SHEARMAN & STERLING

16TH ANNUAL SURVEY OF THE
100 LARGEST U.S. PUBLIC COMPANIES

CORPORATE GOVERNANCE & EXECUTIVE COMPENSATION SURVEY 2018

Shearman

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INTRODUCTION

The 2018 Survey was produced under the leadership of the following Shearman & Sterling attorneys:

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We are pleased to share Shearman & Sterling's 2018 Corporate Governance & Executive Compensation Survey. In this year's Survey, the 16th in our series, we provide insights on significant governance and executive compensation topics and we analyze key governance policies and practices and identify best practices and emerging trends.

We examine the evolution of topics we have reviewed in prior surveys, such as proxy access, shareholder engagement, shareholder proposals, director compensation and activism. The Survey also considers new governance topics that have more recently emerged as key board-level issues, such as corporate culture, CEO pay ratio, cybersecurity, addressing sexual misconduct claims and board diversity. Additionally, the Survey addresses trends in governance practices of newly-public companies.

The Survey consists of a review of key governance characteristics of the Top 100 Companies, which we define as the 100 largest U.S. public, non-controlled companies that have equity securities listed on the NYSE or Nasdaq, measured by market capitalization and revenue.

The results of the Survey can be found in "The Survey" section, as well as in insights contained elsewhere.

We encourage you to use the Survey to benchmark your corporate governance and compensation practices against those of the Top 100 Companies, and to consider our perspectives and practical guidance on trending topics.

Please reach out to a member of our team to discuss any matters contained in the Survey or to learn more about the Shearman & Sterling Corporate Governance practice.

84

of the Top 100 Companies disclose that the board or committee has responsibility for cybersecurity matters, up from 59 in 2017

10

of the Top 100 Companies have a woman serving as board chair and only six of the Top 100 Companies have a woman serving as CEO

162:1

was the median pay ratio of the S&P 500 companies surveyed

INSIGHTS

Over the course of this section of the Survey, we provide our analysis and perspectives on a number of core and emerging governance topics. We use data from our Survey to help you see how the Top 100 Companies are addressing these issues.

THE IMPORTANCE OF ADDING CULTURE TO THE BOARD AGENDA

Doreen E. Lilienfeld and
Gillian Emmett Moldowan

On October 3, 2017, the National Association of Corporate Directors (NACD) published the NACD Blue Ribbon Commission Report on Culture as a Corporate Asset, affirmatively advocating that corporate culture be a part of board room agendas and not just left to management as a soft human resource issue. A company's culture can have a direct influence on its reputation and, often, performance. In the wake of corporate scandals ranging from sexual misconduct by top executives to incentive plans that entice employees to behave in their own self-interest, leading to CEO shake-ups, government investigations, falling stock prices and consumer backlash, a board should consider culture as part of its company's risk profile as seriously as it considers its company's financial and competitive challenges.

The report by NACD, the world's largest association of corporate directors, brings to the forefront what many management leaders already know — corporate culture matters. The absence of a healthy corporate culture can be a significant liability. Culture is linked to business strategy, selection and turnover of management, reputation and employees and customer satisfaction. In 2015, researchers from Columbia Business School and the Duke Fuqua School of Business released a report after surveying more than 1,400 North American CEOs and CFOs about corporate culture. Overwhelmingly, the respondents agreed that "leadership needs to spend more time to develop the culture." But what are the actionable steps that leadership, both directors and executives, can take to tackle this key issue?

A COMPANY'S CULTURE CAN HAVE DIRECT INFLUENCE ON ITS REPUTATION AND, OFTEN, PERFORMANCE.

CULTURE RED FLAGS

- **Focus on financial performance with little regard for how results are achieved**
- **High performers allowed to operate outside established policies and are rewarded for conduct inconsistent with stated values or code of conduct**
- **Exceptions to company policies are frequently granted in order to meet performance targets**
- **Excessive focus on consensus — "going along to get along"**
- **Sharing of bad news is discouraged**
- **Promotions or recognition tied to relationships rather than skills and performance**
- **Criticism of or challenges to existing practices or strategies are discouraged**

WHAT IS CULTURE

Culture can be difficult to define, but if values are about the “what” and the “why” of an organization, then culture is the “how”— the way in which those values are lived day to day. The NACD report uses the definition developed by MIT’s Edgar Schein, who characterizes culture as a series of assumptions individuals make about the groups in which they participate. In this model, a group’s culture is visible through its artifacts, goals and aspirations and common beliefs.

