SULLIVAN & CROMWELL LLP

July 17, 2017

2017 Proxy Season Review

Fewer Governance Proposals Come to a Vote, Led by Decline in Proxy Access Proposals, as More Companies Adopt Proxy Access Rather Than Submit to a Vote; Proposals to Remove Group Limits Fail

Climate Issues and Board Diversity Attract Increasing Support and Attention; Proposals on Independent Chair and Lobbying Remain Common, But Rarely Pass

Perceived Non-Responsiveness and Poor Attendance Remain Most Common Reasons for Low Director Support Levels in Uncontested Elections

Say-on-Pay Results Remain Strong, and Frequency Votes Solidify Dominance of Annual Say-on-Pay Votes

EXECUTIVE SUMMARY

This publication summarizes significant developments relating to the 2017 U.S. annual meeting proxy season, including:

- ***Decline in traditional governance proposals.*** Proposals on traditional governance reforms (destaggering the board, adopting majority voting in uncontested director elections, eliminating supermajority voting provisions, and adopting special meeting rights) continued to decline in frequency. There are simply fewer large companies that have not adopted these practices already, and more smaller companies are doing so as well, especially with respect to majority voting.
- ***Continued acceptance of proxy access leads to fewer proposals.*** Fewer proposals to adopt new proxy access provisions came to a vote in 2017, largely because most companies that received such a proposal reacted by adopting a proxy access bylaw with terms consistent with market practice (*i.e.*, 3% ownership for three years, director cap of 20% of the board but no less than two, and a group limit of 20 shareholders). The proposals that did come to a vote generally passed.
- ***Attempts to amend proxy access terms were unsuccessful.*** Nearly half of the proxy access proposals that were voted on in 2017 sought to amend previously adopted proxy access bylaws, often to remove or loosen restrictions on group size. These have all 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-

40%). However, once again none of these proposals passed, confirming that shareholders are generally satisfied that a sufficiently empowered lead independent director can offset having a combined CEO and chair role.

- ***Greater focus on board diversity.*** Board diversity—in particular, the inclusion of women on boards—received significant attention in 2017, including through institutional investor policies, shareholder proposals, company proxy disclosure and non-binding state legislative resolutions. This is likely to be a topic of continued focus in 2018.
- ***Social/political proposals remain common, but rarely pass.*** Social policy proposals were dominated by those relating to environmental issues and to political contributions and lobbying, with proposals on gender pay equity on the rise. These proposals continue to be common, but rarely pass, though environmental proposals have increased in both number and support levels, and several relating to climate change passed at energy companies.
- ***Near elimination of compensation-related proposals.*** Executive compensation-related shareholder proposals declined to a negligible amount, continuing a trend that began once mandatory say-on-pay became the main focus of executive compensation concerns.
- ***"Withhold" or "against" votes for directors.*** Our analysis of negative recommendations on uncontested director elections by Institutional Shareholder Services demonstrates that new ISS policies to vote against directors at newly public companies with adverse governance provisions and at companies where shareholders cannot amend the bylaws yielded many negative recommendations, but did not have a very significant impact on the election of directors. As in past years, directors who are seen as insufficiently responsive to a prior shareholder vote and directors with poor attendance suffer the greatest impact from a negative ISS recommendation.
- ***Move toward annual say-on-pay votes.*** Most companies had their second advisory vote on say-on-pay frequency in 2017, and the preference for annual votes over biennial or triennial votes was further solidified.
- ***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 1% of companies getting less-than-majority support. Our analysis of ISS negative recommendations on say-on-pay supports the continued importance of a pay-for-performance model, including performance standards that are clearly explained and deemed sufficiently rigorous by ISS.
- ***Broad shareholder support for equity compensation plans.*** Very few companies, and no S&P 500 companies, failed to get shareholder approval for an equity compensation plan, and overall support levels continued to average around 90%.

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The director elections discussed in this publication are uncontested elections at annual meetings. For a discussion of proxy contests and other shareholder activist campaigns, see our publication, dated November 28, 2016, entitled "2016 U.S. Shareholder Activism Review and Analysis."

More generally, for a comprehensive discussion of public company governance, compensation and disclosure, see the *Public Company Deskbook: Complying with Federal Governance and Disclosure Requirements* (Practising Law Institute) by our partners 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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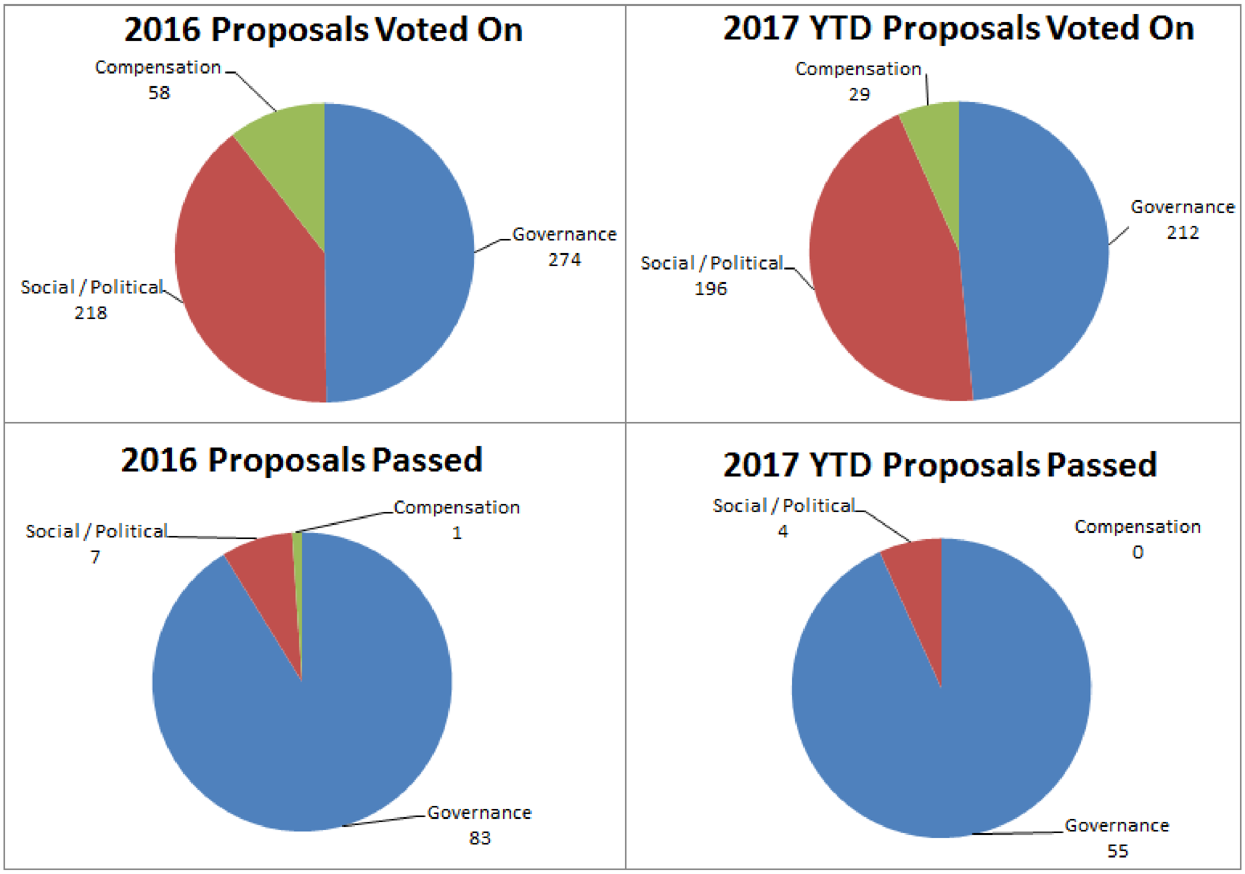
A. OVERVIEW OF SHAREHOLDER PROPOSALS

The following pie charts and table summarize, by general category, the Rule 14a-8 shareholder proposals voted on at U.S. companies in recent years, and the rate at which they passed.



SUMMARY OF 2015-2017 SHAREHOLDER PROPOSALS

	Total Shareholder Proposals Voted On			***Average % of Votes Cast in Favor***			***Shareholder Proposals Passed***		
Type of Proposal	***2017 YTD***	***2016***	***2015***	***2017 YTD***	***2016***	***2015***	***2017 YTD***	***2016***	***2015***
Governance	***212***	274	285	***39%***	40%	44%	***55***	83	95
Social and Political Issues	***196***	218	200	***22%***	22%	21%	***4***	7	0
Compensation-Related	***29***	58	82	***20%***	19%	28%	***0***	1	4
Total	***437***	550	567						

The number of governance-related proposals voted on at 2017 meetings dropped significantly year-over-year, even adjusting for the approximately 10% of companies that did not yet have their annual meeting in 2017. As discussed further in Section I.D.1 below, the decline related largely to the lower number of proxy access proposals, due to the tendency of issuers to respond to proposals by adopting market-standard proxy access provisions. Once again, governance proposals were the only category of proposals that had a significant pass rate.*

Social and political proposals continued to be common, though once again very few actually passed. The most common topics, as discussed further in Section 1.E below, were environmental issues (including those relating to climate change), political contributions and lobbying, gender and other discrimination, and human rights.

The number of compensation-related proposals declined to 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 2017. *See* Section 1.F below for a further discussion.

B. TARGETS OF SHAREHOLDER PROPOSALS—LARGE-CAP FOCUS CONTINUES

Before turning to a detailed discussion of the various categories of 2017 shareholder proposals, it is worth taking a moment to focus on the companies targeted by proposals. Traditionally, the vast majority of shareholder proposals have been received by large-cap companies.[1] Over time, this has led to a bifurcated corporate governance landscape, with so-called shareholder-friendly governance provisions (such as destaggered boards, majority election of directors, special meeting rights, and simple majority vote thresholds) being much more common at larger companies than smaller companies.

Over the years, as large-cap companies have broadly adopted these governance proposals, some have expected mid-cap companies to come under increasing pressure to adopt similar governance structures. To date, however, shareholder proposals have remained primarily targeted at S&P 500 companies. In 2017 so far, S&P 500 companies received nearly 80% of all proposals voted on, which is even higher than in recent years.

