*	*2017*	*2018 YTD*	*2017*
3	11	***3***	4	***14%***	11%	***0***	0

Shareholders submitted meaningfully fewer proposals on director qualifications this year than they did in 2017. Each year, there are a few of these proposals coming to a vote, but the number has declined from eight in 2012 (with two passing) to three in 2018 (with none passing). One of the three proposals voted on in 2018 called for the nomination of a director with environmental expertise, and the other two related to human rights expertise. None of the 2018 proposals received over 30% support. Of the two proposals that passed in 2012, one sought nomination of a corporate governance expert to the board and the other sought the adoption of director stock ownership requirements. No proposals of this type have passed since 2012.

c. Director Tenure

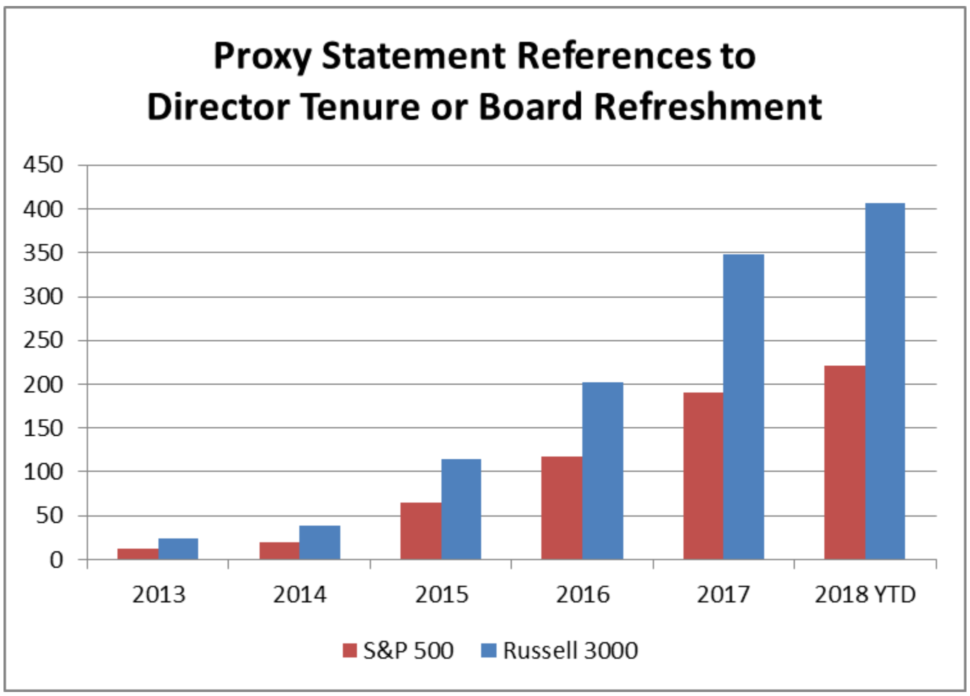
One aspect of board composition that is notable for its absence as a proposal topic is director tenure. The topic of director tenure has generated a significant amount of conversation in recent years. A number of investors, investor groups and governance commentators have queried whether there comes a point where a long-tenured director should not be seen as independent and whether mandatory term limits or retirement ages are advisable. In 2014, State Street announced that it may vote against directors

[24] Institutional Shareholder Services, "An Early Look at US 2018 Proxy Season Trends", Harvard Law School Forum on Corporate Governance and Financial Regulation (May 15, 2018).

(including the governance committee chair and/or long-tenured members of key committees) when the average board tenure or tenure of individual directors is excessive. ISS has included questions on director tenure in its annual investor survey in recent years, but did not do so its 2017-18 survey.[25] ISS also added factors on director tenure to its QualityScore ranking in recent years.

Companies and their shareholders tend to address this topic through proactive engagement, rather than through shareholder proposals seeking mandatory board refreshment or negative votes for long-tenured directors. Most institutional investors that set out policies on the topic assess the experience and attributes of the board as a whole and oppose bright-line rules such as age and term limits.

As one component of shareholder engagement, an increasing number of companies now include more meaningful explanations of the manner in which the board considers tenure in assessing board composition and choosing the management slate. The mounting attentiveness of large- and smaller-cap companies to disclosures on this topic is reflected in the steep rise over the past few years of references to "director tenure" and/or "board refreshment" in proxy statements, as shown below:



[25] *See* ISS, 2017-2018 ISS Global Policy Survey—Summary of Results, *available at* https://www.issgovernance.com/file/policy/2017-2018-iss-policy-survey-results-report.pdf.

7. Dual Class Voting

DUAL CLASS VOTING							
Shareholder Proposals Submitted		Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
2018 YTD	2017	2018 YTD	2017	2018 YTD	2017	2018 YTD	2017
10	13	***8***	10	***34%***	31%	***0***	0

Over the years, dual class voting has consistently ranked among the most controversial topics in corporate governance, and the debate became even more animated during the last 12 months. However, proposals to eliminate supervoting stock (either by adopting a recapitalization plan for all equity securities to have one vote per share or by converting the supervoting shares into low-vote shares) are typically among the least common types of governance-related proposals each year, which continued to be the case in 2018 despite the heightened public scrutiny. Eight such proposals came to a vote in 2018 so far, compared to 10 in all of 2017. These proposals received a higher level of shareholder support in 2018 (average support of 34%) than in 2017. Despite ISS's support for all of these proposals, none of them passed, which is not surprising because holders of supervoting stock tend to vote against them.

Proposals to reclassify supervoting shares do not reflect the full extent of the impact of the debate on dual class voting. For example, the increased scrutiny on dual class companies may translate into negative votes for directors. ISS's 2018 policy updates specifically provide for a negative director vote recommendation at newly public companies where the classes have unequal voting rights, as discussed further in Section II.B, and Glass Lewis's policy for evaluating dual-class companies' board responsiveness in 2018 will be based on a majority vote of the low-vote shares. In its 2017-2018 survey, ISS found that 43% of investor respondents considered unequal voting rights inappropriate for a public company under any circumstances, and the same proportion of investors believed that unequal voting rights might be appropriate for a newly public company subject to limitations such as an automatic sunset or periodic reapproval by holders of the low-vote shares. The position that companies should be allowed to choose any capital structure they see fit received significantly lower (5%) support among investor respondents.[26]

Dual class companies should also continue to monitor developments among index providers, especially because policies adopted recently by index providers could have a significant impact. Following Snap's IPO, S&P Dow Jones announced in July 2017 that it will no longer add new multi-class companies to its S&P Composite 1500 index, including the S&P 500.[27] Shortly thereafter, FTSE Russell announced that, unless public shareholders hold more than 5% of the total voting power, a dual-class company would not

[26] *See* ISS, 2017-2018 ISS Global Policy Survey—Summary of Results, *available at* https://www.issgovernance.com/file/policy/2017-2018-iss-policy-survey-results-report.pdf.

[27] *See* S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules, *available at* https://www.prnewswire.com/news-releases/sp-dow-jones-indices-announces-decision-on-multi-class-shares-and-voting-rules-300496954.html (July 31, 2017).

be eligible for inclusion on its indices after October 2017, provided that existing constituents are grandfathered and do not need to comply with these voting requirements until September 2022.[28] Exclusion from the indices could have a significant impact on a dual class company's shareholder base and its ability to raise capital, in particular, from passive funds that track the major stock indices. These policies have not been without criticism, in particular from large, institutional investors, who claim that excluding companies will lower returns.

Companies with dual class shares should also consider whether their disclosures on voting structure need to be updated. The SEC Investor Advisory Committee recommended that the SEC Division of Corporation Finance adopt rules to expand disclosure requirements regarding a company's dual-class share structure. Even though SEC Chairman Jay Clayton subsequently commented that addressing dual-class voting was not a near-term priority, he also indicated that disclosure regarding dual class voting would be a topic for further SEC discussion.

Furthermore, in February 2018, SEC Commissioner Robert Jackson called on stock exchanges to reconsider their listing rules regarding dual-class share structures, particularly "perpetual" dual class shares. Companies with dual class shares should monitor the policies and requirements of the stock exchanges on which their publicly traded shares are listed for any relevant developments.

8. Other Governance Proposals

Some less frequent and less successful governance-related proposals are addressed below:

- ***No Abstentions in Vote Counting*.** The past few years have seen a number of proposals asking that the general standard for shareholder action be "majority of votes cast" rather than the common standard, and Delaware default, of "majority of votes present at the meeting in person or by proxy and entitled to vote." The only difference is that in the latter case, the denominator includes abstentions, as well as "for" and "against" votes. Such a change would have little practical impact, as most shareholder proposals are precatory anyway, so the legal standard for passing is irrelevant. In addition, the number of abstentions (not to be confused with broker non-votes, which is where a broker is not entitled to vote, and so excluded from both standards) is generally small. Only one of these proposals came to a vote in 2018, compared to 10 in 2017. The lack of practical impact likely explains both the low frequency and low vote results for these proposals, which received an average of less than 10% support in 2017 and 2018. No proposal in either year came close to passing.
- ***Cybersecurity.*** In 2018, two cybersecurity related proposals were voted on, one of which related to governance (the other related to compensation, as further discussed below in Section I.F). On May 10, 2018, shareholders of Express Scripts Holding voted on the New York State Common Retirement Fund's proposal to provide a report on actions taken to mitigate cyber risks. The proposal failed to pass, but received ISS support and relatively high shareholder support level (30%). In light of the recent high-profile breaches at companies like Equifax, the public has been focused on cybersecurity and data privacy, and the SEC issued

[28] *See* FTSE Russell, Minimum Voting Rights Hurdle: Update to Ground Rules, *available at* http://www.ftse.com/products/downloads/Minimum_Voting_Rights_Hurdle_FAQ.pdf.

new guidance on cybersecurity disclosures in February 2018. Given the recent attention on this subject, shareholder proposals on cybersecurity issues may increase going forward.