We “see” culture through:

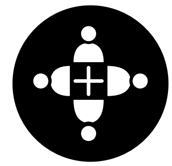
Artifacts

Public statements, organizational structure charts and recruiting materials

Goals and aspirations

Business plans, incentive plans, compensation and governance and compliance and ethics guidelines

Common beliefs



Training activities, norms of leadership behavior, reporting chains and communication and information flows

CULTURE AS A COMPANY ASSET

Culture should be viewed as an asset, a valuable one, similar to an organization’s human capital, financial resources and intellectual property. Studies show that organizations with highly engaged employees (one indicator of a strong, positive culture) outperform others on customer satisfaction, safety, quality, profitability, productivity and shareholder returns. Companies with weak ethical cultures experience levels of misconduct as much as 10 times higher than those with strong ethical cultures.

Despite its proven importance, less than a majority of directors reported to the NACD that their boards assess the cultural alignment of their organizations. Only about half of directors say they have information on the cultural beliefs of employees. Viewing culture through the “asset” lens can help facilitate initial discussions with directors by adding corporate culture to an already crowded board room agenda.

SIGNIFIERS OF A HEALTHY CULTURE

Highly engaged employees	**Alignment between values and actions — actions that get rewarded or punished are aligned with values**	**Strong corporate resilience that allows company to withstand stressors from inside and out**
Communication is strong and transparency embraced	**Accountability — mistakes are regarded as a source of learning rather than blame**	**Changes are implemented in a thoughtful and deliberate manner**

TEN PRACTICAL RECOMMENDATIONS

The NACD report provides 10 recommendations to help boards proactively engage on corporate culture and regularly measure and monitor company-specific values and behaviors.

1. **Ensure that the board, CEO and senior management establish clarity on the foundational elements of values and culture and develop concrete incentives, policies and controls to support the desired culture**

2. **Ensure that directors and company leaders take a forward looking, proactive approach to culture oversight with a level of discipline comparable to leading practices in risk oversight**

3. **Ensure that board policy documents and committee charters clearly delineate allocation of culture oversight responsibilities**

4. **Regularly review the culture of the whole board and its key committees**

5. **Assess whether the general counsel and other officers in key internal control roles are well positioned within management and in relationship to the board to foster an appropriate culture**

6. **Integrate culture into ongoing discussions with management about strategy, risk and performance, emphasizing that means are as important as ends**

7. **Regularly assess culture using both qualitative and quantitative information and include data from outside sources, including monitoring for red flags**

8. **Ensure that culture is an explicit criterion in CEO selection and that the CEO and senior leaders do the same in their own leadership development and succession planning**

9. **Review the company's recognition and reward systems to ensure they reinforce the desired culture and avoid unintended outcomes**

10. **Communicate to shareholders how the board carries out its responsibility for overseeing and actively monitoring culture**

INSTITUTIONALIZING CULTURAL OVERSIGHT

Talking about culture is a start, but it does not end there. Company leadership should look at how to institutionalize the culture conversation so that assessing management's efforts on culture is part of the board review every year. Board members need to achieve a level of discipline with respect to culture oversight that is comparable to their practices in the oversight of other risks. In addition, companies need a top-down strategy to demonstrate the culture on an ongoing basis, including finding ways to incentivize employees to act consistently with the corporate culture and ensure long-term strategies for leadership are aligned with the culture.

Three steps companies can take to move in this direction are adding culture oversight items to board committee charters (see below), providing disclosure of the company's cultural oversight process in the proxy statement and adding performance measures tied to culture contributions to the annual review of executives and other employees.

COMMITTEE-LEVEL RESPONSIBILITIES CONNECTED TO CULTURE OVERSIGHT

Audit Committee

- Oversight of the results of internal and external audits, compliance reviews, employee hotline or whistleblower reports and regulatory examinations
- Oversight of internal controls over financial reporting
- Oversight of risk management process

Compensation Committee

- Development of pay philosophy
- Design of incentive plans, CEO and senior management performance evaluations and resulting compensation decisions
- Oversight of talent strategy (including leadership development plans and goals related to employee engagement, diversity and inclusion)

Nominating and Governance Committee

- Development of board governance policies and operating principles
- Board composition and succession planning
- CEO succession planning
- Board performance assessments of the full board, committees and individual directors

INSIGHTS

CEO PAY RATIO: PERSPECTIVES ON THE FIRST YEAR AND A LOOK FORWARD

Stephen T. Giove,
Doreen E. Lilienfeld,
Lona Nallengara and Gina H. Lee

Labrador, a corporate disclosure documents design firm, assisted with the data collection and analysis

As the dust has settled on the first round of CEO pay ratio disclosures, a few things are clear: companies spent considerable time and money calculating and disclosing their pay ratios, many CEOs worried about the response to their pay ratio and, most importantly, the reactions of investors, special interest groups and the press were much more muted than expected. It appeared that the most interested group was the employees, and they were interested in how their own compensation compared to the median compensation, rather than to what their companies' pay ratio was.