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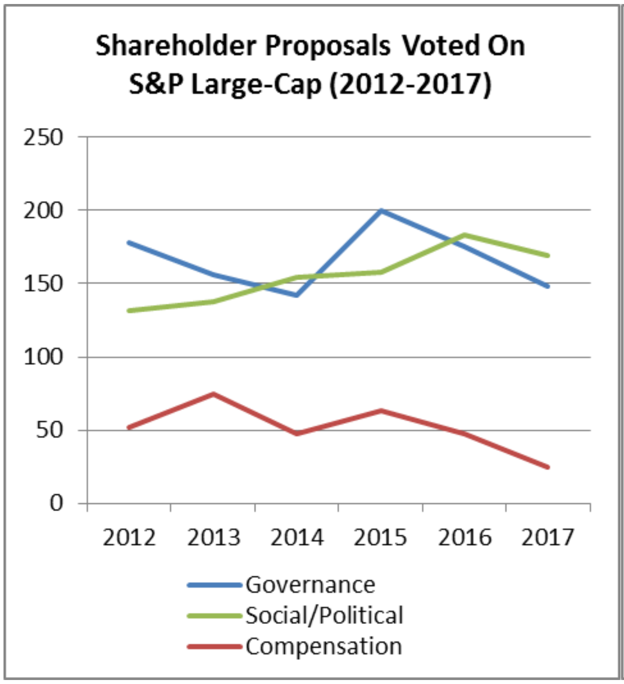
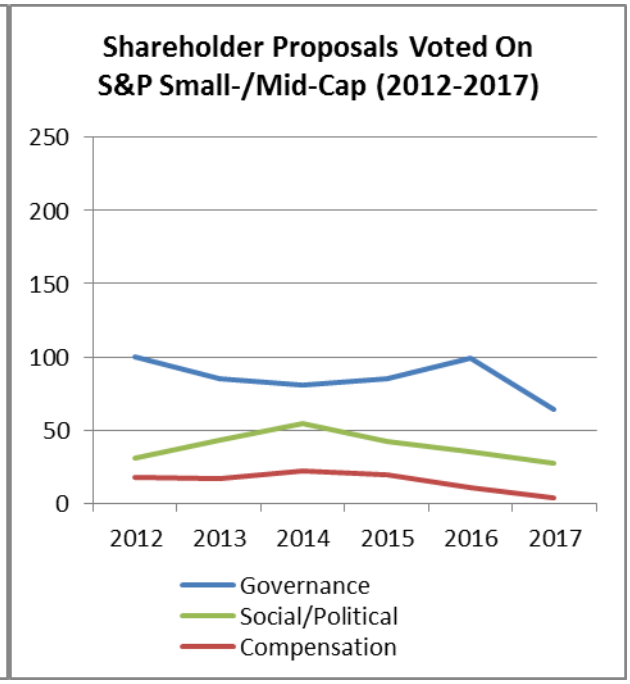
* The data in this publication incorporates proposals made at meetings held on or before June 30, 2017, unless otherwise specified. We estimate that around 90% of U.S. public companies held their 2017 annual meetings by that date. In this publication, when we refer to a proposal as "passing," we mean 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.

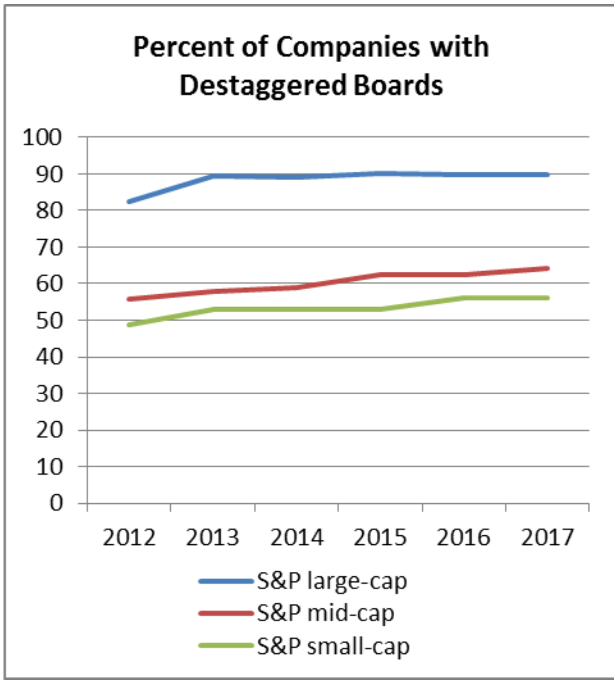
1 In this publication, we use "large-cap" to mean S&P 500 companies, "mid-cap" to mean S&P 400 companies, and "small-cap" to mean S&P 600 companies.

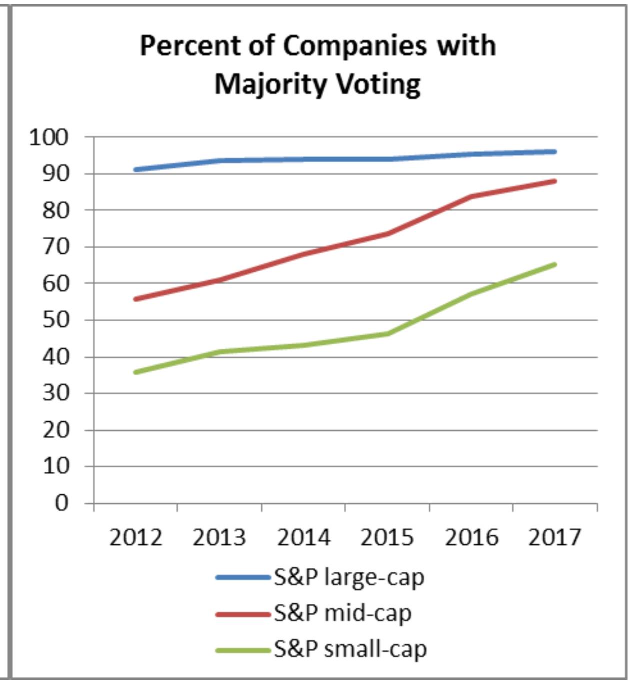
The following graphs show the frequency of proposals, by category, voted on at large-cap companies compared to small- and mid-cap companies. The higher numbers at large-cap companies are particularly notable given that the small-/mid-cap graph includes twice as many companies.





The lower frequency of proposals at small- and mid-cap companies does not mean, however, that developments in governance proposals and practice are not pertinent to these companies. These developments are pertinent for several reasons. 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. 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. As a result, 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, though not as common as at large-cap companies. This is demonstrated in the following charts.





Second, when these proposals do come to a vote at smaller companies, they have similarly high support levels as they do at larger companies. And third, to the extent that proponents do not move on to a new agenda at large companies (*e.g.*, emerging topics such as board diversity, pay equity and climate change impact), they may turn their attention to more "traditional" corporate governance proposals at smaller companies. For majority voting, in particular, proponents have kept pressure on smaller companies, with non-S&P 500 companies representing the vast majority of proposals coming to a vote in recent years.

C. WHO MAKES SHAREHOLDER PROPOSALS

It is informative to review the identity of shareholder proponents, particularly because the priorities of this relatively concentrated group of individuals and entities drive the voting agenda at public companies generally:

- ***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 close to 25% of all proposals submitted, and more than half of all governance-related proposals.
- ***Public Pension Funds and Entities.*** Public sector pension funds and entities proposed more than 140 proposals to public companies for 2017 meetings. The most frequent proponent in this category was the New York City Comptroller, on behalf of the New York City Pension Funds, who submitted over 80 proposals, the vast majority of which were proxy access proposals, as described in Section I.D.1. Other topics commonly addressed by proposals from pension funds and other public sector entities were board diversity, disclosure of political contributions, environmental issues 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. The number of proposals by labor unions was

down year-over-year, consistent with the overall reduction in governance and compensation-related proposals.

- ***Social Investment Entities*.** The majority of proposals on social issues come from asset management or advisory institutions that seek to make "socially responsible" investments and advance social causes, as well as religious organizations. The entities that were most active in 2017 included As You Sow Foundation (47 proposals submitted), Trillium Asset Management (41), Walden Asset Management (23), Mercy Investment Services (22), Holy Land Principles, Inc. (20) and Northstar Asset Management (20).

The above summary is based on data provided by ISS's voting analytics with respect to over 850 shareholder proposals (including proposals which were withdrawn or excluded), supplemented with information published by certain proponents. The numbers may understate the actual number of proposals submitted, as it would not include proposals that were submitted and then withdrawn, often following dialogue with the company, unless either the proponent or the company voluntarily disclosed the proposal.

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 reform in recent years. The Financial CHOICE Act of 2017, which was approved by the U.S. House of Representatives in June 2017 but has not yet been approved by the Senate, would change the threshold to at least 1% of the outstanding stock for three years. The relatively low success rate for many proposals brought by individuals and groups with minimal investments in companies may provide continued support for reforming the Rule 14a-8 limits. Any restriction based on share ownership percentage would be likely to increase the focus of proposals on smaller companies.

D. SHAREHOLDER PROPOSALS ON GOVERNANCE STRUCTURE

The number of proposals on governance matters (board-related and antitakeover concerns) that were voted on in 2017 was down significantly from 2016, which itself had been down from prior years. 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. There are few large companies that 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. Proxy access seems to be settling into a similar pattern, with fewer proposals coming to a vote as more companies adopt a market-standard provision.

Average support for governance proposals in 2017 was 39% overall, about the same as in 2016, but varied significantly for different types of proposals, as discussed further in the following sections.

1. Proxy Access Proposals

	PROXY ACCESS					
	Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
	2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
Adopt new right	**27**	76	**58%**	51%	**17**	39
Amend existing right	**22**	8	**28%**	44%	**0**	2

Proxy access was the most common governance topic for shareholder proposals in 2017, as in 2016, but once again much of what occurred happened outside of the annual meeting voting process. Over the past two 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—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. At this point, over 400 U.S. companies have adopted proxy access provisions, including over 85% of S&P 100 companies and over 60% of S&P 500 companies.

Most companies that received proposals to adopt a proxy access provision at the 3%/3-year level decided to adopt a market-standard provision, which either caused the proponent to withdraw the proposal or allowed the company to exclude the proposal as substantially implemented under SEC rules, notwithstanding certain differences between the proposals and the adopted provision, as discussed further below.