F. COMPENSATION-RELATED SHAREHOLDER PROPOSALS

	COMPENSATION-RELATED PROPOSALS							
	Shareholder Proposals Submitted		Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
	2018 YTD	2017	2018 YTD	2017	2018 YTD	2017	2018 YTD	2017
Social compensation issues	***21***	12	***10***	7	***17%***	18%	***0***	0
Limit golden parachutes	***6***	8	***4***	8	***31%***	33%	***0***	0
Clawbacks	***11***	6	***7***	6	***40%***	14%	***0***	0
Stock retention	***1***	5	***0***	4	***N/A***	23%	***0***	0
Other compensation-related	***20***	14	***15***	8	***16%***	18%	***0***	0

Since 2012, there has been a steep decline in the number of compensation-related proposals, in large part a result of mandatory say-on-pay votes becoming the primary mechanism by which shareholders express concerns over executive compensation. This year, although more executive compensation-related proposals were submitted, the number voted on remained at levels similar to 2017. These proposals still tended to receive relatively low support and almost never pass.

The most common type of compensation-related proposal in 2018 sought to link executive compensation to social issues, such as sustainability or social or environmental impact. Shareholders submitted almost double the number of such proposals in 2018 (21 submitted) compared to 2017 (12 submitted). Unlike 2017, when most of the compensation proposals relating to social issues went to a vote, less than half of these proposals reached a vote in 2018 (10 total, including five proposals relating to the integration of drug pricing risks into compensation plans at pharmaceutical companies[29]). Five of the compensation proposals relating to social issues that did not go to a vote were withdrawn (all relating to sustainability as a performance measure), while the other six, covering a range of topics (mostly covering disclosure and reporting on compensation practices), were excluded. Proposals to limit golden parachutes (*i.e.*, acceleration of performance awards upon a change in control), to adopt clawbacks and to enhance executive stock retention requirements saw temporary increases in frequency and support levels in 2014 and 2015, but have since slowed to a trickle or, in the case of proposals on stock retention requirements, halted entirely.

[29] These included Bristol-Myers Squibb, AbbVie, Amgen and Eli Lilly and Company.

This year, one proposal on data privacy and cybersecurity as performance metrics for senior executive compensation went to a vote.[30] Although ISS did not support this proposal and it received only 11.6% shareholder support, recent regulatory changes, such as the recent SEC cybersecurity guidance referenced above and new data privacy laws (*e.g.*, the General Data Protection Regulation in the E.U.), may spur shareholders to submit more proposals of this type going forward, in particular if they consider a company's disclosures on issues relating to cybersecurity and/or data privacy to be outdated, overly generalized or otherwise lacking.

ISS supported 64% of the compensation-related proposals in 2018, and shareholder support averaged 25% for proposals where ISS recommended in favor, as compared to 9% for proposals where ISS recommended against. This year, ISS recommended in favor of all clawback-related proposals, up from 50% in 2017, which likely was responsible for much of the increase in average support for this proposal in 2018.

II. ANALYSIS OF ISS NEGATIVE RECOMMENDATIONS AGAINST DIRECTORS

As discussed in Section I.C above, majority voting provisions have become commonplace over the past decade, particularly among larger companies but increasingly among smaller ones as well. This widespread adoption, together with NYSE rule changes in 2009 that prevent brokers from exercising discretion to vote uninstructed shares in uncontested elections, has given more potency to negative recommendations on, and votes against, directors. "Withhold" or "against" votes on directors (whether they arise from the application of the voting policies of proxy advisory firms and shareholders or from active campaigns launched by dissident shareholders) can have significant effects on companies and their directors.[31] For companies that have majority voting in uncontested director elections, a director's failure to receive majority support will result in the director not being re-elected and trigger a director resignation policy.

More broadly, negative votes can cause reputational harm to individual directors and the company, discourage qualified directors from continuing to serve (or new qualified candidates from agreeing to be nominated), raise the company's profile as a target for shareholder activists and generally impair a company's public and investor relations efforts. If a director receives a majority negative vote, the

[30] Verizon received a request to assess the feasibility of using cybersecurity and data privacy as performance measures for senior executive compensation. The proposals went to a vote on May 3, 2018.

[31] SEC rules require that, even in an uncontested election, shareholders be given the opportunity to vote "against," or to "withhold" the grant of voting authority with regard to, a director. Typically, the option to vote "against" a director rather than "withhold" authority applies at companies with majority voting in uncontested director elections. In this publication, we refer to both types of votes as "negative" votes on the director or "votes against" the director.

continued service of that director and/or the failure to address the underlying cause for the majority negative vote may well result in a negative vote for other directors in the following year. Companies should therefore be aware of the primary reasons that shareholders may vote against specific directors, committee members and/or the board as a whole, and the likely impact of these reasons on voting results. A prior knowledge of what causes negative board recommendations from proxy advisors and negative votes from specific institutions also may, in some instances, enable the issuer to take preventive action, particularly in cases of non-attendance, overboarding and independence issues.

ISS's policies provide a number of reasons for recommending against directors.[32] In 2018, ISS issued negative recommendations against around 10% of directors in uncontested elections, totaling over 1,600 directors at more than 500 U.S. companies among the Russell 3000, compared to 1,095 last year. These negative recommendations had an appreciable effect on (or at least an appreciable correlation with) lower director support levels, with the average level of voter support being about 97% if ISS recommends "for" a director and 78% if ISS recommends "against" him or her. However, it remains relatively uncommon for directors to receive less-than-majority support—less than 2% of directors who received negative recommendations had more "against" votes than "for" votes in 2018. Although the number of directors who receive less-than-majority support is typically very low, the percentage was relatively significant for unilateral board action that reduces shareholder rights (14%), lack of responsiveness to shareholder concerns (13%), and insufficient responsiveness to say-on-pay proposals (8%).

The following table summarizes the frequency of ISS negative recommendations, the resulting shareholder vote and the number of directors receiving less-than-majority support during 2018 for U.S. Russell 3000 and S&P 500 companies, broken down by the rationale given by ISS for the negative recommendation.[33] The frequency of both negative recommendations and less-than-majority support were lower among the S&P 500—ISS issued negative recommendations against approximately 100 directors at U.S. S&P 500 companies in the first half of this year, and only one of these directors received less-than-majority support. Except as noted below in Section II.M, the rationales behind these negative

32 For convenience, we refer to recommendations against "directors" rather than "nominees" throughout this section. The vast majority of ISS negative recommendations are against incumbent directors, since new nominees will not be deemed responsible for past board actions (though could receive negative recommendations due to overboarding or independence concerns).

33 Data used in this section is based on information provided by ISS summarizing the rationales for around 75% of ISS's negative director recommendations at annual meetings of Russell 3000 and S&P 500 companies through June 20, 2018, supplemented by our own review of public filings and statements by issuers. Because this data captures most, but not all, negative recommendations, the absolute numbers are likely higher than those stated here, though the trends and comparative amounts are meaningful.

There is some overlap in the categories in this table because some directors received negative recommendations for more than one reason.

recommendations, as well as the average shareholder support for directors who received negative recommendations on each of these bases, were similar between S&P 500 and Russell 3000 companies.

	2018 ISS DIRECTOR "WITHHOLD" OR "AGAINST" RECOMMENDATIONS (U.S. RUSSELL 3000 COMPANIES)			2018 ISS DIRECTOR "WITHHOLD" OR "AGAINST" RECOMMENDATIONS (U.S. S&P 500 COMPANIES)		
	Number of Directors	*Average Shareholder Vote (% of Votes Cast)*	*Directors Receiving <50% of Votes Cast*	*Number of Directors*	*Average Shareholder Vote (% of Votes Cast)*	*Directors Receiving <50% of Votes Cast*
Independence issues (non-independent directors on key committees or failure to maintain a majority independent board)	642	88%	6	33	79%	0
Newly public company with adverse governance provisions not subject to a sunset	625	86%	7	4	76%	0
Absence of a formal nominating committee	235	90%	0	16	78%	0
Shareholders not permitted to amend bylaws	198	77%	4	20	77%	0
Poor attendance at board and committee meetings (<75%)	142	79%	8	13	70%	0
Compensation issues:						
• Lack of responsiveness to low say-on-pay vote	132	70%	10	19	85%	0
• Other compensation issues (with no 2017 say-on-pay vote)	25	73%	4	6	87%	0
• Other compensation issues (with 2017 say-on-pay vote)	95	80%	3	37	79%	0
Poison pill issues (*e.g.*, failing to obtain shareholder approval)	128	77%	4	3	76%	0
Overboarding	109	85%	0	12	78%	0
Lack of responsiveness to shareholder concerns (*e.g.*, failure to implement a successful shareholder proposal)	101	64%	13	15	72%	0
Failure of risk oversight due to pledging of shares by executives	74	87%	0	7	90%	0
Failure to address material weakness in internal controls	32	82%	1	4	62%	1
Taking unilateral action that reduces shareholder rights	21	71%	3	2	71%	0
General performance or oversight concern	16	71%	0	3	76%	0
Excessive non-audit fees paid to auditors, or failure to disclose a breakdown of fees	18	70%	1	0	N/A	0
Failure to opt out of amendment to Indiana law resulting in classified board	3	80%	0	3	80%	0

A. BOARD INDEPENDENCE

The most common rationale for a negative ISS recommendation against a director in 2018 related to independence issues, which was also the case in 2017 and 2016. ISS will recommend against directors that it deems non-independent if, among other things, they serve on the audit, compensation or nominating committee or if the board is not made up of a majority of independent directors under the ISS independence standards (which are, in some circumstances, more stringent than the company's own independence policies or applicable stock exchange rules).

Directors in this category received average shareholder support of 88% of votes cast in 2018, and only six out of 642 such directors received less-than-majority support. This suggests that shareholders do not necessarily view a violation of ISS's strict independence standards as a significant concern. Given the varying independence definitions used by proxy advisory firms and certain institutional investors, companies may wish to consider including in the board's annual independence review process some discussion of whether any particular relationships are expected to trigger adverse recommendations or votes from proxy advisory firms or from the company's significant shareholders. Boards are, of course, in no way required to comply with the director independence definitions of these parties, but an assessment of perceived independence issues under these definitions can help the company identify and prepare for potential adverse votes from shareholders.