The first round of disclosures did not get us any closer to settling the long-running debate as to whether pay ratio disclosure provides useful information for investors. Some continue to argue it is a tool for special interest groups to raise the drum beat of wage inequality and to wag a finger at perceived corporate greed, while others believe it sheds light on a company's compensation philosophy. A company's pay ratio may become a more useful data point when it is analyzed over time and compared to industry peers.

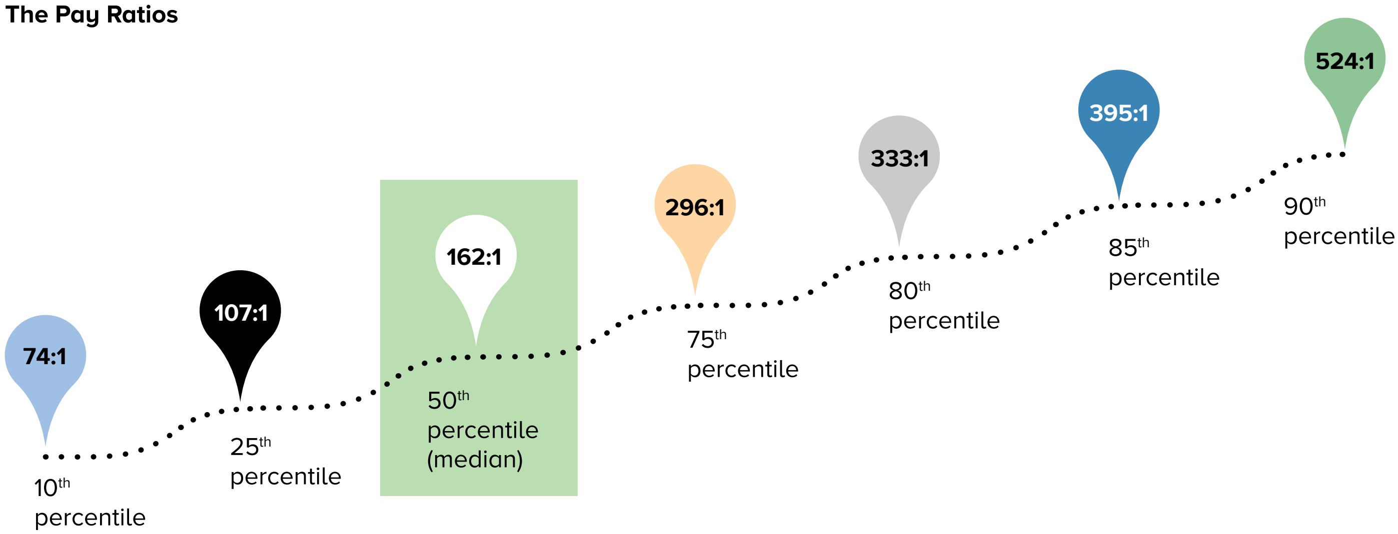
We reviewed and analyzed the CEO pay ratio disclosures of the 400 companies in the S&P 500 that disclosed their CEO pay ratio on or before July 20, 2018.

Information about the CEO pay ratio by industry sector, market capitalization, revenues and number of employees is presented at the end of this insight.

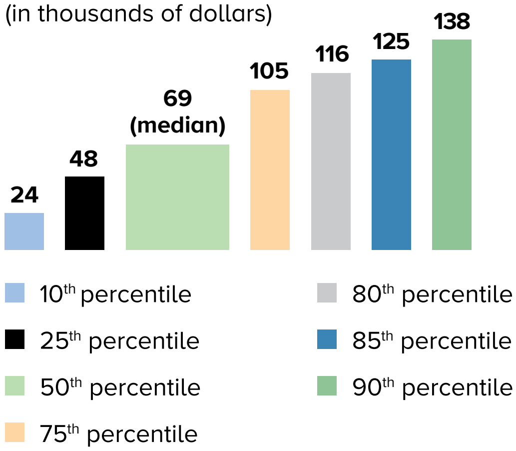
THE KEY STATISTICS

As shown below, for the S&P 500 companies surveyed, the median CEO pay ratio was 162:1, the median employee pay was approximately $69,000 and the median CEO compensation was approximately $12.3 million.