A total of 49 proposals on proxy access have come to a vote in 2017, 27 of which sought the adoption of a new right, and 22 of which sought amendments to an existing right. Of the 27 proposals seeking a new right, 17 of them received over 50% support (and one received 49.6% support). Of the nine proposals that received lower levels of support eight were at companies with large insider holdings, and one was at a company that put forward a competing proposal to adopt a market-standard bylaw. All of the proposals seeking an amendment to an existing right failed, as discussed further below.

The bulk of the proposals came from either the New York City Comptroller or one of a group of individual governance activists.

a. NYC Comptroller Proxy Access Proposals

The New York City Comptroller, acting on behalf of pension funds for city employees, submitted proxy access proposals to over 70 companies for 2017, which is comparable to its activity levels in 2015 and 2016. The Comptroller withdrew most of these (at least 50) upon adoption of an acceptable proxy access bylaw. In selecting companies to receive proposals, the Comptroller focused on the same factors as in 2016—climate risk, board diversity, excessive chief executive officer (CEO) pay, and the size of NYC pension fund holdings.

The form of the Comptroller's proposal was essentially the same as in 2016, with the key features being a 3% ownership threshold, a three-year holding requirement, and a limitation on nominees of 25% of the board. The proposals did not address the size of any permitted group.

The Comptroller generally has been amenable to withdrawing its proposal if the company adopts a market-standard 3/3/20/20 proxy access provision, though the Comptroller often uses the process of negotiating withdrawal to guide market practice on ancillary provisions, such as the use of proxy access at an otherwise contested election.[2]

b. Proxy Access Proposals Made by Individuals

The individuals referenced above in Section I.C were particularly active in this area in 2017, with proxy access being the most common topic for their proposals. These proposals continued to advance a 3%/3-year ownership and a 25%/2-director cap, and specifically called for having no restriction on the size of a group of nominating shareholders.

These individuals were far less likely than the Comptroller to agree to withdraw their proposal if the issuer adopted a market-standard proxy access provision, with the main sticking points being the importance that these individuals placed on the 25% director cap (rather than the market standard of 20%) and the absence of a restriction on group size (rather than the market standard of 20). However, in 2017, despite these differences, the SEC staff continued its practice of allowing companies to exclude these proposals as substantially implemented under Rule 14a-8(i)(10) if the company adopts a market-standard proxy access bylaw. In addition, the ability of companies to exclude the proposals as "substantially implemented" was not affected by the fact that their bylaw provisions contained a number of other common terms and conditions that were not contemplated by the proposals, including a "net long" definition of ownership (that is, full voting and economic ownership, excluding hedged positions), various qualification requirements for nominees (such as independence under relevant stock exchange standards and a lack of affiliation with a competitor), counting incumbent access nominees against the nominee cap, restrictions on repeat nominees, and requirements to provide additional information along with the nomination notice similar to what is required under advance notice bylaws.

2 The vast majority of proxy access bylaws provide that proxy access is not available at all if the company receives a notice under its advance notice bylaws that a shareholder intends to nominate a candidate outside the proxy access provision (that is, in a proxy contest) at the relevant meeting. The Comptroller, however, has suggested addressing this concern by reducing the proxy access director cap by the number of proxy contest candidates, which nevertheless leaves the company in the position of waging a two-front war.

In contrast, the staff did not permit exclusion in the case of companies that adopt a 5% threshold, which suggests that the ownership threshold is viewed by the staff as the key element of these proposals for purposes of Rule 14a-8(i)(10).

This record indicates that a company that adopts a proxy access bylaw with terms that are currently viewed as market standard would be able to exclude a typical shareholder proposal as substantially implemented. What is unclear, however, is the extent to which following this approach will result in the shareholder proponent proposing an amendment in the following year to include the provisions originally requested by the proponent, as discussed in the following section.

c. Proposals to Amend Proxy Access Terms

Shareholder proposals seeking to amend the terms of proxy access were more common in 2017 than in 2016, which is not surprising given the increased number of provisions adopted over the past year. In 2017, 22 amendment proposals have gone to a vote, none of which passed. In 2016, eight such proposals went to a vote, and two passed. The two that passed in 2016 both involved lowering the threshold percentage from 5% to 3%, while all of the proposals that did not pass in 2016 and 2017 were made at companies that already had a 3% threshold. These proposals 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.

These results indicate that a market-standard 3/3/20/20 proxy access provision is likely to be resilient against proposals to amend it. 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 2017 to date. The proposals did receive relatively strong support levels, ranging from 18% to 37% of votes cast, and ISS supported all of them. It is possible that a company with perceived governance and board composition problems could see an amendment proposal pass in the future.

In appropriate cases, Rule 14a-8(i)(10) is available to exclude a proposal to amend a proxy access bylaw as “substantially implemented,” even where the company has not taken any action in response to the proposal. In such a case, the SEC staff puts the burden on the company to demonstrate that the requested change would not significantly impact the existing provision. This was made clear in a number of no-action responses issued on March 2, 2017 with respect to proposals to increase group size. These no-action letters generally granted relief to companies that showed, using data on both the duration and size of the holdings of their shareholder base, that the requested increase would not significantly change the availability of proxy access to shareholders. For example, the staff initially denied relief to UnitedHealth Group, Inc. when the company presented data only on current ownership levels, but granted relief upon reconsideration when the company presented further data as to the number of shareholders who have held for three years.[3] It is unclear whether or how this rationale would apply to other types of amendment proposals.

d. Market-Standard Proxy Access Bylaws for Large Companies

Since the 2015 proxy season, hundreds of public companies (mostly large-cap companies) have adopted some form of proxy access, compared to only 15 companies before 2015. At this point, consistency has emerged in most of the key terms of these proxy access provisions. In particular, of the nearly 400 proxy access bylaws adopted by U.S. companies from April 2015 through June 2017:

- 99% have a 3% ownership threshold.
- 100% have a 3-year holding period.
- 100% require full voting and economic ownership.
- 92% allow aggregation by groups of up to 20 holders.
- 94% count funds under common management as a single holder for aggregation purposes.
- 86% limit the number of access nominees to 20% of the board, and 13% use a 25% limit. In either case, most bylaws provide a minimum of two access nominees.
- 83% count incumbent access nominees against the current-year maximum.
- 73% provide a nomination window of 120 to 150 days before the prior year's proxy mailing date.
- 94% prohibit or limit the availability of proxy access in the event of a concurrent proxy contest.
- 82% prevent resubmission of a failed candidate who received less than a specified vote percentage (usually 25%) in the past few years.
- 95% specifically include loaned stock for purposes of meeting the ownership threshold and holding period, with 53% of all bylaws requiring the loaned stock to be recalled at some point in time and 35% of all bylaws requiring that the stock be promptly recallable, but not actually requiring it to be recalled by a specific point in time.
- 72% do not address post-meeting holding of the stock, 8% require a representation of an intent to hold post-meeting for at least one year, and 20% require a description of the holder's intent to hold post-meeting.
- 80% require disclosure of (but do not prohibit) third-party compensation arrangements. Another 12% do prohibit third-party compensation arrangements with respect to service as a director and, in some cases, with respect to the nomination. The rest do not address the topic in the bylaws, though in most cases disclosure of such arrangements would be called for in a standard director questionnaire.

The high degree of convergence to date reflects, in part, that proxy access has been adopted primarily by large companies so far. Naturally, the appropriate terms for a proxy access provision, and the

[3] *See* UnitedHealth Group, Inc. (Feb. 10, 2017, *reconsideration granted* Mar. 2, 2017).

appropriateness of adopting a provision at all, will depend on the particular circumstances of a company and its shareholder base. We could very well see different terms become common at smaller companies over time, such as a higher ownership threshold to reflect the investment necessary to reach any specified percentage.

e. What to Do in Preparation for 2018

Given the widespread adoption of proxy access by a number of large companies over the past few years, many companies that have not yet received a proxy access proposal will likely consider whether it makes sense to adopt a proxy access bylaw preemptively rather than waiting for a proposal.

There is no one-size-fits-all approach to this question. On the one hand, adopting a proxy access bylaw with market-standard terms avoids the need for negotiations with a proponent (including the often detailed and protracted negotiations with the Comptroller on ancillary provisions), and the expense and public attention of the no-action process or a contested vote on proxy access. Doing so will likely put the issue behind the company, with no need for interaction or negotiation with any third party, and with market-standard terms that are, at this point, fairly reasonable.

On the other hand, there is little pressure to act early, and doing so will make proxy access available to shareholders sooner than could otherwise be required. There is no guarantee that a company will receive a proxy access proposal for 2018 (especially companies outside the S&P 500) and, even if a proposal is received, any proxy access provision adopted in response would likely not take effect until 2019. Although proxy access has yet to be utilized at any U.S. issuer, and the typical terms and conditions make proxy access an unappealing alternative to a proxy contest for many activists that can fund one, proxy access does give smaller shareholders the ability to impose significant costs on the company in terms of time and expense.

Regardless of the ultimate decision, management can take steps during the off-season to facilitate the board's and the company's readiness on the issue of proxy access. Companies should consider having a form of proxy access bylaw "on the shelf" that reflects management's recommendation, in consultation with counsel, for terms that would be appropriate for the company, so that the company can act quickly when necessary. Management should make themselves aware of, and as appropriate update the board on, the actions taken by the company's peers on proxy access and the views of the company's significant shareholders on proxy access, and on governance and social responsibility topics in general.

2. Independent Chair Proposals

INDEPENDENT CHAIR					
Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
40	47	**30%**	29%	**0**	0

Once again, proposals requesting that companies separate the roles of CEO and chair, or that the chair be an independent director, were the most common type of governance proposal other than proxy access. However, the number of proposals was down from 2016, which is not surprising given the low success rate of this proposal in recent years. Large companies have regularly received these proposals since the mid-2000s, reflecting the views expressed by certain shareholders 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 25-40%), but rarely pass.

The declining frequency and lower success 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 a suitable alternative to mandatorily separating the CEO and chair roles. Shareholders broadly do not appear to demand the separation of the roles as a matter of principle, but instead vary in their support for this proposal depending 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.