B. NEWLY PUBLIC COMPANY WITH ADVERSE GOVERNANCE PROVISIONS

The second most common basis for ISS negative recommendations related to adverse governance provisions at newly public companies not subject to a sunset, which was also the case in 2017 and 2016. As confirmed in its policy updates for meetings on or after February 1, 2018, ISS will generally vote against or withhold from individual directors, committee members or the entire board (except new nominees, who are considered case-by-case) if, prior to or in connection with the company's initial public offering, the company or its board adopted bylaw or charter provisions materially adverse to shareholder rights, or implemented a multi-class capital structure in which the classes have unequal voting rights. The factors that ISS will consider include:

- the level of impairment of shareholders' rights;
- the disclosed rationale;
- the ability of shareholders to change the governance structure;
- whether the company has a classified board structure; and
- any reasonable sunset provision.

While the policy itself does not define "newly public," ISS has stated in an FAQ that this policy applies to companies that held their first annual meeting as a public company on or after February 1, 2015.[34]

[34] See ISS, U.S. Proxy Voting Procedures & Policies (Excluding Compensation-Related) FAQs, *available at* https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf/, at Question 54.

In 2018, in the vast majority of cases, the reason for the negative recommendation was a failure to remove, or subject to a reasonable sunset, dual class voting rights, supermajority voting requirements and/or a classified board structure.

The average support level for directors in this category was 86%, and only seven out of 625 directors in this category received less-than-majority support (each of whom also had less than 75% attendance or had unilaterally amended the articles of incorporation or bylaws, which are more impactful rationales, as discussed below). Based on these results, directors at companies that have gone public with dual class stock, classified boards and/or supermajority voting provisions are likely to face reduced support levels, but do not face significant risk of receiving less-than-majority support. The relatively low impact on voting results may be due, in part, to the fact that newly public companies are more likely to have a large portion of shares held by insiders.

C. LACK OF FORMAL NOMINATING COMMITTEE

The absence of a formal nominating committee also continued to be a common basis for a negative recommendation. Under ISS's policies, this will trigger a negative recommendation for all non-independent directors, even if these responsibilities are undertaken by the independent directors as a group, as permitted for listed companies under Nasdaq rules. At a small number of companies, the negative recommendation was also based on the lack of a formal compensation committee, though this is less common than it was in the past, now that NYSE and Nasdaq rules require listed companies to have formal compensation committees. As noted in the table above, ISS issued 235 negative recommendations for this reason in 2018—even more than the number issued in 2017—but directors in this category still generally received high levels of shareholder support, indicating that shareholders generally do not share ISS's concerns in this regard. There were no directors in this category with less-than-majority support, and the average support level for directors in this category was 90%.

D. SHAREHOLDER INABILITY TO AMEND BYLAWS

As confirmed in its policy updates for meetings on or after February 1, 2018, ISS will recommend against members of the governance committee of companies where shareholders do not have the right to amend the bylaws. Only a handful of states permit companies to deny shareholders the right to amend the bylaws—of the 76 companies whose directors received negative recommendations for these reasons, 63 companies (the majority of which are real estate investment trusts) are organized in Maryland, eight in Indiana, two in Texas, two in Delaware, and one in Utah.

The policy, which ISS adopted last year, is somewhat unusual in that it results in negative recommendations even in the absence of any recent action by the board to reduce shareholder rights, and in the absence of any proposal or other action by shareholders of a particular company indicating their discontentment with the bylaw restriction.

A total of 198 directors at these 76 companies received negative recommendations on this basis, but only four such directors received less-than-majority support (all of whom had other rationales for their negative recommendations as well). The average support level for directors in this category was 77%. In late 2017, several companies adopted provisions that permit direct bylaws amendments by a holder (or a group of up to five shareholders) of 1% of outstanding shares continuously for one year. This year, ISS issued negative recommendations against the governance committee members of at least two such companies, AvalonBay Communities and CoreCivic, in each case citing its opinion that the restrictions on shareholders' ability to amend bylaws were excessive.

E. POOR ATTENDANCE

ISS will recommend a negative vote in the case of a director that attended less than 75% of all board and committee meetings in the relevant year. This was a significant issue for shareholders in prior years, with 10 of 26 directors in this category receiving a majority of "against" votes. This year, despite the number of directors in this category increasing to 142 directors, only eight received a majority of "against" votes and the average level of support for directors rose to 79% from 67% in 2017. It appears that issuers have become more sensitive to this issue and have been including more comprehensive disclosure regarding the reasons for director absence. Notably, it appears that shareholders remain highly concerned about directors with multiple years of poor attendance absent the disclosure of an acceptable reason for their absences. Such directors often received the lowest support levels—as low as 29% in 2018.

F. COMPENSATION ISSUES

A total of 252 directors received negative recommendations from ISS in 2018 for compensation-related reasons, nearly doubling the number in 2017.

- ***Non-responsiveness to low 2017 say-on-pay vote.*** One hundred thirty-two (132) directors were at companies that received less than 70% support on the previous year's say-on-pay vote, where ISS determined that the companies failed to respond (or to disclose that they responded) adequately to the underlying concerns through shareholder outreach and changes in compensation programs.[35] The number of directors in this category increased from 38 in 2017, becoming the most common reason this year for a compensation-related negative recommendation from ISS. The average level of shareholder support for directors in this category was among the lowest of any category, with 10 of these 132 directors receiving less-than-majority support. These results reflect the importance for companies with low say-on-pay results to focus their efforts on engaging in shareholder outreach efforts, and disclosing those efforts and any resulting compensation changes in their next proxy statement, to demonstrate to ISS and shareholders that management has taken action with respect to the prior year's vote.
- ***Compensation concerns and no 2018 say-on-pay vote.*** Twenty-five (25) directors (less than half the number in 2017) who received negative recommendations from ISS for compensation-related reasons were at companies that did not have a 2018 say-on-pay vote.

[35] ISS's policy is to vote case-by-base on compensation committee members (or, in exceptional cases, the full board) if the company's prior year say-on-pay vote receives less than 70% support, taking into account the company's response (among other factors).

Under ISS's policies, if a company does not have a say-on-pay proposal up for a vote in a particular year, ISS will direct its concerns on compensation issues toward director recommendations (typically against the compensation committee, though "in exceptional cases" ISS will recommend a vote against the full board). The rationales for the negative recommendations in these cases, therefore, were generally consistent with those that would drive negative say-on-pay results as discussed in Section III, including a disconnect between pay and performance, or the inclusion in compensation arrangements of tax gross-up rights or single-trigger severance arrangements. The average level of shareholder support was 73%, with four of the 25 directors in this category receiving less-than-majority support.

- ***Egregious compensation issues.*** A total of 95 directors (more than four times the number in 2017) received negative recommendations due to compensation-related concerns, despite the company having a 2018 say-on-pay proposal up for a vote. Under ISS's policies, it will recommend against compensation committee or board members in these circumstances only for "egregious" compensation concerns. For these companies, ISS cited persistent poor or troubling compensation practices over a multi-year period and the granting of CEO pay incentives that were not strongly linked to company performance, such as discretionary bonuses in the form of stock awards that vested immediately as well as equity awards that were entirely time-based. The average level of shareholder support in these cases was 80%, with three directors receiving less-than-majority support.

G. POISON PILL ISSUES

In 2018, poison pill issues became one of the most common reasons for a negative recommendation—the total number of directors in this category more than quadrupled from 31 in 2017 to 128 this year. This increase was attributable to ISS's new policies on poison pills. As set out in its policy updates for meetings on or after February 1, 2018, ISS will recommend against directors at a company for each year that the company maintains a poison pill with a term of more than 12 months, as opposed to once every three years under the previous policies. In addition, ISS no longer considers a company's commitment to obtain shareholder approval in the following year a mitigating factor, and has eliminated the grandfathering of long-term poison pills that were put in place before ISS adopted its previous policies. Instead, ISS's updated policy is to recommend against all director nominees (except new nominees, who are considered case-by-case) if the company has in place, or makes any material adverse modifications (*e.g.*, extends, renews or lowers the triggering threshold) to, a poison pill that has not been approved by shareholders. ISS will continue to evaluate poison pills with terms of 12 months or less on a case-by-case basis, but will focus on the company's reason for adopting the pill and factors such as a commitment to put any renewal to a shareholder vote instead of the company's overall governance practices.

Despite the policy change and the dramatic increase in the total number of directors that received a negative recommendation on this basis, in both 2018 and 2017, directors in this category had average voter support of 77%, with only 3% (four and one total in 2018 and 2017, respectively) receiving less-than-majority support. The directors in this category that received less-than-majority support had several other reasons underlying their negative recommendations, including an ongoing lack of responsiveness to shareholders' concerns as well as non-independence on key board committees.

H. OVERBOARDING

ISS will recommend a negative vote in the case of directors who:

- sit on more than five public company boards; or
- are the CEOs of public companies and sit on more than two public company boards besides their own.

In addition, there are similar overboarding standards used by Glass Lewis and other institutional investors. For example, even though Glass Lewis imposes the same limit of five public company board memberships on non-executive directors, it will generally recommend voting against executive directors who serve on more than two public boards (including their own). Similarly, BlackRock's 2018 policies provide that it will consider CEO directors who serve on more than two public boards (including their own) overboarded, but has a lower threshold for non-executive directors (four total public company board memberships) than either ISS or Glass Lewis. Given these varying overboarding standards, it is especially important for companies to provide appropriate disclosure on director nominees who serve on multiple outside public boards, including disclosures on the nominees' duties, responsibilities and capacity to focus on each board's requirements. In clarifying its overboarding analysis for directors who serve in executive roles other than CEO (*e.g.*, executive chair), Glass Lewis stated in its 2018 guidelines that it will "evaluate the specific duties and responsibilities of their executive role in addition to the company's disclosure regarding that director's time commitments."[36]

Compared to prior years, investors generally seemed to be less concerned with director overboarding than ISS has been in 2018. Although the total number of directors who received a negative recommendation on this basis increased from 40 in 2017 to 109 in 2018, none received less-than-majority support this year (compared to four last year). The average support level for directors in this category also increased (85% in 2018, compared to 78% in 2017).