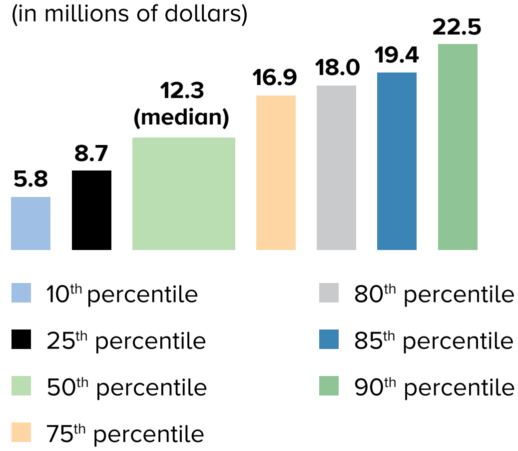
The Pay Ratios



Median Employee Pay
(in thousands of dollars)



CEO Compensation
(in millions of dollars)



PRESENTING THE RATIO

We identified four key presentation options that companies considered as they prepared their CEO pay ratio disclosure – alternative pay ratios, comparing the company's pay ratio to that of its peers, the location of pay ratio disclosure in the proxy statement and the level of detail provided about the pay ratio calculation.

Alternative Pay Ratios

Approximately

62

companies, or 16% of the S&P 500 companies surveyed, presented an alternative pay ratio

Of those that did,

49

companies, or 80%, presented an alternative pay ratio that was LOWER than the required pay ratio

13

companies, or 20%, presented an alternative pay ratio that was HIGHER than the required pay ratio

Companies reported a higher alternative pay ratio for a variety of reasons, including increasing the CEO's compensation by using target total compensation for the CEO (as opposed to reported CEO compensation) for the year because the CEO did not receive an annual equity award in the year. Companies also reported a higher alternative pay ratio to take into account a special one-time equity award the CEO was getting in the following year – likely to get out well ahead of an expected increase in the pay ratio in the following year.

ISS/GLASS LEWIS APPROACHES

ISS:
In 2018, ISS began displaying both the CEO pay ratio and the total annual compensation of the median employee in its research reports – but indicated that pay ratio information will not affect ISS's voting recommendations in 2018

Glass Lewis:
In 2018, Glass Lewis began displaying CEO pay ratio information as a data point in its research reports – but noted that while pay ratio information may provide additional insight when assessing a company's pay practices, it will not be a determinative factor in Glass Lewis's voting recommendations in 2018

Comparative Pay Ratios

Only one of the S&P 500 companies surveyed provided a comparison of its pay ratio to its peers – and that company made comparisons of its ratio to both the ratios of companies with similar revenues and to those with a similar number of employees, although it did not identify the companies in either of these comparisons with any specificity.

Location of Disclosure

Overwhelmingly, the S&P 500 companies surveyed chose not to draw attention to their pay ratio disclosure and placed it deep into their proxy statements. They also generally did not reference their pay ratio in either their proxy statement summary or in the summary or "highlights" section of their corporate governance or executive compensation practices.

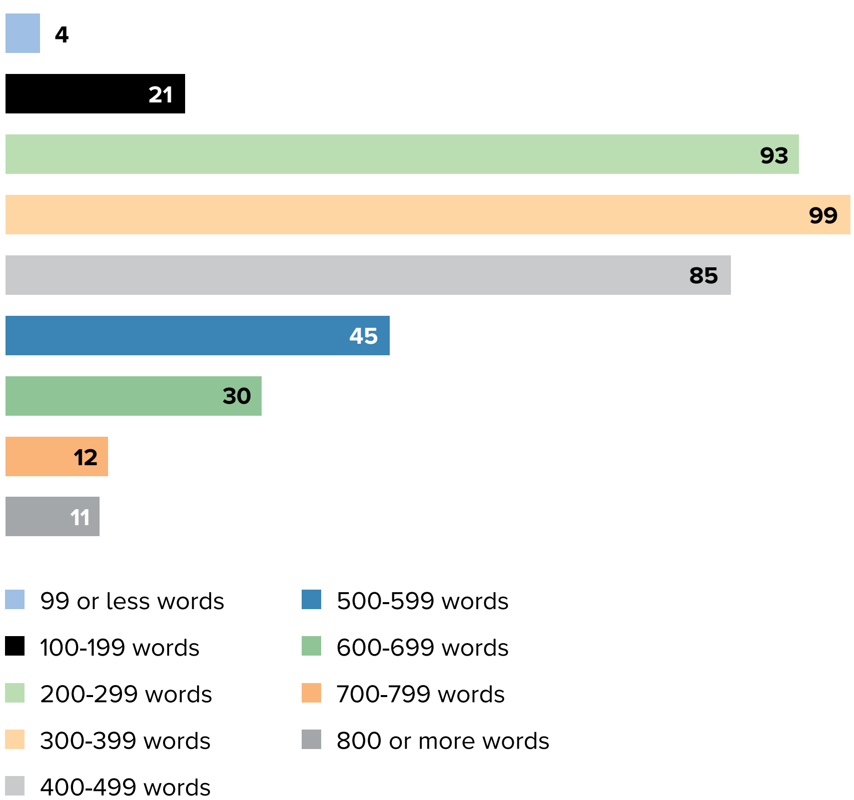
Approximately 77% of the S&P 500 companies surveyed included their pay ratio disclosure in the executive compensation section of their proxy statement. Our Survey found that only 12 companies, or 3%, of the S&P 500 companies surveyed included their pay ratio disclosure in the CD&A. Companies likely did not include pay ratio in the CD&A to not suggest that the pay ratio was a factor in the compensation committee's analysis and determination of executive pay.