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

	MOST SUCCESSFUL GOVERNANCE PROPOSALS					
	Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
	2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
Majority Voting in Uncontested Elections	**14**	19	**68%**	71%	**10**	15
Eliminate Supermajority Thresholds	**14**	16	**73%**	60%	**13**	10
Declassify Board	**6**	6	**64%**	79%	**4**	5

The only common shareholder proposals that consistently pass, other than those to adopt proxy access, are the three governance proposals that have been adopted at large companies on a widespread basis—the adoption of majority voting in uncontested director elections (rather than plurality voting), the elimination of supermajority voting thresholds to effect certain corporate actions (such as charter or bylaw changes or the removal of directors), and the declassification of boards. When these proposals come to a vote, they usually pass. However, the widespread adoption of these practices at large companies has led to a sharp decrease in these proposals in recent years. As a result, there are fewer high-profile targets left—in 2017 fewer than half of the proposals on these topics were at S&P 500 companies. Governance activists, having achieved broad success at driving these changes at large-cap companies, have tended not to show similar fervor in advancing their cause at smaller companies, choosing instead to shift their focus to advancing proxy access. Nevertheless, as shown in the graphs in Section I.B, these governance reforms (particularly majority voting) have been steadily advancing at smaller companies as well.

4. Shareholder Right to Call Special Meetings

	RIGHT TO CALL SPECIAL MEETINGS					
	Total Shareholder Proposals Voted On		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
	2017 YTD	***2016***	***2017 YTD***	***2016***	***2017 YTD***	***2016***
Adopt new right	***4***	4	***47%***	41%	***3***	2
Lower % on existing right	***19***	15	***41%***	42%	***1***	2

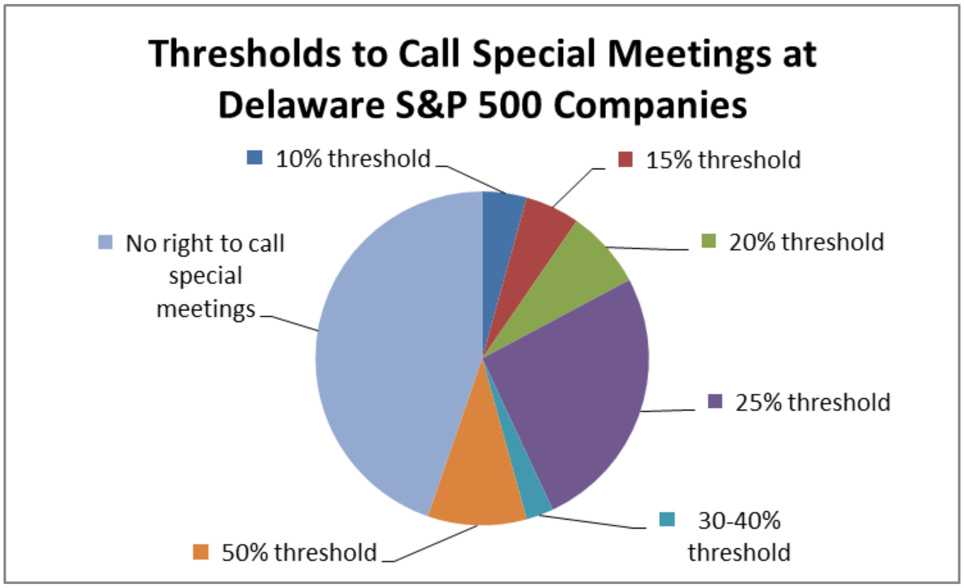
Proxy advisory firms and many shareholders support the right of shareholders to call a special meeting because this enables shareholders to act on matters that arise between annual meetings (such as the replacement of one or more directors, including in circumstances intended to permit an acquisition offer to proceed, or the amendment of bylaws). The right to call special meetings should be viewed in conjunction with the 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 consider hostile takeover proposals and seek superior alternatives. Nearly two-thirds of S&P 500 companies 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.

Due to the widespread adoption of special meeting rights at large companies, most shareholder proposals on the topic seek to reduce the ownership threshold for an existing special meeting right, rather than to introduce a new right at a company that does not provide one. Three of the four companies that had a vote on a proposal for a new right in 2017 included in their proxy both the shareholder proposal with a 10% threshold and a company proposal with a 25% proposal. At two of the companies, both the company proposals and the shareholder proposal passed, and at the third only the company proposal passed.

The significant number of proposals seeking to reduce the ownership threshold to call a special meeting shows that some governance activists are not satisfied with the 25% threshold that has become the market standard at large companies. All the 19 such proposals that came to a vote in 2017 sought to reduce a 25% threshold to either 10% or 15%, and all but one of these failed.

Issuers considering putting forth a special meeting 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. Both Vanguard and T. Rowe Price have indicated that 25% is an appropriate level in their view. The following chart shows the threshold for special meeting rights at S&P 500 companies that are incorporated in Delaware.[4]



- ***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 ensure that the information required to be provided by the requesting shareholders includes 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.
- ***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

[4] 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%.

meeting, the company may include the specified item in a meeting called by the company within that same time period (if there is no blackout 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 most 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.

If a shareholder proposal is made, there is a potential advantage in putting forward a management proposal, rather than letting the shareholder proposal come to a vote with no management alternative and determining whether and in what form to adopt proxy access after the fact. If a 10% special meeting shareholder proposal comes to a vote and passes, the adoption of a provision with the terms described above (in particular, a 25% threshold) may well not be seen as "responsive" by proxy advisory firms assessing director recommendations in the following year. ISS's FAQs[5] indicate that a threshold above 10% will be deemed responsive only if the company's outreach to its shareholders finds a different threshold acceptable to them, and the company disclosed these results in its proxy statement, along with the board's rationale for the threshold chosen, and even then the analysis is on a case-by-case basis.[6] In addition, ISS takes a limited view of the permissible restrictions on the special meeting right, including a view that restrictions on agenda items are generally seen as negating the right to call a special meeting.

5. Shareholder Right to Act by Written Consent

RIGHT TO ACT BY WRITTEN CONSENT					
Total Shareholder Proposals Voted On		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
2017 YTD	***2016***	***2017 YTD***	***2016***	***2017 YTD***	***2016***
14	17	***45%***	41%	***3***	1

The number of proposals requesting that the company grant shareholders the right to act by written consent has continued to drop significantly in recent years, primarily because the individuals who were the main proponents shifted their attention to proxy access. ISS recommended in favor of all of these proposals in 2017, and the proposals, as usual, received relatively strong support levels. In 2017, three proposals (21% of the total) have passed, compared to one (6% of the total) in all of 2016.

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5 *See* ISS, U.S. Proxy Voting Policies and Procedures (Excluding Compensation-Related) FAQs, *available at* https://www.issgovernance.com/policy-gateway/2017-policy-information/, at Question 39.

6 In 2017, for example, ISS recommended "against" votes with respect to all the members of the Governance Committee at CBRE Group, Inc., because ISS deemed the company's proposal of a 30% special meeting right to be insufficiently responsive to a successful 2016 shareholder proposal to lower the threshold to 10%.

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 an orderly and transparent debate on the merits of the proposed action, as would occur if it were raised at a shareholder meeting.

In 2017, all the companies that had written consent proposals up for a vote already provided shareholders with the right to call a special meeting, and the companies stressed in their opposition statements that special meetings were a preferable and sufficient mechanism for allowing shareholder action between annual meetings. The low success rate of written consent proposals seems to reflect broad agreement by shareholders that special meeting rights adequately address this concern, and render written consent rights unnecessary.

6. Proposals on Board Composition

a. Increase Board Diversity

INCREASE BOARD DIVERSITY					
Total Shareholder Proposals Voted On		***Average % of Votes Cast in Favor***		***Shareholder Proposals Passed***	
2017 YTD	***2016***	***2017 YTD***	***2016***	***2017 YTD***	***2016***
8	8	***31%***	26%	***2***	2

In 2017, eight shareholder proposals have come to a vote regarding board diversity, two of which have passed; this is the same as the results for all of 2016. The relatively small number of shareholder proposals on this topic may seem surprising considering the recent focus by institutional investors and others on the topic of gender diversity in particular. For example:

- State Street Global Advisors announced in March 2017 its intention to focus on boardroom gender diversity and to vote against governance committee chairs at companies that fail to take action. In that release, State Street cites research by the Conference Board that companies with women on their boards have "stronger financial performance as well as fewer governance-related issues such as bribery, corruption, shareholder battles and fraud."[7] State Street does not set out any specific minimum threshold, but presents data suggesting that women should constitute at least 15% of the board.

7 *See* State Street Global Advisors, Guidance on Enhancing Gender Diversity on Boards (Mar. 7, 2017).

- Vanguard Group's head of corporate governance has discussed Vanguard's commitment to furthering board diversity, on the basis that board diversity is crucial to a board's effectiveness and, ultimately, maximizing clients' investments.[8]
- BlackRock's engagement priorities for 2017-18 state that "over the coming year, we will engage companies to better understand their progress on improving gender balance in the boardroom …. If there is no progress within a reasonable time frame, we will hold nominating and/or governance committees accountable for an apparent lack of commitment to board effectiveness."[9]
- 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.[10]
- As discussed in Section I.D.1.a, one of the factors used by the New York City Comptroller in determining where to submit proxy access proposals is whether a company has little or no apparent gender or racial diversity on their board.

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. We have summarized the key terms of these non-binding resolutions below:

- ***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

8 *See* Paul DeNicola, PricewaterhouseCoopers LLP, Investor Priorities This Proxy Season: A conversation with Vanguard's Glenn Booraem (April 2017). Mr. Booraem notes that one "could argue that board diversity is a social issue, but the research shows that it is also an economic issue—diversity positively impacts long-term performance."

9 *See* BlackRock engagement policies for 2017-2018.

10 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/.