I. BOARD RESPONSIVENESS TO SHAREHOLDERS

Typically, ISS makes a negative recommendation related to a lack of "responsiveness" if the board has failed to act on a successful shareholder proposal from a prior year or failed to address the underlying issue that led to a director receiving a majority "against" vote.[37] The total number of directors in this category increased from 26 in 2017 to 101 this year, although responsiveness concerns still did not rank among the top reasons for a negative recommendation.

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[36] *See* 2018 Proxy Paper, Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice, *available at* http://www.glasslewis.com/wp-content/uploads/2018/01/2018_Guidelines_United_States.pdf.

[37] See Section II.F for discussion of a third type of nonresponsiveness—a perceived failure to take sufficient steps to address receiving less than 70% support on the prior year's say-on-pay vote. This too had a significant impact on director support levels.

As the above discussions show, the impact of a negative ISS recommendation varies considerably depending on the reason for the recommendation. A lack of responsiveness continues to be one of the most impactful recommendations against incumbent directors, and it seems that shareholders as a whole tend to take this issue particularly seriously—as was the case in 2017, directors in this category received the lowest support (an average of only 64% of votes) of any category. Nearly a quarter of directors who received a negative recommendation in this category last year, as well as 13% of the directors in this category this year, received less-than-majority support. Given the significant impact on voting results for directors in this category, issuers should take such responsiveness concerns very seriously.

J. PLEDGING BY INSIDERS

Under ISS's policies, any amount of hedging or the significant pledging of stock by directors or executives will be viewed as a "failure of risk oversight" that can lead to recommendations against some or all directors (commonly audit committee members). ISS's FAQs provide that a "significant level of pledged company stock is determined on a case-by-case basis by measuring the aggregate pledged shares in terms of common shares outstanding or market value or trading volume."[38]

ISS does not provide a bright-line percentage that will be considered "significant" for these purposes as compared to shares outstanding, market value or trading volume. Based on our review of the relevant proxy statements and other filings, these negative recommendations were made at companies where the amount of stock pledged by insiders ranged from 3% to 85% of a class of outstanding stock, broken down as follows:

Pledged Shares as a % of Outstanding Class	*Number of Companies at Which Directors Received Negative Recommendations*
3%-10%	8
10%-20%	5
20%-30%	0
30%-40%	3
Over 40% (highest being 85%)	3

In a number of cases, the proxy statements for these companies describe newly adopted anti-pledging policies (with exceptions for pledges already in place), and detail efforts and commitments by insiders and companies to manage down the amount of insider pledging. This is typically in response to similar negative director recommendations from ISS and others in past years. Even for companies that are taking

38 *See* ISS, U.S. Proxy Voting Procedures & Policies (Excluding Compensation-Related) FAQs, *available at* https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf, at Question 62. ISS notes, however, that it deems *any* pledging of stock by an insider not to be a responsible use of company equity. Any amount of pledged stock by a director or officer will be a negative factor in the company's corporate governance rating under ISS's QualityScore rating system.

these actions, ISS will continue to recommend against directors if the amount of pledged shares is significant.

There are instances where pledged shares amounted to over 5% of the outstanding stock but ISS did not issue a negative recommendation; for example, ISS has issued a cautionary note, rather than a negative recommendation, at a company where insiders had pledged shares representing 7.5% of the outstanding stock. This is likely due to the company having a higher trading value and/or market cap than other companies, as these are also factors in ISS's analysis.

In both 2018 and 2017, directors at 18 companies received negative recommendations due to pledging by insiders, although the total number was up from 51 to 74. Support for these directors remained high, averaging at approximately 87%. None received less-than-majority support.

In most cases, the negative recommendations were made against the incumbent members of the audit committee, given this committee's typical responsibility for risk management. The only exceptions were at companies where the proxy statement expressly states that risk oversight is a function of the full board; in those cases, all incumbent directors received negative recommendations.

Although ISS's policies also call for negative recommendations if there is *any* hedging by insiders (not just a "significant" amount as with pledging), no directors have received negative recommendations on that basis (due, perhaps, to the fact that, unlike pledging, there is no proxy requirement to disclose specific hedging arrangements by insiders, although such information is often available on Forms 4).

K. MATERIAL WEAKNESS ISSUES

ISS's policies state that it will vote on a "case-by-case" basis in the event of "poor accounting practices," which include material weaknesses identified in Sarbanes-Oxley Section 404 disclosure. In fact, all situations where ISS issued a negative recommendation for accounting practices in 2018 involved a perceived failure to address material weaknesses, such as in internal controls, in consecutive years. A total of 32 directors (generally audit committee members) received a negative recommendation for this reason in 2018, but only one received less-than-majority support. Directors in this category averaged support levels of 82%.

L. UNILATERAL ACTION BY THE BOARD

In 2016, ISS adopted a policy to vote against directors who unilaterally adopt certain bylaw provisions or amendments to the articles of incorporation that materially limit shareholders rights. In 2018, the unilateral actions that spurred this recommendation included limiting shareholders' rights to amend the bylaws, adopting a classified board structure and providing that directors may only be removed for cause, among other issues.

The average support level for directors who received negative ISS recommendations due to the unilateral adoption of provisions that limit shareholder rights was 71% in 2018, and three directors received less-than-majority support. Although this suggests that, in some cases, shareholders do not view a violation of ISS's standards for these actions as a significant concern, the particular circumstances of the individual issuers may be more relevant. For example, issuers with high insider holdings or supportive investors may be more likely to adopt such changes because they are less concerned about the impact of a negative recommendation.

M. EXCESSIVE NON-AUDIT FEES

Under ISS policies, it will generally recommend shareholders vote against or withhold from members of the audit committee if the non-audit fees paid to the auditor are excessive, the company receives an adverse opinion on its financial statements from its auditor, or the audit committee entered into an inappropriate agreement with its auditor that would limit the ability of the company or shareholders to pursue legitimate legal recourse against the audit firm. ISS will vote on a case-by-case basis against members of the audit committee or the full board if poor accounting practices rise to the level of serious concern, such as fraud, misapplication of GAAP, or material weaknesses identified in Section 404 disclosures.

Though ISS only issued 18 negative recommendations in this category, shareholders appeared to take note, with directors at companies that had paid excessive non-audit fees to auditors or failed to disclose a breakdown of such fees gaining only 70% of shareholder support on average. One of these directors received less-than-majority support from shareholders. Given the low support for directors who received negative recommendations in this category, companies should evaluate their procedures for approving non-audit services performed by their auditors. Under ISS guidelines, non-audit fees are excessive if they exceed the sum of audit fees, audit-related fees and fees associated with the preparation of original and amended tax returns and refund claims and tax payment planning. (ISS includes any other services in the tax category, such as tax advice, planning, or consulting, as non-audit.)

N. TRENDS AMONG THE S&P 500

Among directors at U.S. S&P 500 companies, the most common rationales for a negative recommendation from ISS were generally the same as for the Russell 3000, with a few exceptions. Compensation issues (62 at S&P 500 compared to 252 at Russell 3000), independence issues (33 at S&P 500 compared to 642 at Russell 3000) and shareholder inability to amend bylaws (20 at S&P 500 compared to 198 at Russell 3000) each represented a significant portion of the total number of negative recommendations at both the U.S. S&P 500 and Russell 3000 companies. On the other hand, adverse governance provisions at newly public companies not subject to a sunset (four at S&P 500 compared to 625 at Russell 3000), absence of a formal nominating committee (16 at S&P 500 compared to 235 at Russell 3000), poison pill issues (three at S&P 500 compared to 128 at Russell 3000), and poor attendance at meetings (13 at S&P 500 compared to 142 at Russell 3000) were among the top rationales for negative recommendations at Russell 3000 companies but rarely lead to negative recommendations at S&P 500 companies.

Shareholder support levels typically followed similar trends among the S&P 500 and Russell 3000 companies, with the difference in average shareholder support for most categories remaining within 5%. However, there were a few notable exceptions, even after taking into account the possibility of distortion due to the smaller size of the S&P 500 data set. Compared to Russell 3000, the average shareholder support was significantly higher at S&P 500 companies for directors who received negative recommendations for a company's lack of responsiveness to a low 2017 say-on-pay vote (85% at S&P 500 compared to 70% at Russell 3000), other compensation issues and absence of a say-on-pay vote (87% at S&P 500 compared to 73% at Russell 3000), and lack of responsiveness to shareholder concerns, including failures to implement a successful shareholder proposal (72% at S&P 500 compared to 64% at Russell 3000). The higher support levels at the S&P 500 companies underscore the importance of well-tailored disclosures on compensation and shareholder engagement issues, since these companies as a whole tended to provide proxy materials that specifically addressed these issues and/or clearly conveyed the companies' efforts to implement best practices that suit their particular circumstances.

In contrast, with respect to directors who received a negative recommendation due to concerns regarding their ability to discharge the responsibilities of public company board service (*i.e.*, poor attendance, overboarding and failure to address material weaknesses in internal controls, items that are generally required to be disclosed in SEC filings), shareholder support at S&P 500 companies tended to be significantly lower than at Russell 3000 companies. In particular, directors who received a negative recommendation due to poor attendance (*i.e.*, failing to attend a minimum of 75% of board and/or committee meetings) received the lowest average shareholder support (70%) among S&P 500 companies (compared to 79% at Russell 3000 companies). Investors at large-cap companies also seemed to be more concerned about director overboarding (78% average support at S&P 500 compared to 85% at Russell 3000) and failures to address material weaknesses in internal controls (62% at S&P 500 compared to 82% at Russell 3000). The only S&P 500 director who failed to gain a majority of shareholder support after receiving a negative recommendation received the recommendation for failing to address material weaknesses.