Level of Detail

The level of detail provided by companies varied considerably both in terms of the length of their pay ratio disclosure as well as the level of detail of the calculation process.

Many of the longer pay ratio disclosures were made by companies that presented alternate pay ratios or had multiple CEOs during the year.

Pay Ratio Length



FAST FACTS

432 words

was the average length of pay ratio disclosures of the S&P 500 companies surveyed

83 to **1,038** words

was the range of the length of pay ratio disclosures of the S&P 500 companies surveyed

34

companies, or 9%, of the S&P 500 companies surveyed had multiple CEOs during 2017

Of those that had multiple CEOs,

31

companies made adjustments, such as annualization, to the compensation of the person who was serving as CEO on the date used to select the median employee

CALCULATING THE RATIO

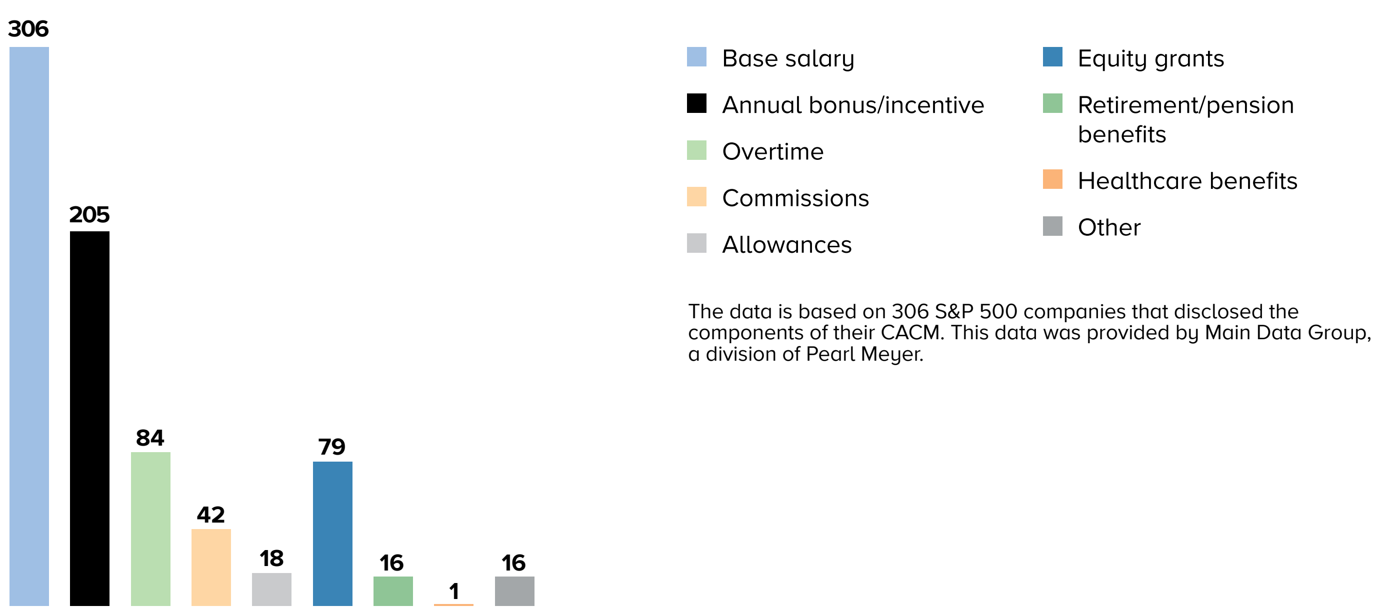
Under SEC guidance, companies had considerable flexibility in how they calculated their pay ratio. As a result, there was a great degree of variability in the components of their calculations and related disclosures. Key issues include:

- **Identifying consistently applied compensation measure (or CACM)**
- **Setting a measurement date for determining the median employee**
- **Use of statistical sampling**
- **Use of adjustments, including cost-of-living adjustments (COLA)**
- **Annualization of the salaries of employees that did not work an entire year**
- **Adjusting the median employee's compensation by including items such as health, welfare or retirement benefits or medical, dental, disability and life insurance premiums**
- **Exclusion of employees pursuant to the data privacy exception**
- **Exclusion of employees pursuant to the de minimis exception**
- **Exclusion of employees of a business that was acquired during the prior year**