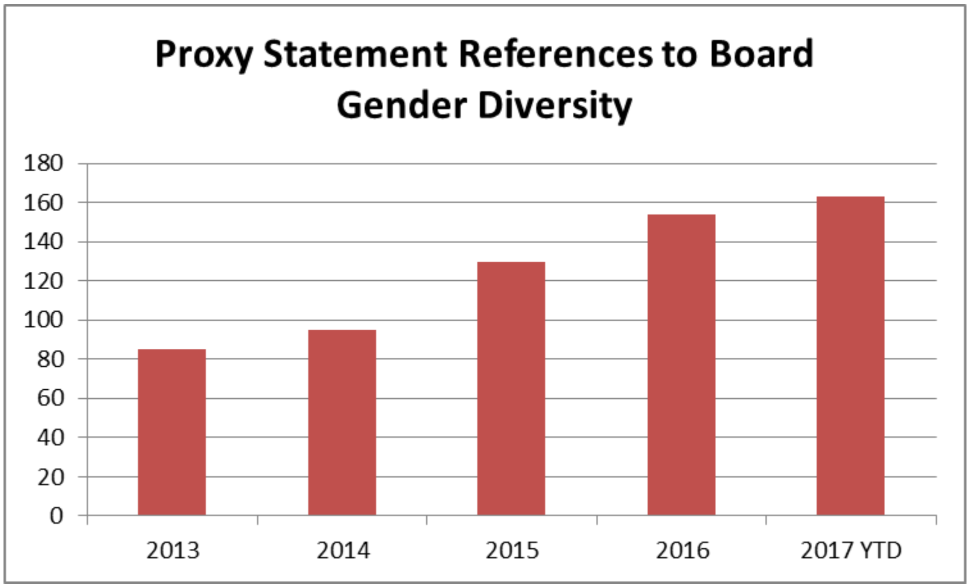
- ***Massachusetts Senate Resolution No. 1007***

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
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

As demonstrated in the following chart, gender diversity in particular has become an increasingly common topic for companies to address prominently in their proxy statements, as they seek to respond to the greater focus on these issues by investors.[11]



Female representation on boards has, in fact, been increasing in recent years, particularly at larger companies. In a June 2017 report, ISS noted that 23% of directors of S&P 500 companies were female in 2017, compared to only 19% in 2014. For smaller companies, the percentages are smaller but also increasing (15% in 2017, compared to 12% in 2014, for Russell 3000 companies, excluding the S&P 500). However, ISS also noted that proportionately fewer female directors serve in board leadership positions, such as board or committee chairs. In that report, ISS speculated that the presence of women in board leadership positions may be where the conversation is headed.[12]

The relatively small number of shareholder proposals concerning board diversity in 2017 is likely because many of the above developments—including the most pointed public statements by institutional investors—came after the shareholder proposal deadline for 2017 meetings. The current interest in this topic on a number of fronts points to the possibility of an uptick in the frequency of these proposals at 2018 meetings. In any event, companies should be prepared to engage with investors on this topic and, in particular, to articulate the principles by which the board considers gender, racial and other types of

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11 Based on a search of proxy statements for a number of representative phrases such as “women on the board,” “gender diversity” or “female directors.”

12 ISS Corporate Solutions, “More Women in the Boardroom, But Not in Charge”, Governance Insights Newsletter (Jun. 23, 2017).

diversity in choosing a slate, the steps taken to ensure a diverse pool of potential nominees are considered, and how the board is considering this issue for the upcoming meeting.

b. Director Qualifications

DIRECTOR QUALIFICATIONS					
Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
4	3	***11%***	20%	***0***	0

Each year there are a handful of proposals that come to a vote on director qualifications, but these have been declining in frequency, from eight proposals voted on in 2012 (with two passing) to four proposals voted on in 2017 (with none passing). Three of the four proposals voted on in 2017 called for the nomination of a director with environmental expertise, and the fourth related to lead independent director qualifications. None of the 2017 proposals received over 20% 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 raised the questions of whether there comes a point where a long-tenured director should not be seen as independent, and whether mandatory term limits are advisable. In 2014, State Street announced that it may vote against directors (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, with the 2016-17 survey indicating that 68% percent of respondents view a high proportion of long-tenured directors as a cause for concern.[13] ISS also added factors on director tenure to its QualityScore ranking in recent years.

Most institutional investors that set out policies on the topic, however, oppose bright-line rules, including age- or term-limits, and assess the experience and attributes of the board as a whole. This topic has tended to be addressed not through shareholder proposals seeking mandatory board refreshment or negative votes for long-tenured directors, but rather through shareholder-issuer engagement, and more meaningful explanations by companies of the manner in which the board considers tenure in assessing board composition and choosing the management slate.

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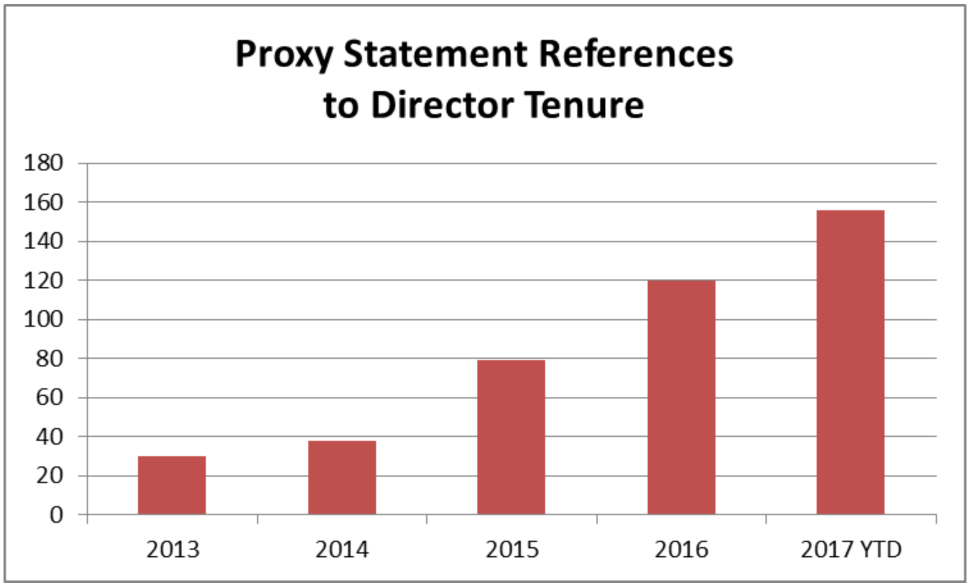
[13] *See* ISS, 2016-2017 ISS Global Policy Survey—Summary of Results, *available at* https://www.issgovernance.com/iss-announces-results-annual-benchmark-voting-policy-survey/.

This increased focus is reflected in the steep increase over the past few years of references to “director tenure” in proxy statements, as shown below:



7. Other Less Successful Governance Proposals

Some less frequent and less successful shareholder proposals on governance are addressed below.

- ***Dual Class Voting*.** Proposals to eliminate supervoting stock (that is, to approve a recapitalization plan where all stock has one vote per share) were voted on nine times in 2017 so far, compared to 12 times in 2016. Despite ISS’s support for all of these proposals, none of them has passed, which is not surprising, because holders of supervoting stock would tend to vote against them. ISS’s 2017 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.
- ***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. Ten of these proposals came to a vote in 2017, as compared to eight in 2016. The lack of practical impact likely explains the low vote results for these proposals, with an average of less than 10% support in 2016 and 2017, and no proposals coming close to passing.

E. SOCIAL/POLITICAL SHAREHOLDER PROPOSALS

	SOCIAL/POLITICAL PROPOSALS					
	Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
	2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
Political issues	***60***	73	***26%***	26%	***0***	2
Environmental issues	***59***	67	***29%***	24%	***3***	1
Anti-discrimination	***28***	23	***15%***	13%	***0***	2
Human rights issues	***23***	21	***7%***	8%	***0***	0
Sustainability report	***10***	15	***29%***	30%	***1***	1
Health and safety	***8***	10	***17%***	11%	***0***	0
Animal rights	***3***	3	***12%***	37%	***0***	1
Other social policy issues	***5***	6	***4%***	11%	***0***	0

Proposals on social and political issues continued to be common in 2017, and once again the most common subjects were environmental issues (including climate change) and political contributions and lobbying. There was an increased number of proposals relating to employment discrimination, including gender pay equity, as well as human rights issues.

While almost all social and political proposals failed, usually by a wide margin, proposals on environmental issues (particularly climate change) have achieved incrementally greater success levels over the past several years—in 2015, the average support level was 18% and no proposals passed, while in 2017 the average support level was 29% and three proposals passed, all climate change-related proposals at energy companies.

ISS supported around two-thirds of the social/political proposals in 2017, including 88% of the environmental proposals and 81% of the political proposals. Overall, shareholder support averaged 30% for social/political proposals where ISS recommended in favor, as compared to 7% for proposals where ISS recommended against.

The continued frequency of proposals on social and political policy issues, despite their overwhelming failure to receive majority support, suggests that activist shareholders submitting these proposals use corporate proxy statements as a forum for engaging with companies and raising social issues in a high-profile manner.

F. COMPENSATION-RELATED SHAREHOLDER PROPOSALS

	COMPENSATION-RELATED PROPOSALS					
	Total Shareholder Proposals Voted On		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
	2017 YTD	*2016*	*2017 YTD*	*2016*	*2017 YTD*	*2016*
Social compensation issues	***7***	7	**18%**	10%	***0***	0
Limit golden parachutes	***6***	18	**32%**	30%	***0***	0
Clawbacks	***6***	6	**14%**	14%	***0***	0
Stock retention	***3***	12	**30%**	18%	***0***	0
Other compensation-related	***7***	15	**14%**	19%	***0***	1

Executive compensation-related proposals continued the steep decline experienced over the past several years. These proposals tend to get relatively low support and almost never pass. The most common type of compensation-related proposal in 2017 sought to link executive compensation to social issues such as environmental impact or sustainability. Proposals to limit golden parachutes (that is, acceleration of performance awards upon a change in control), to adopt clawbacks and to enhance executive stock retention requirements saw a temporary increase in frequency and support levels in 2014 and 2015, but have since slowed to a trickle. The long-term decline in these proposals is in large part a result of mandatory say-on-pay votes becoming the primary mechanism by which shareholders express concerns over executive compensation.

ISS supported 59% of the compensation-related proposals in 2017, and shareholder support averaged 28% for proposals where ISS recommended in favor, as compared to 10% for proposals where ISS recommended against.

II. ANALYSIS OF ISS NEGATIVE RECOMMENDATIONS AGAINST DIRECTORS

As discussed in Section I.B 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.[14] For companies that have majority voting in uncontested director elections, a director's

[14] 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.

failure to receive majority support can trigger a director resignation policy but, 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 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 or the board as a whole, and the likely impact of these reasons on voting results.

ISS's policies provide a number of reasons why ISS recommend votes against directors.[15] In 2017, ISS issued negative recommendations against around 10% of directors in uncontested elections, totaling over 1,000 directors at more than 500 U.S. companies in the Russell 3000. These negative recommendations do have an appreciable effect on (or at least an appreciable correlation with) lower director support levels, with the average level of voter support being 97% if ISS recommends "for" a director and 83% if ISS recommends "against." However, it remains relatively uncommon for directors to receive less-than-majority support—only 2% of directors who received negative recommendations had more "against" votes than "for" votes in 2017.[16]

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 2017 for U.S. Russell 3000 companies, broken down by the rationale given by ISS for the negative recommendation.[17] Although the number of directors who receive less-than-majority support is typically very low, the percentage was relatively significant for lack of responsiveness to shareholder concerns (23%), poor attendance (19%) and overboarding (10%).