III. SAY-ON-PAY VOTES

A. COMPANIES MAINTAIN STRONG SAY-ON-PAY PERFORMANCE

The following table summarizes the 2017 and 2018 say-on-pay voting results for meetings at U.S. S&P 500 and Russell 3000 companies through June 30, 2018:

	Russell 3000		S&P 500	
	2018	2017	2018	2017
Percentage passed (majority support)	**97%**	99%	**98%**	99.5%
Percentage with >70% support	**92%**	94%	**93%**	94%
Percentage with ISS "Against" recommendations	**13%**	12%	**10%**	9%
Average support with ISS "For" recommendations	**95%**	95%	**94%**	94%
Average support with ISS "Against" recommendations	**66%**	70%	**62%**	69%

U.S. companies, broadly speaking, had similar results on say-on-pay votes in 2018 as compared to 2017 and other recent years, with the vast majority of companies achieving high levels of support. In addition, say-on-pay results between the U.S. S&P 500 companies and the U.S. Russell 3000 companies have largely converged.

Although there has been a slight increase in the percentage of failed votes (*i.e.*, votes with less-than-majority support) in 2018 to date, very few say-on-pay votes overall came close to failing, consistent with prior years. The generally low rate of negative results is a result of the efforts that companies have made to engage with shareholders and address concerns through changes in compensation practices and clearer compensation disclosure. Companies, shareholders and shareholder advisory firms all have become more adept at effective off-season communications where the company can obtain feedback on the most recent voting results, as well as set expectations and hear concerns for the coming year.

There continues to be significant year-over-year turnover in failed votes. However, this year, the number of companies that failed their say-on-pay vote after failing in the previous year was meaningfully higher than in the past. Of the 22 companies that failed their say-on-pay votes in 2017 and have had their 2018 vote, only 13 achieved majority support in 2018, and only nine had support levels over 70%. Although companies with failed votes generally have been able to be successful in engaging in, and disclosing, shareholder outreach efforts and, as appropriate, implementing program changes in a way that brings high support levels in future years, this year's results may suggest that low say-on-pay votes have become stickier.

Of the 50 companies in the Russell 3000 that failed say-on-pay votes in 2018 so far, only 10 had failed their 2017 vote, and 24 had support levels over 70% in 2017. The seven S&P 500 companies that failed say-on-pay in 2018 so far had support levels ranging from 66% to 99.7% in 2017. These reversals of results highlight the importance of continuous attention to compensation reporting and related shareholder concerns. Companies should be aware that the metrics that impact levels of say-on-pay support are endpoint sensitive and can change significantly year-to-year.

Increasingly, off-season shareholder outreach has become a regular feature of corporate governance and shareholder relations for many large companies, facilitating an open dialogue between issuers and investors on compensation and other key topics. Shareholder outreach takes various forms at different companies, including face-to-face meetings, one-on-one phone calls, group conference calls and web meetings, and, in some cases, includes board members. Companies conducting such outreach must be mindful that company representatives may not disclose material non-public information in these discussions due to selective disclosure concerns under Regulation FD.

Companies should ensure that the appropriate personnel at institutional clients are involved in the discussions and the decision process—often institutional investors have both governance experts and investment professionals, each of whom will have critical input into the voting process, but may have differing views. Companies should also ensure that the appropriate company representatives are part of discussions with institutional investors. Board representation in discussions with large investors, especially on topics such as succession planning or executive compensation, may be appropriate but should be evaluated on a case-by-case basis, taking into account the purpose of the meeting and the preferences of the investor with whom the company is engaging.

Companies have increasingly engaged with proxy advisory firms in the off-season as well. ISS[39] and Glass Lewis[40] post their engagement policies on their websites. The policies of both firms restrict their ability to engage with companies during the solicitation period for the annual meeting, which means broader discussions with these firms must occur in the off-season.

As discussed above, recommendations from proxy advisory firms continued to influence voting results this year, and the role of proxy advisory firms and their impact on shareholder voting continue to attract debate and legislative reform efforts. The Corporate Governance Reform and Transparency Act, which was approved by the U.S. House of Representatives in December 2017 but has not yet been approved by the Senate, would require proxy advisory firms to register with the SEC and provide issuers with greater opportunity to preview, and more time to respond to, the firms' reports. While it is unclear to what extent any such reforms would affect the role and impact of these firms, companies should closely monitor the progress of these efforts.

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39 ISS's engagement policies are available at http://www.issgovernance.com/policy/EngagingWithISS.

40 Glass Lewis's engagement policies are available at http://www.glasslewis.com/for-issuers/glass-lewis-corporate-engagement-policy/.

For a more detailed discussion on trends in shareholder engagement, institutional investor influence and shareholder activism, see our publication, dated March 26, 2018, entitled "Review and Analysis of 2017 U.S. Shareholder Activism."

B. OVERALL ISS APPROACH ON SAY-ON-PAY EVALUATION

ISS has a multipronged approach to assessing executive compensation for the purposes of recommending a vote for or against the management say-on-pay proposal.[41] However, an analysis of ISS's 2018 negative recommendations for S&P 500 companies suggests that the most important criterion continues to be the pay-for-performance assessment, and that the most important factor under this pay-for-performance assessment is the alignment of CEO pay with Total Shareholder Return (or TSR) in relation to the ISS-determined peer group.[42]

ISS's policies provide that it will recommend a vote against a company's say-on-pay proposals if any of the following is true:

- there is a significant misalignment between CEO pay and company performance (pay-for-performance);
- the company maintains significant problematic pay practices (for example, excessive change-in-control or severance packages, benchmarking compensation above peer medians, repricing or backdating of options, or excessive perquisites or tax gross-ups); or
- the board exhibits a significant level of poor communication and responsiveness to shareholders.

ISS applies these standards by assigning companies a "high," "medium" or "low" level of concern for each of the five evaluation criteria listed in the following table, which shows the number of "high concerns" under each criterion for U.S. S&P 500 companies that received a negative say-on-pay recommendation from ISS in 2018:[43]

[41] Glass Lewis's executive compensation assessment policy appears to be less formulaic than ISS's, though Glass Lewis publicly discloses less detailed information about its policy than ISS does. Based on Glass Lewis's published information, it evaluates compensation based on five factors: overall compensation structure, implementation and effectiveness of compensation programs, disclosure of executive compensation policies and procedures, amounts paid to executives and the link between pay and performance. In evaluating pay for performance, Glass Lewis looks at the compensation of the top five executive officers, not just the CEO. In addition, Glass Lewis looks at performance measures other than total shareholder return—it measures performance based on a variety of financial measures and industry-specific performance indicators. See http://www.glasslewis.com/wp-content/uploads/2018/01/2018_Guidelines_United_States.pdf for more information.

[42] Of the 41 S&P 500 companies that received negative ISS recommendations in 2018, nearly all warranted "high concern" on their pay-for-performance assessment, indicating a misalignment between CEO pay and company performance.

[43] The numbers for the categories add up to more than the total because some companies received "high concerns" in more than one category.

	U.S. S&P 500 Companies with Negative ISS Recommendations
Total with negative recommendations	41
Number that had "high concern" on:	
• Pay-for-Performance	39
• Compensation Committee Communication and Responsiveness	2
• Severance/Change-in-Control Arrangements	3
• Peer Group Benchmarking	1
• Non-Performance-Based Pay Elements	4

These results indicate that, although pay-for-performance is just one factor in the overall compensation assessment, it is the dominant determinant of ISS's outcome on the say-on-pay vote. A more detailed discussion of ISS's pay-for-performance policies and how they were applied in 2018 follows.

C. ISS PAY-FOR-PERFORMANCE ANALYSIS

Since the 2012 proxy season, ISS's methodology for evaluating the pay-for-performance prong of its assessment of executive compensation in the context of say-on-pay proposals begins with a quantitative analysis of both relative and absolute alignment of pay-for-performance.[44] If the quantitative assessment reflects an apparent pay-for-performance disconnect (*i.e.*, a "high" or "medium" concern), ISS applies a qualitative analysis, including an in-depth review of the company's Compensation Discussion & Analysis, to "identify the probable causes of the misalignment and/or mitigating factors."

1. Components of Quantitative Analysis

Beginning for 2018, there are four components of ISS's quantitative assessment:

- ***Relative Degree of Alignment, or RDA (relative alignment of CEO pay and total shareholder return over three years).*** The metric that is given the greatest weight in the quantitative assessment is the alignment of CEO pay and TSR,[45] relative to those of a peer group. The relative alignment metric looks at the difference between (a) the percentile rank within the ISS-selected peer group of a company's TSR and (b) the percentile rank within that peer group of a company's CEO pay.[46] The company's score is based on this difference calculated on a three-year basis. The threshold for receiving "high concern" is a difference of 50 percentile points or more. *As discussed below, this metric continues to be the strongest predictor of ISS recommendations and of overall voting results.*
- ***Multiple of Median, or MOM (relative CEO pay to peer group median over one year).*** The second relative component of the pay-for-performance assessment is prior-year CEO pay as a multiple of the peer group median. This metric considers pay independent of

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[44] Technical information and guidance on ISS's say-on-pay methodology is available on the ISS website.

[45] TSR measures how much an investment in the stock would have changed over the relevant period, assuming the reinvestment of dividends.

[46] See Section III.C.3.a for a discussion of how "CEO pay" is calculated and some potential comparative problems this may cause.

company performance. ISS's scoring system may trigger a "high concern" if this multiple is 3.33x or higher.