Consistently Applied Compensation Measure

SEC rules require companies to identify a methodology to determine compensation – a consistently applied compensation measure, or CACM. There was considerable variability in the CACMs used by companies. In reviewing CACM disclosures, we analyzed the various components of employee compensation that companies included in their CACM calculation. The frequency with which companies disclosed that their CACM calculation included a particular element of compensation is set forth below:

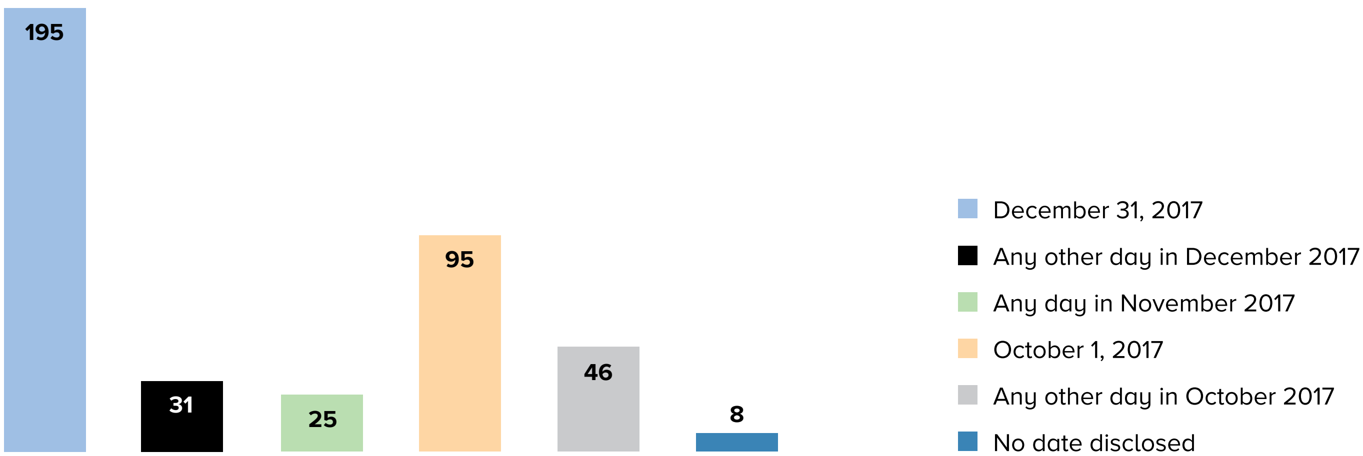
Frequency of Inclusion of Various Compensation Elements of CACM Definition



The data is based on 306 S&P 500 companies that disclosed the components of their CACM. This data was provided by Main Data Group, a division of Pearl Meyer.

Median Employee Measurement Date

A significant majority of companies used their fiscal year end as their measurement date for purposes of determining the median employee. The next most commonly used date was the first day of the third-to-last month of their fiscal year.



Statistical Sampling

6% Only 25 of the S&P 500 companies surveyed used statistical sampling in determining their median employee.

Cost-of-Living Adjustments (COLA)

1% Only five of the S&P 500 companies surveyed disclosed that they made cost-of-living adjustments.

Annualization of Employee Salaries

46% 187 of the S&P 500 companies surveyed disclosed that they annualized the salaries or wages of their full- or part-time employees in connection with the determination of their median employee.

Adjustments to the Compensation of the Median Employee

20% 80 of the S&P 500 companies surveyed adjusted the compensation of the median employee (and that of the CEO) by including items such as health, welfare or retirement benefits or medical, dental, disability and life insurance premiums.

Data Privacy Exception

0% None of the S&P 500 companies surveyed used the data privacy exception.

De Minimis Exception

40% 160 of the S&P 500 companies surveyed used the de minimis exception, which allows a company to exclude non-U.S. employees so long as they constitute less than 5% of total employees. Approximately 68 companies, or 46%, of the S&P 500 companies surveyed that used the de minimis exception excluded more than 4% of their workforce. Companies excluded employees from greater than 180 different countries. Of the eight companies that excluded more than 10,000 employees, 53 was the median number of countries from which employees were excluded.

Acquisition Exception

13% 53 of the S&P 500 companies surveyed excluded employees from businesses acquired in the past year. The number of employees excluded pursuant to this exception ranged from 16 to 12,000.

FUTURE CONSIDERATIONS

As the year has progressed, companies have been carefully reviewing pay ratio disclosures made by other companies, particularly those in their industry to understand the methodologies used in order to better understand the level of comparability among them.