[15] 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).

[16] A total of 27 directors at U.S. Russell 3000 companies received less-than-majority support in 2017; of these 26 had received negative ISS recommendations.

[17] 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 companies through June 20, 2017, 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.

	2017 ISS DIRECTOR "WITHHOLD" OR "AGAINST" RECOMMENDATIONS (U.S. RUSSELL 3000 COMPANIES)		
	Number of Directors Receiving Negative ISS Recommendations	Average Shareholder Vote for Directors (% of votes cast)	Number of Directors Receiving <50% of Votes Cast
Independence issues (non-independent directors on key committees or failure to maintain a majority independent board)	311	88%	4
Newly public company with adverse governance provisions not subject to a sunset (***new basis for 2017***)	300	87%	2
Shareholders not permitted to amend bylaws (***new basis for 2017***)	202	79%	3
Absence of a formal nominating committee	117	91%	0
Compensation issues:			
• Lack of responsiveness to low say-on-pay vote	38	71%	2
• Other compensation issues (with no 2017 say-on-pay vote)	67	84%	2
• Other compensation issues (with 2017 say-on-pay vote)	20	93%	0
Poor attendance at board and committee meetings (<75%)	53	67%	10
Failure of risk oversight due to pledging of shares by executives	51	87%	0
Overboarding	40	78%	4
Poison pill issues (*e.g.*, maintaining a pill with dead-hand provisions or failing to put a pill up for a shareholder vote)	31	77%	1
Failure to address material weakness in internal controls	28	85%	0
Taking unilateral action that reduces shareholder rights	27	78%	2
Lack of responsiveness to shareholder concerns (*e.g.*, failure to implement a successful shareholder proposal)	26	62%	6
General performance or oversight concern	15	71%	0
Excessive non-audit fees paid to auditors, or failure to disclose a breakdown of fees	6	78%	0
Failure to opt out of amendment to Indiana law resulting in classified board	4	78%	0

A. BOARD INDEPENDENCE

The most common rationale for a negative ISS recommendation against a director in 2017 related to independence issues, which was also the case in 2016. ISS will recommend against directors that ISS 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 2017, and only four out of 311 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 was new in 2017. As set out in its policy updates for meetings on or after February 1, 2017, 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 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.[18]

[18] See ISS, U.S. Proxy Voting Policies and Procedures (Excluding Compensation-Related) FAQs, *available at* https://www.issgovernance.com/policy-gateway/2017-policy-information/, at Question 23.

In 2017, 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 88%, and only two out of 300 directors in this category received less-than-majority support (both of whom also had less than 75% attendance, which is a more impactful rationale, 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. SHAREHOLDER INABILITY TO AMEND BYLAWS

Another new ISS policy that took effect in 2017 applies to companies where shareholders do not have the right to amend the bylaws. For meetings on or after February 1, 2017, ISS will recommend against members of the governance committee if this is the case. Only a handful of states permit companies to deny shareholders the right to amend the bylaws—of the 69 companies whose directors received negative recommendations for these reasons, 60 are organized in Maryland (including a number of real estate investment trusts), six in Indiana, two in Texas and one in Colorado.

This policy 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 202 directors at these 69 companies received negative recommendations on this basis, but only three such directors received less-than-majority support (all of whom had other separate rationales for their negative recommendations as well). The average support level for directors in this category was 79%.

D. BOARD RESPONSIVENESS TO SHAREHOLDERS

As the above discussions show, the impact of a negative ISS recommendation varies considerably depending on the reason for the recommendation. As in prior years, the most impactful recommendations in that regard are those against incumbent directors for a lack of "responsiveness"—typically, 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.[19] Although this is far from the most common reason for a negative recommendation, shareholders as a group seem to take this issue particularly seriously—directors in this category received the support of an average of only 62% of votes cast, the lowest of any category, and lower even than in prior years. A total of six directors out of 26, nearly a quarter of the directors in this category, received less than 50% of votes cast. Given the significant impact on voting results for directors in this category, issuers should take such responsiveness concerns very seriously.

E. LACK OF FORMAL NOMINATING COMMITTEE

Another common basis for a negative recommendation, particularly at smaller companies, is the absence of a formal nominating committee. 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 a significant number of negative recommendations for this reason 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.

F. COMPENSATION ISSUES

A total of 115 directors received negative recommendations from ISS in 2017 for compensation-related reasons. These can be broken down as follows:

- ***Non-responsiveness to low 2016 say-on-pay vote.*** 38 directors were at companies that received less than 70% support on the 2016 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.[20] The average level of shareholder support was relatively low, at 71%, with two of these 38 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.

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[19] 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.

[20] 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).

- ***Compensation concerns and no 2017 say-on-pay vote.*** 67 directors who received negative recommendations from ISS for compensation-related reasons were at companies that did not have a 2017 say-on-pay vote, because it was not on their biennial or triennial vote cycle. 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 84%, with two of the 67 directors in this category receiving less-than-majority support.
- ***Egregious compensation issues.*** A total of 20 directors at four companies received negative recommendations due to compensation-related concerns, despite the company having a 2017 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 four companies, ISS cited persistent poor or troubling compensation practices over a multi-year period, and, in one case, the granting to the CEO of equity awards with superior voting rights without a compelling rationale. The average level of shareholder support in these cases was 93%, with no directors receiving less-than-majority support.

G. 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 also appears to be a significant issue for shareholders, as 10 of the 26 directors who received a majority of "against" votes were in this category, and the average support level for directors in this category was only 67%. Directors with multiple years of poor attendance often receive some of the lowest support levels – as low as 28 percent in 2017.

H. 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."[21]

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

[21] *See* ISS, U.S. Proxy Voting Policies and Procedures (Excluding Compensation-Related) FAQs, *available at* https://www.issgovernance.com/policy-gateway/2017-policy-information/, at Question 29. 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.

proxy statements, these negative recommendations were made at companies where the amount of stock pledged by insiders ranged from 5% to 77% 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*
5-10%	5
10-20%	3
20-30%	1
30-40%	2
40-50%	0
Over 50% (highest being 77%)	4

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

ISS appears to analyze the significance of pledging on a class-by-class basis. For example, at one company in this category, insider pledging amounted to less than 3% of the overall outstanding stock of the company, but over 5% of one class of stock. In another case, an insider had pledged 24% of the Class B shares of the company, which amounted to only 3% of the overall outstanding stock.

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.

A total of 51 directors at 15 companies received negative recommendations in 2017 due to pledging by insiders. Voting results for these directors averaged 87%, and none received less-than-majority support. In nearly all 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.

The frequency of negative recommendations on this basis was down from the first half of 2016, when 73 directors at 23 companies received them, which is consistent with the trend for more companies to discourage or prohibit significant insider pledging.

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).

I. OVERBOARDING

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

- sit on more than five public company boards;[22] or
- are the CEOs of public companies and sit on more than two public company boards besides their own.

Based on the voting results, investors generally seem to share ISS's concern with directors who sit on a large number of boards. Four directors of the 40 directors who were in this category received less-than-majority support, and the average support level for directors in this category was 78%.

J. POISON PILL ISSUES

Another relatively impactful reason for a negative recommendation in 2017 involved poison pill issues. In particular, ISS will recommend against directors if:

- the company has a poison pill with a "dead hand" feature that limits the ability of a future board to remove the pill;
- the board adopts a poison pill with a term of more than 12 months, or renews an existing poison pill, without shareholder approval; or
- the board makes a material adverse change to an existing poison pill without shareholder approval.

Directors receiving negative recommendations for this reason had average voter support of 77%. Only one director in this category received less-than-majority support, and that director had several other reasons underlying ISS's recommendation, including lack of independence and insufficient responsiveness to a low say-on-pay vote.

K. MATERIAL WEAKNESS ISSUES

ISS's policies state that they 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 2017 involved

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[22] Prior to February 2017, the "five" in the first prong was "six." Some large institutional investors set the permissible number of board positions at a lower number. For example, BlackRock's policies state that it is "most likely to withhold votes for over-boarding where a [non-CEO] director is … serving on more than four public company boards."

a perceived "failure to address material weaknesses in consecutive years." A total of 28 directors (generally audit committee members) received a negative recommendation for this reason in 2017, but none received less-than-majority support. Directors in this category averaged support levels of 85%.

L. UNILATERAL ACTION BY THE BOARD

In 2016, ISS adopted a policy to vote against directors who unilaterally adopt certain bylaw provisions that materially limit shareholders rights. In 2017, the unilateral actions that spurred this recommendation included increasing the special meeting threshold, adding significant impediments to submission of shareholder proposals, effecting a reverse stock split that increased authorized share count, and adopting a fee-shifting bylaw.[23]

The average support level for directors who received negative ISS recommendations due to the unilateral adoption of provisions that limit shareholder rights was 78% in 2017, and two directors received less-than-majority support. Although this suggests that, in most 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.