- ***Pay-TSR Alignment, or PTA (absolute alignment of CEO pay and TSR over five years)*.** The third component measures alignment between the long-term trend in the CEO's pay and the company's shareholder returns over a five-year period. This does not depend on year-by-year sensitivity of CEO pay to changes in TSR, but instead compares the straight-line slopes of five-year trend lines (based on a linear regression) for each of CEO pay and TSR. A "high concern" may be triggered if the CEO pay trend slope exceeds the TSR trend slope by 35 percentage points or more.
- ***Financial Performance Assessment, or FPA (relative alignment of CEO pay and financial performance over three years).*** This new relative measure compares the percentile ranks of a company's CEO pay and financial performance across three or four financial metrics, relative to the ISS-selected peer group, over the prior three-year period. FPA was first introduced as part of the pay-for-performance qualitative evaluation in 2017. As of 2018, the FPA measure has been added to the quantitative assessment and is applied as a secondary measure after the traditional three components (RDA, MOM and PTA) have been calculated. The FPA uses three or four of the following financial measures, depending on the company's industry: return on invested capital, return on assets, return on equity, EBITDA growth and cash flow. Performance is measured using the 12 most recent trailing quarters. The weighted average performance rank is compared to the company's CEO pay rank, similarly to the RDA.

The "medium concern" and "high concern" thresholds for non-S&P 500 companies are summarized as follows:

Primary Quantitative Measure	***Medium Concern Threshold***	***High Concern Threshold***
Relative Degree of Alignment	-40	-50
Multiple of Median	2.33x	3.33x
Pay-TSR Alignment	-20%	-35%

For S&P 500 companies, ISS updated its policy for meetings held on or after February 1, 2018, lowering the MOM medium concern threshold from 2.33x (which continues to be applicable for other Russell 3000 companies) to 2.00x. The lower threshold corresponds to the intensified investor scrutiny on the escalating CEO compensation among large-cap companies.

Primary Quantitative Measure	***Medium Concern Threshold***	***High Concern Threshold***
Relative Degree of Alignment	-40	-50
Multiple of Median	***2.00x***	3.33x
Pay-TSR Alignment	-20%	-35%

Based on the preceding, ISS will assign an initial quantitative score (ISS may deem multiple "medium concern" levels as the equivalent of an overall "high" quantitative concern). ISS then applies the FPA score as a potential modifier. The FPA will modify the initial score only if a company has either (a) a medium concern or (b) a low concern that borders on a medium concern threshold under one of the three primary measures.

2. 2018 Results of ISS Quantitative Analysis

The following table summarizes the outcome of these quantitative tests for U.S. S&P 500 companies that received a negative ISS recommendation on say-on-pay in 2018:

	Number of U.S. S&P 500 Companies with Concern Level		
	High	*Medium*	*Low*
Overall pay-for-performance concern level (quantitative + qualitative)	***26***	11	4
Overall concern level on quantitative screen only	***26***	7	8
Number that had "high concern" on each quantitative test:			
• RDA – Relative Alignment of CEO Pay and TSR (3-year)	***22***	9	10
• MOM – Relative CEO Pay to Peer Group Median (1-year)	5	9	***27***
• PTA – Absolute Alignment of CEO Pay and TSR (5-year)	3	3	***35***

	Impact of FPA on U.S. S&P 500 Company Concern Level
Remain High Concern	***26***
Remain Medium Concern	7
Remain Low Concern	4
Move from Low Concern to Medium Concern	4

As the first table indicates, most large companies that received negative ISS recommendations had a "high concern" on the RDA test. In contrast, most of these companies had "low concern" on the MOM and PTA tests. Based on our review, FPA did not appear to have any significant impact on ISS's analysis of the pay-for-performance concerns it identified. Thirty-seven companies remained at the same level of concern as where they were following the RDA, MOM, and PTA tests. FPA only impacted ISS's concern level with respect to four companies, which had FPA scores ranging from -58 to -72.7 and were moved from low to medium concern. These results reflect the continued importance of the three-year relative TSR alignment test in driving ISS recommendations.

3. Potential Problems with Quantitative Analysis

Companies should be mindful of the variables that go into the ISS quantitative tests, some of which (such as their stock price and ISS's peer group selection) companies may have little control over and bring a level of arbitrariness to the calculation. Certain features of ISS's quantitative analysis have been subject to some criticism and may yield inappropriate results in certain circumstances. Many companies have raised these or other arguments in supplemental proxy filings that seek to rebut a negative recommendation from ISS. If a company receives, or thinks it is going to receive, an adverse outcome under the ISS quantitative test in circumstances where it is not warranted, the company should reach out as appropriate to ISS to make sure that the qualitative portion of the test takes into account any special circumstances and should maintain a dialogue with shareholders to gauge their level of concern and ensure that they are viewing the results of the quantitative assessment in the proper context. In addition, the concerns outlined below are often the focus of companies' supplemental proxy materials following a negative recommendation, as discussed in Section III.D below.

a. Determination of Total CEO Pay

All the ISS quantitative metrics look at the level of "CEO pay." The "CEO pay" for a particular year for these purposes is the total compensation reported in that year's Summary Compensation Table in the proxy statement under SEC rules, with some minor valuation differences.[47] Among other problems, this introduces potential comparative difficulties, because different forms of compensation are reflected differently in the table even though they may pertain to services in the same period. For example, equity awards for services in a particular year that are made shortly after year-end are included in the Summary Compensation Table in the proxy statement for the subsequent year (because that is when the grant occurred), but awards that are made in cash and already earned are included in the Summary Compensation Table for the current year. In addition, differences in equity granting practices may skew results—for example, in the case of special one-time grants. Furthermore, this measurement does not take into account the outcome of any post-grant performance conditions in equity awards or any post-grant change in value of an equity award due to an increase or decrease in the stock price.

ISS introduced "realizable pay" as a qualitative factor for S&P 500 companies in 2013, in an effort to address concerns that the quantitative "grant date" calculation does not capture when or whether compensation is actually earned. "Realizable pay" is the sum of relevant cash and equity-based grants and awards made during a three-year measurement period, based on equity award values for actual earned awards, or target values for ongoing awards, calculated using the stock price at the end of the measurement period. "Granted pay," by contrast, is the sum of the relevant cash and equity-based grants and awards, calculated using their grant-date values. The qualitative analysis involves a consideration of whether the total pay granted during the three-year period is significantly higher or lower than the realizable pay at the end of the period. This metric, however, still involves a valuation of unearned compensation, albeit at the end of a period rather than as of the grant date, and thus continues to mix elements of the grant date and earned compensation in a way that can yield disparate results.

b. Use of TSR over Fixed Periods

The formulaic use of three- and five-year TSR can place undue emphasis on short-term spikes or drops in stock price at the start or end of the measurement periods and does not provide an opportunity for a thorough analysis of the factors relating to the company, its industry or the markets generally that may be contributing to the shareholder return. Companies should seek to ensure that their shareholders and ISS

[47] According to ISS, total compensation = Base Salary + Bonus + Non-Equity Incentive Plan Compensation + Stock Awards + Option Awards. ISS's calculation of total compensation will generally match the compensation reported in the proxy statement's Summary Compensation Table, except that ISS calculates the value of stock-based awards without relying on the grant date value reported in the proxy statement, and calculates option awards using a Black-Scholes option pricing model.

recognize and take into account any meaningful factors that cause the TSR in the tests used by ISS to be not reflective of the company's performance in the context of its compensation decisions.

c. Peer Group Construction

As the above numbers show, the "relative alignment" between CEO pay and TSR when compared with the company's peer group is an influential element of ISS's calculation. Accordingly, the selection of an appropriate peer group is a critical factor. ISS's peer group construction generally consists of 14 to 24 companies that are identified based on market cap, revenue (or assets for financial firms), GICS industry group and a company's self-selected peers.[48] Companies should review their peer group used in ISS's 2018 report to confirm whether it is appropriate in light of a particular company's business and competition for talent. If the ISS peer group contains companies that the company believes are not, in fact, suitable comparisons, or omits peers the company believes should be included, the company should give consideration to discussing with ISS in the off-season the appropriateness of the peer group construction, or consider whether the inclusion of a different self-selected peer group in the proxy statement may lead to a more appropriate ISS peer group under ISS's policies.

Glass Lewis uses a less formulaic approach to peer group construction than ISS does, stating that its approach "avoids the limitations of arbitrary financial cut-offs or discrete industry groupings and better represents the complex relationships that exist in a competitive marketplace." Glass Lewis instead bases its peer groupings on an analysis of the proxy disclosure by various companies of the peers they use for compensation benchmarking purposes, combined with "analytics from the social networking space." Glass Lewis (through its partnership with Equilar, a compensation benchmarking firm) then uses this data to create a "peer network" through which it ranks a company's peers based on the strength of their connection as indicated by these analytics.[49] Glass Lewis's focus on the peers each company selects as its competition, and the reciprocity of these relationships, is an attempt to model market choices.

4. ISS Qualitative Analysis

If ISS's quantitative analysis reflects an apparent pay-for-performance disconnect, then ISS uses a further qualitative review to determine a final vote recommendation. Under ISS's policies, the qualitative review takes into account a range of factors, including:

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48 The introduction of a company's self-selected peers into ISS's methodology for selecting peer groups was implemented in 2013 to address criticism of ISS's past practices, which had resulted in some companies being placed in peer groups with companies that operated in different industries, or different segments of their industry.

49 Information on Glass Lewis's say-on-pay and pay-for-performance assessment policies is available at http://www.glasslewis.com/understanding-our-compensation-analysis/. The company's U.S.-specific policies are available at http://www.glasslewis.com/wp-content/uploads/2018/01/2018_Guidelines_UNITED_STATES.pdf.

- the ratio of performance-based equity awards to time-based equity awards;
- the overall ratio of performance-based compensation to total compensation;
- the completeness of disclosure and rigor of performance goals;
- peer group benchmarking practices;
- financial and operational performance (both absolute and relative to peers);
- realizable pay compared to grant pay; and
- any special circumstances, such as a new CEO or anomalous equity grant practices.