As companies reflect on the first year of pay ratio disclosures, they should consider potential changes to their calculation methodology and disclosure including whether to:

- **Use the same median employee or change the methodology to identify the median employee**
- **Annualize the pay of new hires**
- **Make a cost of living adjustment**
- **Use the de minimis exception for employees in a foreign jurisdiction**
- **Include items, such as health and welfare benefits, in the median employee's pay and the CEO's compensation**
- **Present an alternative pay ratio or include a comparison to peer pay ratios**

If a company makes a change in its approach to calculating its pay ratio in 2019, it should be mindful that SEC rules may require disclosure of both the change and why it was made.

Another thing that companies will be carefully watching is the various proposed and enacted legislation that tie reported CEO pay ratios to various taxes and fees. Currently six states (California, Connecticut, Illinois, Massachusetts, Minnesota and Rhode Island) have legislation pending that would increase the corporate tax rate or impose a surtax or additional fee on any corporation that reports a pay ratio in excess of certain thresholds. In addition, the City of Portland, Oregon has enacted a pay ratio surtax on a company's local business tax liability and the City of San Francisco, California has announced that imposition of a pay ratio tax is under consideration.

In addition, it remains to be seen whether the SEC will issue comments on pay ratio disclosures or provide general observations on the quality of and practices used in preparing and disclosing pay ratios.

It is also unclear to what extent, if at all, ISS or Glass Lewis will take into account pay ratio information in formulating their voting recommendations for 2019. The first insights into this question may be available in connection with ISS's 2019 policy formulation process.

And last but certainly not least, it remains unclear how investors will view or use the 2018 pay ratio disclosures. No doubt investor views will span a wide spectrum, and companies will likely spend a fair amount of time preparing for their next round of shareholder engagement on this issue.

FAST FACTS

For the Top 100 Companies:*

224:1

Median pay ratio

$74,000

Median employee pay

$18.5 MILLION

Median CEO compensation

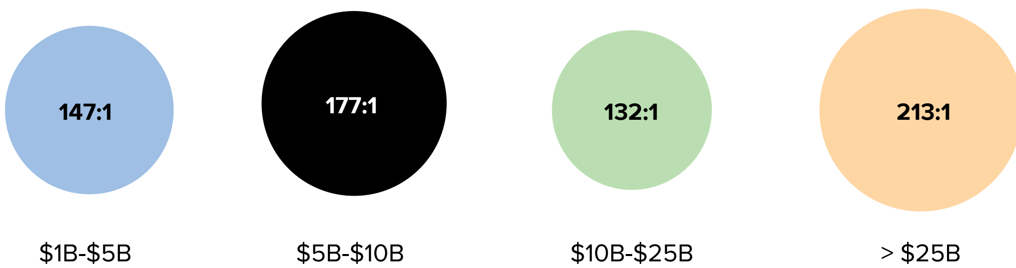
*Reflects information for 81 of the Top 100 Companies that reported their pay ratio on or before July 20, 2018.

MARKET CAPITALIZATION, REVENUES AND NUMBER OF EMPLOYEES INFORMATION

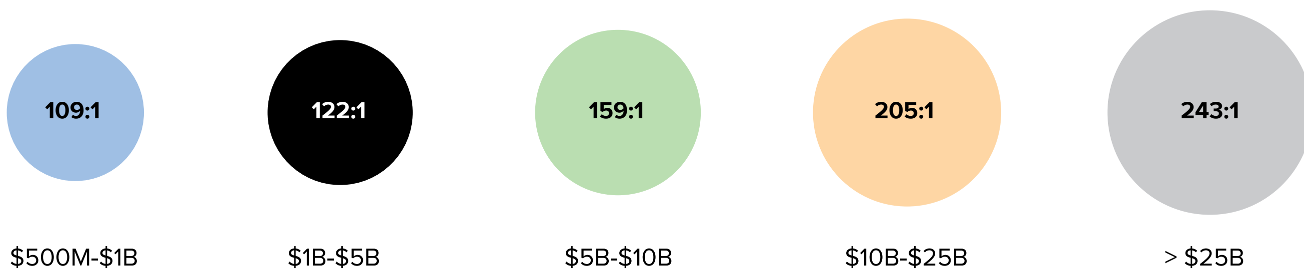
Not surprisingly, pay ratios were generally positively correlated with market capitalization, revenues and number of employees at a company. That is, where these measures are higher, the CEO pay ratio is also higher.