III. SAY-ON-PAY VOTES

A. SAY-ON-PAY FREQUENCY MOVES DECISIVELY TOWARD ANNUAL VOTES

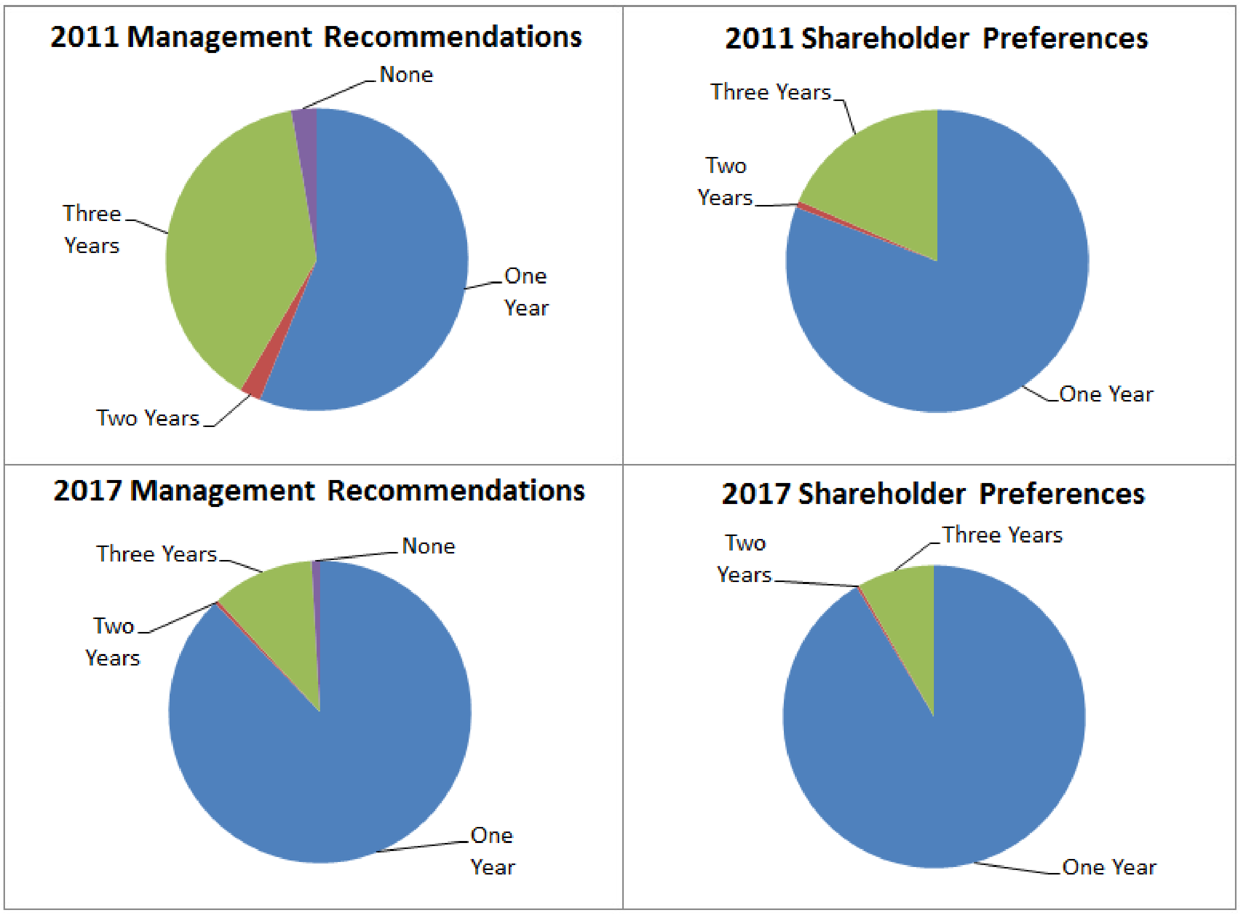
Following the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the SEC issued rules requiring public companies to include in their 2011 proxy statements both an advisory "say-on-pay" vote to approve executive compensation and an advisory "say-on-frequency" vote to determine whether say-on-pay votes will occur every one, two or three years. Companies are required to have another say-on-frequency vote at least every six years, which means that most companies had a second vote at their 2017 annual meeting.

In 2011, it was unclear where market practice would settle. A number of issuers, institutional investors and other commentators posited that a triennial vote would be best, in that it would allow investors to

[23] Fee-shifting bylaws seek to impose liability on a stockholder for attorneys' fees or expenses of the corporation or any other party in connection with a derivative action or other internal corporate claim. These provisions became less common in 2015, after the Delaware General Corporation Law was amended to prohibit them. For a further discussion, see our publication, dated June 12, 2015, entitled "Delaware Legislature Says No to "Loser-Pays" Fee-Shifting Bylaws But Yes to Forum-Selection Bylaws for Stock Corporations."

assess compensation practices and outcomes over a longer time period rather than make short-term judgments, and would avoid bandwidth issues that arise from investors having to vote on compensation at every portfolio company every year.

This outlook was reflected in management's recommendations in 2011, which included a significant number of recommendations for both annual and triennial votes. As shown in the below charts, however, shareholders overwhelmingly supported having annual say-on-pay votes. The recommendations and outcomes in 2017 show this market practice solidifying, with non-annual votes becoming even more unusual. This is particularly the case at large-cap companies, with annual votes being the management recommendation and shareholder preference at over 95% of S&P 500 companies in 2017.



A number of issuers and investors continue to believe that triennial votes are the best alternative, either generally or for a particular company. BlackRock, for example, supports triennial votes as a general matter, though will support annual votes in cases where "the company has failed to align pay with performance." BlackRock's policies explain that it is preferable for shareholders to review compensation annually and "express their concerns through their vote on the members of the compensation committee."[24] Experience has shown that many shareholders do exactly this—in a year with no say-on-pay vote, they express their concerns over compensation levels and practices by voting against compensation committee members, as reflected in ISS's policy discussed in Section II.F. This particular downside of triennial votes has likely contributed to the move by more companies to annual votes.

B. COMPANIES MAINTAIN STRONG SAY-ON-PAY PERFORMANCE

The following table summarizes the 2016 and 2017 say-on-pay voting results for meetings at U.S. companies through June 30, 2017:

	Russell 3000		*S&P 500*	
	2017	***2016***	***2017***	***2016***
Percentage passed (majority support)	***99%***	98%	***99.5%***	99%
Percentage with >70% support	***94%***	93%	***94%***	94%
Percentage with ISS "Against" recommendations	***12%***	11%	***9%***	8%
Average support with ISS "For" recommendations	***95%***	95%	***94%***	94%
Average support with ISS "Against" recommendations	***70%***	67%	***69%***	63%

U.S. companies, broadly speaking, had similar results on say-on-pay votes in 2017 as compared to 2016 and other recent years, with the vast majority of companies achieving high levels of support, and very few coming close to failing. The generally low rate of negative results is a result of the efforts that companies, particularly larger 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 (*i.e.*, votes with less-than-majority support). Of the 22 companies that failed their say-on-pay votes in 2016 and have had their 2017 vote, 17 achieved majority support in 2017, and 14 had support levels over 70%. This demonstrates that companies with failed votes have generally been successful in engaging in and disclosing shareholder outreach efforts and, as appropriate, implementing program changes, in a way that brings them back to high support levels in future years.

The year-over-year turnover has a negative implication, in that success in one year is by no means a guarantee of continued success. Of the 25 companies in the Russell 3000 that failed say-on-pay votes in

[24] BlackRock's Proxy Voting Guidelines for U.S. Securities are available on its website.

2017 so far, only five had failed their 2016 vote, and eight had support levels over 70% in 2016.[25] The two S&P 500 companies that failed say-on-pay in 2017 so far had support levels of 55% and 84% in 2016. These reversals of results highlight the importance of continuous attention to shareholder concerns and shareholder outreach on compensation matters, even if the most recent vote has demonstrated high support levels.

Off-season communications with shareholders, which have become a regular feature of corporate governance and shareholder relations for many large companies, help the company anticipate and address shareholder concerns, whether by adjusting compensation practices, crafting responsive disclosure, or both. Increasingly, these off-season communications serve to facilitate discussion on topics other than compensation as well. 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. This is typically not a concern, however, because the purpose of these meetings is for the company to gather information from shareholders—that is, primarily to listen. Companies with largely retail shareholder bases, of course, necessarily must engage in much of these outreach efforts through their ongoing public disclosure.

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 have increasingly engaged with proxy advisory firms in the off-season as well—for example, to address any misconceptions evident from the prior vote and to discuss issues that may be relevant to the next year's vote. ISS[26] and Glass Lewis[27] 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 can occur in the off-season.

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25 Of the 12 others, five had support of 50-70% in 2016, and seven did not hold a say-on-pay vote in 2016.

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

27 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 November 28, 2016, entitled "2016 U.S. Shareholder Activism Review and Analysis."

C. 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.[28] However, an analysis of ISS's 2017 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.[29]

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"

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[28] 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/2016/11/2017_Guideline_US.pdf for more information.

[29] Of the 37 S&P 500 companies that received negative ISS recommendations in 2017, 35 warranted "high concern" on their pay-for-performance assessment and 23 had high concern on either the relative or absolute alignment of CEO pay and TSR.

under each criterion for U.S. S&P 500 companies that received a negative say-on-pay recommendation from ISS in 2017:[30]

	U.S. S&P 500 Companies with Negative ISS Recommendations
Total with negative recommendations	37
Number that had "high concern" on:	
• Pay-for-Performance	35
• Compensation Committee Communication and Responsiveness	5
• Severance/Change-in-Control Arrangements	4
• Peer Group Benchmarking	1
• Non-Performance-Based Pay Elements	0

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 2017 follows.

D. 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.[31] 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."[32]

1. Components of Quantitative Analysis

The three components of ISS's quantitative assessment are as follows:

- ***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,[33] 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

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

[31] Technical information and guidance on ISS's say-on-pay methodology is available on the ISS website at https://www.issgovernance.com/policy-gateway/2017-policy-information/.

[32] *See* ISS's U.S. Executive Compensation Policies FAQs, *available at* https://www.issgovernance.com/policy-gateway/2017-policy-information/.

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

peer group of a company's CEO pay.[34] The company's score is based on this difference calculated on a three-year basis. Beginning in 2017, the threshold for receiving "high concern" is a difference of 50 percentile points or more (compared to 30 or more in prior years). *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 company performance. ISS's scoring system may trigger a "high concern" if this multiple is 3.33x or higher (a change from 2.33x or higher in prior years).
- ***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 (compared to 30 or more in prior years).

ISS may deem multiple "medium concern" levels as the equivalent of an overall "high" quantitative concern. The "medium concern" and "high concern" thresholds are summarized as follows:

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%

2. 2017 Results of ISS Quantitative Analysis

The following table summarizes the outcome of these quantitative tests for the U.S. S&P 500 companies that received a negative ISS recommendation on say-on-pay in 2017:

	Number of Companies with Concern Level		
	High	***Medium***	***Low***
Overall pay-for-performance concern level (quantitative + qualitative)	***35***	1	1
Overall concern level on quantitative screen only	***22***	11	4
Number that had "high concern" on each quantitative test:			
• RDA – Relative Alignment of CEO Pay and TSR (3-year)	***21***	7	9
• MOM – Relative CEO Pay to Peer Group Median (1-year)	3	5	***29***
• PTA – Absolute Alignment of CEO Pay and TSR (5-year)	2	3	***32***

As the 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

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

tests. 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 which 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.E 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.[35] 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.

35 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.

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 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.[36] Companies should review their peer group used in ISS's 2017 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.

[36] 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.