Based on our review of the narrative in the relevant ISS reports, the qualitative factor that most commonly contributed to the negative recommendation for U.S. S&P 500 companies in 2018 was the failure of incentive compensation to be sufficiently performance-based in one or more of the ways described below. This concern was discussed by ISS for 39 of the 41 U.S. S&P 500 companies that received negative ISS recommendations on say-on-pay. This is perhaps not surprising, because it would seem to be closely related to the pay-for-performance alignment that the quantitative tests are intended to address. ISS's identified concerns in this regard generally fall into the following categories (with most companies receiving more than one of these concerns):

- ***The use of performance conditions that are not sufficiently rigorous, or insufficient disclosure of performance goals*.** Even if a company does utilize performance-based awards, ISS will see the awards as problematic if ISS views the goals as too easy to meet, or if the goals are not disclosed in sufficient detail for ISS to make an assessment. Thirty of the 41 S&P 500 companies receiving negative ISS recommendations were identified as either having performance standards that were not sufficiently rigorous or were limited, opaque or undisclosed.
- ***The use of above-target payouts*.** ISS referenced the existence of payouts that exceeded the company's target in 14 of the 41 cases. ISS viewed these above-target payouts as suggestive of weak performance standards, or, at least, the need for the company to closely examine its performance standards.
- ***The use of subjective criteria for determining compensation*.** ISS cited the use of subjective criteria for the determination of a bonus or the ability to use discretion to increase an executive's bonus as a negative factor for 20 of the 41 companies. ISS viewed companies using these discretionary measures as excusing poor performance. While ISS did cite these provisions with approval when companies elected to use this discretion to reduce the size of an award, these cases were rare and ISS largely viewed discretion as suspect.
- ***The use of time-based awards rather than performance-based awards*.** ISS identified this concern at 11 of the 41 S&P 500 companies that received negative recommendations. ISS's failure to consider time-vested option awards or other equity awards to be performance-based has been the subject of criticism because such awards can give the holders a stake in the performance of the company and align the interests of executives with those of shareholders.

5. ISS Non-Performance-Related Factors

ISS's qualitative assessment takes into account various non-performance-related factors that can trigger a negative recommendation even where a company does not have a "high concern" on pay-for-performance. Ten of the 41 S&P companies that received negative recommendations had a “high concern” for one or more non-performance-related issues. The most common non-performance-related “high concern” in 2018, applicable to four of these companies, was problematic severance benefits related to a change in control of the company or voluntary terminations of named executive officers that were not in shareholder interests. The second most common non-performance-related “high concern,” affecting three of the companies, was the provision of income tax gross ups to executives in cases that ISS perceived as an inefficient use of corporate assets. In addition, two of the companies received a negative recommendation because they had provided excessive perquisites, such as frequent use of corporate aircraft or payments on country club dues and home security, and one company received a negative recommendation because it had selected an incorrect peer group of firms that were much larger in size. In past years, the most common non-performance-related “high concern” was poor responsiveness to shareholders on say-on-pay votes, generally marked by what ISS perceived as a lack of adequate disclosure. This year, however, ISS only flagged “high concern” at two companies for this issue, likely because companies across the board tend to have improved say-on-pay disclosures and are proactively engaging with shareholders to address any concerns on executive pay.

D. COMPANY REBUTTALS TO ISS SAY-ON-PAY RECOMMENDATIONS

A significant number of the S&P 500 companies that received negative ISS vote recommendations regarding their 2018 say-on-pay proposals filed supplemental proxy materials to communicate to shareholders their disagreement with the proxy advisory firm’s assessment or to reaffirm support for their executive compensation practices more generally. Eleven of the 41 companies issued explicit rebuttals mentioning the proxy advisory firm by name.[50] In some cases, these supplemental filings are very detailed, point-by-point rebuttals, including pointed criticisms of the application of the proxy advisory firm’s tests, further explanation of the compensation committee’s rationale for particular decisions, and alternative measures that show pay aligned with performance. An additional five companies filed general releases in support of their executive compensation practices without referencing ISS.[51]

These supplemental filings serve the important purpose of educating shareholders and encouraging a thoughtful consideration of the issues and can function as a presentation deck for one-on-one discussions with significant investors. In addition, for many institutional investors, these communications, together with any direct discussions with the company, can serve as documentation to support the investor’s decision to reject a negative recommendation and vote with management.

[50] These included Abbott Laboratories, Ameriprise Financial, Inc., Ball Corporation, CSX Corporation, Exxon Mobil Corporation, FMC Corporation, General Dynamics Corporation, Hologic Inc., Humana Inc., Schlumberger Limited, and Synchrony Financial. Several of these rebuttals explicitly noted that Glass Lewis, unlike ISS, had recommended in favor of their say-on-pay proposal.

[51] These included American Express Company, Apache Corporation, CF Industries Holdings, Inc. Mattel, Inc., and SL Green Realty Corp.

IV. EQUITY COMPENSATION PLAN APPROVALS

	ADOPTION OR AMENDMENT OF OMNIBUS STOCK PLANS			
	Russell 3000		***S&P 500***	
	2018	***2017***	***2018***	***2017***
Number of proposals voted on	***478***	785	***68***	129
Percentage with ISS “against” recommendations	***21%***	20%	***9%***	5%
Average level of support with ISS “for” recommendations	***91%***	93%	***93%***	93%
Average level of support with ISS “against” recommendations	***77%***	77%	***73%***	76%
Number of failed proposals (<50% support)	***2***	3	***0***	0

U.S. listed companies are required under stock exchange rules to obtain shareholder approval for the plans under which they award executive compensation to employees and directors. [52] Because shareholders generally support the use of equity compensation by public companies as a means to align the interests of employees with those of investors, in most cases these proposals are uncontroversial and pass by a wide margin. As indicated in the chart above, the average support levels for these proposals are typically around or above 90%, and only two proposals failed to achieve majority support this year.

Beginning in 2015, ISS introduced an “equity scorecard” approach to assessing equity plans. The scorecard method, in which the passing score was raised from 53 to 55 in the 2018 policy updates, considers factors under three main categories:[53]

- ***Plan cost.*** Cost is calculated as the Shareholder Value Transfer relative to industry/market-cap peers; this measures the dilutive effect of the new shares requested as well as shares remaining for issuance under existing plans (often called “dilution” or “overhang”), and is calculated both with and without outstanding unvested awards.
- ***Equity plan features.*** Specifically, penalizing lack of minimum vesting periods, broad discretionary vesting authority, liberal share recycling and single-trigger change-in-control provisions.
- ***Historical grant practices.*** Specifically, three-year “burn rate” relative to market and industry peers, among other factors.

ISS recommended against around 21% of equity plan proposals, but recommended against only 9% in the case of S&P 500 companies; this difference is likely due to the impact of the larger public float on the plan cost and the movement away from problematic plan features. ISS recommendations have a fairly significant impact on voting results—in 2018, the average support level was 91% when ISS recommended “for” approval and 77% when ISS recommended “against.”

52 *See* Section 303A.08 of the NYSE Listed Company Manual; Nasdaq Stock Market Rule 5635.

53 ISS’s current equity plan scorecard approach is described in its U.S. Equity Compensation Plans: Frequently Asked Questions.

ISS issued "against" recommendations for only six equity plan proposals at S&P 500 companies so far in 2018. For all of these companies, ISS cited excessive plan cost and problematic treatment of equity upon a change in control among the reasons for its negative recommendation. Other common reasons included excessive burn rate, discretionary vesting authority and liberal share recycling.

Despite the negative recommendations, all of the proposals at S&P 500 companies (and Russell 3000 companies more broadly) received majority support—the lowest support level was 57%.

V. PREPARING FOR 2019

A. NO-ACTION RELIEF

The landscape for no-action relief is changing. Although the changes have not been as dramatic as some predicted at the beginning of this season, companies should take these changes into account as they evaluate potential avenues for exclusion with respect to the shareholder proposals they receive for the 2019 season.

Overall, the SEC staff has not been more inclined to grant no-action relief with respect to shareholder proposals this season. The SEC staff has acted on 291 requests for no-action relief so far this year and granted 132 (or 45%). By this time last year, the staff had acted on 293 proposals and granted 193 (or 66%). In this regard, both 2018 and 2017 have been consistent with historic trends. Underlying the general trends, however, are some shifts in approach that could have a meaningful impact for companies.

First, the SEC staff continues to refine the "ordinary business" exclusion. In November, just in time for the beginning of the 2018 proxy season, the staff of the SEC's Division of Corporation Finance issued Staff Legal Bulletin No. 14I ("SLB 14I"), which provided guidance on the excludability of shareholder proposals on the basis that (1) they constitute ordinary business more properly in the province of management (Rule 14a-8(i)(7)) or (2) relate to operations that account for less than 5% of assets, earnings and gross sales (Rule 14a-8(i)(5)).[54] Although many commentators suggested that the SLB 14I forecast increased deference to no-action requests, that has not been the case so far. For example, no-action relief on the basis of ordinary business has been considered by the SEC staff 120 times so far this year and granted only 44 times (or 37%), as compared to last year, when the staff had considered relief on this basis 129 times by this time and granted it 77 times (or 60%).[55] To date, there have been at least seven instances where the SEC has granted no-action relief on the basis of ordinary business to a company whose no-

[54] *See* our publication, dated November 3, 2017, entitled "SEC Staff Begins Taking Steps to Reform Shareholder Proposals."

[55] With respect to some of the no-action letters included in our analysis, the ordinary business exclusion may not be the only basis for relief in the company's request or the only basis for the SEC's grant of relief.

action request included a board analysis pursuant to the guidance in SLB 14I,[56] including one instance where a no-action request containing a board analysis received relief under Rule 14a-8(i)(5).[57]

It is notable that the SEC staff has concurred with the exclusion of several climate change proposals on the basis of ordinary business this season. For the 2018 season, the SEC staff granted no-action relief to Deere & Co., PayPal and EOG Resources on the basis of ordinary business with respect to proposals to prepare reports to evaluate "net-zero" greenhouse gas emissions that included quantitative, time-based targets.[58] The SEC staff had refused to grant relief with respect to a similar proposal in the 2017 season for PayPal. Given the background of heightened interest in ESP proposals, companies should be aware that proposals contemplating specific actions and/or specific timeframes to respond to climate risk now may fall within the ordinary business exclusion.