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 "social networking analytics." 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.[37] Glass Lewis's focus on who each company self-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:

- 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 2017 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 35 of the 37 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. Thirteen of

[37] 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/2016/11/Guidelines_US.pdf.

the 37 S&P 500 companies receiving negative ISS recommendations were identified as having performance standards that were not sufficiently rigorous, while nine of the 37 were assessed to have limited, opaque or undisclosed performance goals. An additional seven of the 37 were found to have lowered their performance goals below the prior year's achieved performance, a move which ISS viewed as signifying weak performance standards.[38]

- ***The use of above-target payouts*.** ISS referenced the existence of payouts that exceeded the company's target in 17 of the 37 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 15 of the 37 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 14 of the 37 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. New ISS Financial Metrics for Qualitative Consideration

Beginning in 2017, ISS has supplemented its quantitative and qualitative analysis of pay-for-performance with a new, multi-pronged measure of financial performance as compared to CEO pay relative to a company's GICS industry peer group. This financial performance rank will be a weighted measure of six financial metrics:

- Return on equity;
- Return on assets;
- Return on invested capital (ROIC);
- Revenue growth;
- EBITDA growth; and
- Cash flow (from operations) growth.

ISS reports now include a performance measure calculated as the company's financial performance rank minus its CEO pay rank. Where possible, the rankings measure both financial performance and CEO pay over a three-year period and are applied only if a company has at least two years of CEO pay and trading or financial data.

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[38] Similarly, several of the companies that received negative ISS recommendations were noted for having lowered their performance goals from the previous year, consistently lowering goals for consecutive years, and/or increasing the amount of award payouts despite lowered goals.

This new financial measure does not affect ISS's quantitative analysis of pay-for-performance, but may be considered in its qualitative assessment and may mitigate or heighten identified pay-for-performance concerns.

Our review of ISS's reports for the S&P 500 companies that received negative say-on-pay recommendations, however, suggests that this new metric was not a significant factor in ISS's qualitative analyses for these companies. Consider the proxy research report for an S&P 500 company that received one of the worst financial alignment measures:[39] ISS's qualitative assessment briefly mentions the company's negative EBITDA, EPS and TSR measures, as well as the fact that the CEO's base salary is set higher than that of its industry peers and the CEO's total direct pay levels were in excess of its peer group median. The company's relatively low performance and relatively high CEO pay, as compared to its ISS-selected peer group, are factors ISS considered, but the overall analysis focuses more on traditionally weighty factors, such as responsiveness to shareholder feedback and above-target awards.

Conversely, a positive score on the new metric does not necessarily lead to a positive qualitative assessment. While most of the S&P 500 companies that received a negative recommendation also received a negative financial alignment (meaning, their CEO pay peer rank exceeded their financial performance peer rank), five of the 37 companies scored positively. Among S&P 500 companies that received negative say-on-pay recommendations, Alphabet Inc. received the most positive score under this new metric, surpassing 85% of peers according to ISS. Nevertheless, ISS's qualitative analysis only briefly noted the company's financial metrics, but placed more emphasis on what ISS viewed as poor oversight of the pay program and excessive, time-based equity grants.

The introduction of additional metrics received strong support from investors.[40] Even if the new metric may not be outcome-determinative for many companies, it may be viewed as important information to investors, particularly in industries where one or more of the component metrics are commonly used to assess performance. Companies should consider whether the company's performance under any of the new metrics will require further explanation to enable investors to understand pay-for-performance

[39] The company considered is Chesapeake Energy Corporation, whose relative CEO pay/financial performance analysis resulted in a value of -91.6, which ISS reports is better than 0% of companies within its GICS peer group that trigger the same high quantitative concern level. Similarly, the proxy research report for Vertex Pharmaceuticals Inc., whose CEO pay/financial performance metric of -94.0 was also valued as being better than 0% of peer companies, spared only a single sentence of the qualitative analysis for this point.

[40] Nearly 80% of investors responding to ISS's 2017 global benchmark policy survey indicated that they support or strongly support the use of additional metrics. *See* https://www.issgovernance.com/iss-announces-pay-performance-methodology-updates-2017/.

alignment and may wish to consider whether it is appropriate to broaden the financial metrics used in compensation decisions or disclosure.

The new metric is also yet another area in which the peer group selected by ISS affects the say-on-pay assessment. Companies should utilize the ISS peer group submission process to ensure that ISS is using the most updated list of company-selected peers.

6. 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. Eight of the 37 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 2017, applicable to five of these companies, was poor responsiveness to a low 2016 say-on-pay vote, generally marked by what ISS perceived as a lack of adequate disclosure.[41] The second most common non-performance-related "high concern," affecting four of the companies, involved severance or change-in-control arrangements that were not in shareholder interests, due to factors such as pay-for-failure, termination or severance awards that exceeded market norms, CEO salary and target bonus award levels, and inclusion of excise tax gross-up provisions. ISS notes that excise tax gross-ups are not the market norm and are generally met with shareholder opposition, and labels such provisions as a problematic pay practice. Finally, one company received a "high concern" for above-median benchmarking practices.

Of the two S&P 500 companies that received negative ISS recommendations on say-on-pay but did *not* have a "high concern" on overall pay-for-performance, one had a "high concern" for non-responsiveness to a 63% say-on-pay vote in 2016, and the other received a "high concern" for excessive severance payment to the outgoing CEO and interim CEO.

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

A significant number of the S&P 500 companies that received negative ISS and/or Glass Lewis vote recommendations regarding their 2017 say-on-pay proposals filed supplemental proxy materials to

[41] Responsiveness can be determinative of whether ISS will recommend a company's say-on-pay provision. One of the S&P 500 companies that received a negative 2017 recommendation met all of the quantitative thresholds for "low concern" and received a "low concern" finding on its pay-for-performance alignment. It was enough for a negative recommendation, however, that the company had received a low percentage of shareholder votes for their 2016 say-on-pay vote (63% of votes cast) and failed to demonstrate sufficient responsiveness to shareholders' concerns from the previous year. See Section II.F for a discussion of negative director recommendations in 2017 due to an inadequate response to a low 2016 say-on-pay vote.

communicate to shareholders their disagreement with the proxy advisory firm's assessment or to reaffirm support for their executive compensation practices more generally. Seven of the 37 companies issued explicit rebuttals mentioning one or more of the proxy advisory firms by name.[42] In some cases these supplemental filings are very detailed, point-by-point rebuttals of the ISS or Glass Lewis analysis, 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 eight companies filed general statements in support of their executive compensation practices without referencing ISS or Glass Lewis.[43]

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 ISS or Glass Lewis recommendation and vote with management.

IV. EQUITY COMPENSATION PLAN APPROVALS

	ADOPTION OR AMENDMENT OF OMNIBUS STOCK PLANS			
	Russell 3000		*S&P 500*	
	2017	*2016*	*2017*	*2016*
Number of proposals voted on	***721***	760	***114***	123
Percentage with ISS "against" recommendations	***20%***	24%	***4%***	11%
Average level of support with ISS "for" recommendations	***93%***	92%	***93%***	94%
Average level of support with ISS "against" recommendations	***77%***	80%	***74%***	77%
Number of failed proposals (<50% support)	***3***	4	***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.[44] 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 a very small number of proposals fail to achieve majority support.

[42] These included Affiliated Managers Group, Inc., CVS Health Corp., Exxon Mobil Corp., FMC Corp., Newmont Mining Corp., Praxair, Inc., and Union Pacific Corp. At least three of these rebuttals—those of Affiliated Managers Group, Newmont Mining, Praxair and Union Pacific—explicitly noted that Glass Lewis, unlike ISS, had recommended in favor of their say-on-pay proposal.

[43] These included American Express Co., Chesapeake Energy Corp., ConocoPhillips, FirstEnergy Corp., IBM Corp., Kansas City Southern, Range Resources Corp. and The Southern Company.

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

Beginning in 2015, ISS introduced an "equity scorecard" approach to assessing equity plans. The scorecard method considers factors under three main categories:[45]

- ***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 peers and vesting requirements in recent CEO grants, among other factors.

ISS recommended against around 20% of equity plan proposals, but recommended against only 4% 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 2017, the average support level was 93% when ISS recommended "for" approval and 77% when ISS recommended "against."

ISS issued "against" recommendations for only five equity plan proposals at S&P 500 companies so far in 2017. For all of these companies, ISS highlighted "excessive burn rate" as one of the reasons for the negative recommendation. Other common reasons included excessive plan cost, discretionary vesting authority and liberal share recycling. In one case, ISS cited as an "overriding factor" that the plan permits repricing of awards and transfer of awards to financial institutions without shareholder approval.

Despite the negative recommendations, all of the proposals at S&P 500 companies received majority support—the lowest support level was 66%. At Russell 3000 companies more broadly, only three out of 721 proposals received less-than-majority support in 2017, with support levels of 27%, 47% and 48%.

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[45] ISS's current equity plan scorecard approach is described in its Equity Plan Scorecard: Frequently Asked Questions, available on its website.

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CONTACTS

New York

Frank J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohena@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Heather L. Coleman	+1-212-558-4600	colemanh@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Matthew M. Friestedt	+1-212-558-3370	friestedtm@sullcrom.com
Joseph B. Frumkin	+1-212-558-4101	frumkinj@sullcrom.com
David B. Harms	+1-212-558-3882	harmsd@sullcrom.com
Alexandra D. Korry	+1-212-558-4370	korrya@sullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Melissa Sawyer	+1-212-558-4243	sawyerm@sullcrom.com
Glen T. Schleyer	+1-212-558-7284	schleyerg@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com

Marc Trevino	+1-212-558-4239	trevinom@sullcrom.com
Krishna Veeraraghavan	+1-212-558-7931	veeraraghavank@sullcrom.com
Washington, D.C.		
Janet T. Geldzahler	+1-202-956-7515	geldzahlerj@sullcrom.com
Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Los Angeles		
Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
Palo Alto		
Scott D. Miller	+1-650-461-5620	millersc@sullcrom.com
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com
London		
Nikolaos G. Andronikos	+44-20-7959-8470	andronikosn@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com
George H. White III	+44-20-7959-8570	whiteg@sullcrom.com
Paris		
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Frankfurt		
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Melbourne		
Robert Chu	+61-3-9635-1506	chur@sullcrom.com
Sydney		
Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
Tokyo		
Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
John D. Young Jr.	+852-2826-8668	youngj@sullcrom.com