Second, the SEC staff continues to evaluate the exclusion of proposals that conflict with management proposals (Rule 14a-8(i)(9)). As discussed in Section I.E.1, beginning with AES and then Capital One, the SEC staff has allowed companies to exclude proposals seeking a reduction of the company's existing ownership threshold for calling a special meeting to 10%. In these no-action letters, the SEC staff concurred with the companies that the proposals conflicted with management counterproposals to ratify the existing threshold, since a reasonable shareholder could not logically vote in favor of both. In total, the SEC staff has granted relief at least eight times on this basis in the past 12 months.

The staff's positions this year appear to limit meaningfully the effect of SLB 14H, which was issued in 2015 and narrowed the application of conflicting proposal exclusion by redefining the meaning of "direct conflict." Accordingly, for 2019, companies may want to reconsider whether a management counterproposal represents an appropriate response to a shareholder proposal. Companies should take into account that, since Capital One, the SEC staff's relief in this area has been conditioned on the company's making the following disclosures:

- a statement that the company has omitted a shareholder proposal to lower the ownership threshold for calling a special meeting and that it believes a vote in favor of ratification is tantamount to a vote against a proposal lowering the threshold;

56 *See* the SEC's no-action letters to Dunkin' Brands (Feb. 22, 2018), JP Morgan (letters dated Feb. 28, 2018, Mar. 30, 2018 and Mar. 30, 2018), American Airlines (Mar. 23, 2018), Red Hat (June 12, 2018), and NIKE (June 22, 2018)

57 *See* the SEC's no-action letter to Dunkin' Brands (Feb. 22, 2018), where the SEC staff explicitly states that its basis for relief under Rule 14a-8(i)(5) includes "the description of how [the company's] board of directors has analyzed this matter."

58 The staff's recent decisions were based on the "micromanagement" prong of the ordinary business exclusion, which was not addressed by SLB 14I. *See* the SEC's no-action letters to Deere & Co. (Dec. 27, 2017), PayPal (Mar. 6, 2018) and EOG Resources (Feb. 26, 2018, together with the SEC's letter denying proponent's request for reconsideration, dated Mar. 12, 2018).

- the impact on the special meeting threshold, if any, if ratification is not received; and
- the company's expected course of action, if ratification is not received.

Companies also should be aware that this approach has attracted considerable criticism from ISS and CII.

B. BOARD DIVERSITY

A significant number of the nation's largest investors now list board diversity, particularly in terms of gender, among their top priorities for the companies in which they invest. As discussed in Section I.E.3, the New York City Comptroller has requested companies to provide standardized annual disclosure on board diversity and may use proxy access to advance his campaign to increase diversity, independence and climate-related expertise in the boardroom. Even at companies that have not received a request from the Comptroller, there may be increased pressure to provide greater transparency on current board composition and ongoing efforts to improve diversity.

In response to this environment, a number of companies have committed to include a diverse slate or pool of candidates in board searches. In 2018, after publicity following the filing of its proxy statement, Amazon dropped its objection to a shareholder proposal for a policy requiring a diverse slate, instead opting to adopt the policy. Over 35 other public companies already had statements regarding the use of diverse candidate pools in their governance guidelines or proxy disclosures, including Apple, Capital One, Costco, eBay, Leucadia, Microsoft and United Continental. Although a commitment to a diverse candidate pool may not be appropriate for all companies, most would likely benefit from a review of their disclosures on board diversity initiatives to assess whether the clarity and content of these disclosures could be improved for 2019.

C. NON-EMPLOYEE DIRECTOR COMPENSATION

Beginning in 2019, ISS's policy will be to recommend against directors responsible for setting non-employee director compensation where there is a recurring pattern of "excessive" non-executive director compensation absent the disclosure of a compelling rationale or other mitigating factors. ISS's recommendation will be based on compensation relative to a peer group over two years. Also, companies should be aware of developments since the 2017 Delaware Supreme Court decision in *In re Investors Bancorp, Inc. Stockholder Litigation*, which applied the entire fairness standard instead of the more deferential business judgment review to discretionary non-employee director compensation awards made pursuant to a shareholder approved equity plan that appeared to have meaningful limits. Both of these developments underscore the potential benefit of enhanced process and disclosure around non-employee director compensation for the 2019 season.

Notably, JP Morgan Chase has received considerable attention for the inclusion of director compensation limits responsive to *Investors Bancorp* in its Long-Term Incentive Plan, which was submitted for shareholder approval in 2018.[59] In addition to specified retainers, which may be increased within bands of limited discretion, the plan also provides the board with safety-valve discretion to pay any director an additional retainer or other fee, including for service on any specific purpose committee or for any other special service, in its discretion. The plan was approved with more than 95% support. Companies that will be submitting equity compensation plans for shareholder approval in 2019 may want to evaluate whether a similar approach would be appropriate.

D. VIRTUAL-ONLY MEETINGS

Over the last three years, an increasing number of companies have moved from in-person meetings to virtual-only meetings. According to ISS data, the frequency of virtual-only meetings increased almost 30% year-over-year (127 between January and May of 2018, compared to 99 during the same period in 2017). While the vast majority of U.S. public companies have not yet transitioned to virtual-only meetings at this point, the ones that have include a number of high-profile companies such as Ford and Intel.

For 2018, ISS surveyed institutional investors with respect to virtual-only and hybrid meetings. ISS reports that slightly over 50% considered virtual-only meetings acceptable, with 19% generally considering the practice of holding either virtual-only or “hybrid” (both physical and electronic/online) meetings acceptable without reservation and another 32% stating that they would generally accept hybrid meetings, and would be comfortable with virtual-only shareholder meetings if the company provided the same shareholder rights as a physical meeting. Eight percent of the investors did not support either hybrid or virtual-only meetings, and 36% considered hybrid shareholder meetings to be acceptable but not virtual-only meetings.[60]

ISS does not have a policy on virtual meetings in the U.S. It updated its U.K. policy for 2018 to provide that it will generally recommend voting for proposals allowing hybrid meetings and against proposals allowing virtual-only meetings. For 2018 meetings, Glass Lewis did not make voting recommendations on the basis that a company was holding a virtual-only meeting. Effective in 2019, however, Glass Lewis will vote against governance committee members at companies without in-person meetings unless their proxy materials contain disclosures that are sufficiently robust to assure shareholders that they would not lose any participation rights by moving to virtual-only meetings.

E. EXEMPT SOLICITATIONS

Each year, some institutional shareholders (including public pension funds) file notices of exempt solicitation with the SEC under Rule 14a-6(g) to encourage votes on shareholder proposals, say-on-pay proposals and in “vote no” campaigns. Rule 14a-6(g) requires a person who conducts a solicitation of

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59 *See* JP Morgan Chase’s definitive proxy statement, filed with the SEC on April 5, 2018.

60 *See* ISS, 2017-2018 ISS Global Policy Survey—Summary of Results, *available at* https://www.issgovernance.com/file/policy/2017-2018-iss-policy-survey-results-report.pdf.

shareholders that is exempt (because the person does not seek to have proxies granted) and who owns more than $5 million of the company's securities to file with the SEC all written materials used. These notices of exempt solicitation appear on the SEC's Edgar internet system as "PX14A6G" filings.

To date, the SEC has not restricted shareholders owning less than $5 million of a company's securities from filing a notice of exempt solicitation on a "voluntary" basis. An exempt solicitation provides an easy, cost-effective way for proponents to express their views and lobby fellow shareholders beyond the 500-word limit imposed by Rule 14a-8 for a proposal and supporting statement in the company's proxy statement. This year so far, 140 notices of exempt solicitation have been filed with the SEC, up 17% from the 120 filed by this time in 2017.

For the first time, two of the three most prolific shareholder proponents, John Chevedden and James McRitchie, have filed notices of exempt solicitation in support of their shareholder proposals. Mr. Chevedden filed his first PX14A6G notice in connection with AES's proposal to ratify its existing 25% special meeting ownership threshold. As discussed above, the SEC staff previously concurred that AES could exclude Mr. Chevedden's shareholder proposal (requesting a 10% special meeting threshold) from its proxy materials pursuant to Rule 14a-8(i)(9) because the company's ratification proposal and the shareholder proposal conflicted.

Since his initial filing, Mr. Chevedden has filed 18 other PX14A6G notices, and Mr. McRitchie has filed two. William Steiner has not filed any notices of exempt solicitation this year. Companies should be prepared to monitor and respond to a proliferation of PX14A6G filings in the 2019 season.

F. CEO PAY RATIO DISCLOSURE

For the first time this season, U.S. issuers were required to disclose the ratio of CEO pay to the pay of the median company employee in their proxy statements. To date, institutional investors have generally expressed ambivalence toward these new disclosures. For example, both BlackRock and T. Rowe Price have indicated that they will not use these ratios to inform their voting or engagement. However, in response to ISS's 2018 policy survey, nearly three-quarters of the investor respondents indicated that they intend to assess year-on-year changes in the ratio at an individual company, compare the ratios across companies/industry sectors, or use both of these methodologies.[61]

For the first time in 2019, investors will have the opportunity to compare year-to-year changes in the CEO pay ratio either at an individual company or across companies. Although the potential impact of this disclosure is speculative, issuers should be prepared to address these changes in their proxy disclosure.

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61 *See* ISS, 2017-2018 ISS Global Policy Survey—Summary of Results, *available at* https://www.issgovernance.com/file/policy/2017-2018-iss-policy-survey-results-report.pdf.

G. CYBERSECURITY

This year, the SEC issued guidance on public company cybersecurity disclosure that requires issuers to report on, among other things, their ongoing cybersecurity efforts. Although only one shareholder proposal for a company to report on its cyber risk mitigation efforts reached a vote in 2018, companies may face increasing pressure going forward and may wish to consider a proactive review of their current disclosures on this topic.

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