Median CEO Pay Ratio By:

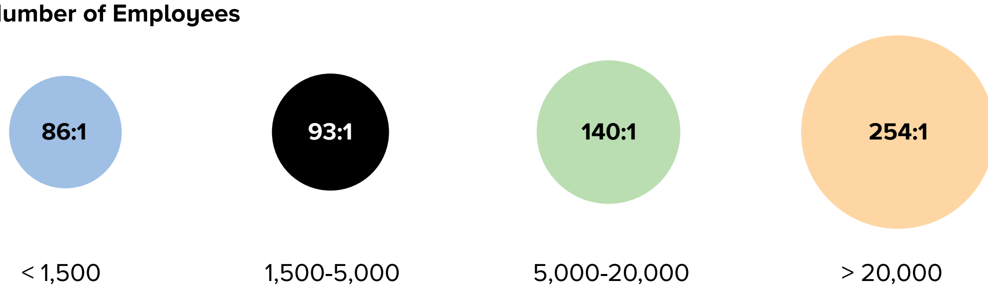
Market Capitalization



Revenues



Number of Employees



Data provided by Main Data Group, a division of Pearl Meyer.

INDUSTRY INFORMATION

As expected, the CEO pay ratios varied considerably across industry sectors. This was largely driven by differences in median employee pay across industry sectors rather than by differences in CEO compensation.

Among the 11 industry sectors set forth below, the median pay ratio in the consumer discretionary and the consumer staples sectors were considerably higher than those in the other nine industry sectors. This appears to have been largely driven by the relatively lower median employee pay in these sectors as companies in these industry sectors tend to have larger numbers of part-time and temporary employees and full time employees who are paid at or near minimum wage. On the other end of the spectrum, median pay ratios in the energy and utilities sectors were considerably lower than those in the other nine industry sectors, primarily as a result of the relatively higher median employee pay.

CEO Pay Ratio By Industry Sector (ranked by Median Pay Ratio)

Industry Sector	5th percentile	25th percentile	Median	75th percentile	95th percentile	Median CEO compensation	Median employee pay
Consumer Discretionary	84:1	251:1	454:1	774:1	2,532:1	$12,278,000	$28,000
Consumer Staples	91:1	133:1	276:1	475:1	1,010:1	$12,266,000	$48,000
Telecommunication Services	149:1	177:1	212:1	289:1	351:1	$17,947,000	$78,000
Industrials	63:1	129:1	166:1	231:1	379:1	$10,825,000	$61,000
Healthcare	63:1	129:1	166:1	302:1	464:1	$15,389,000	$67,000
Materials	94:1	124:1	163:1	243:1	400:1	$12,972,000	$75,000
Financials	54:1	121:1	159:1	225:1	369:1	$12,693,000	$69,000
Information Technology	30:1	88:1	144:1	243:1	429:1	$11,291,000	$96,000
Real Estate	48:1	88:1	122:1	160:1	296:1	$9,983,000	$76,000
Energy	61:1	85:1	104:1	138:1	267:1	$12,843,000	$121,000
Utilities	52:1	73:1	96:1	124:1	169:1	$12,676,000	$122,000

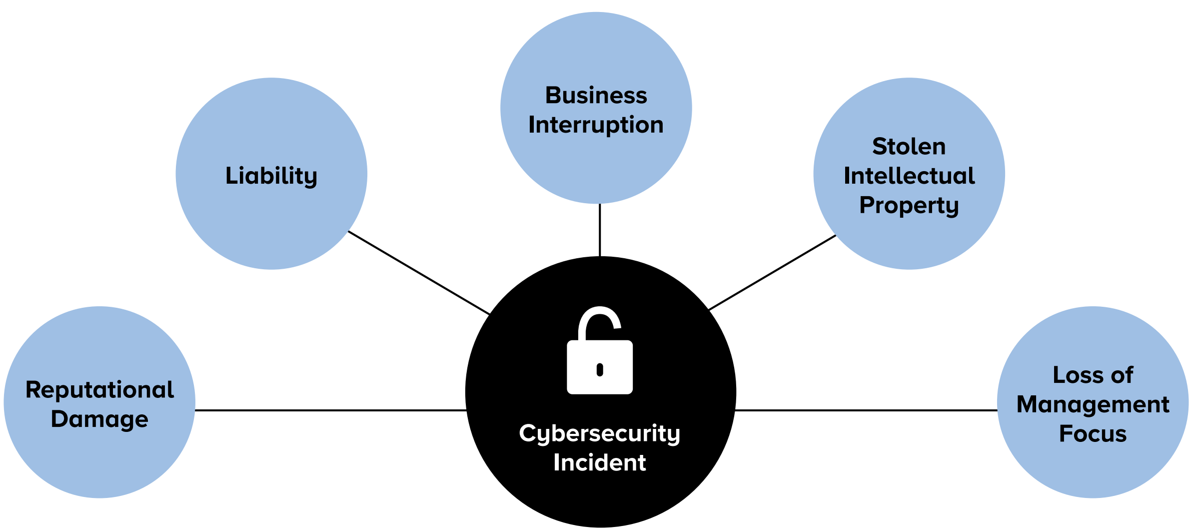
Industry sector classification is based on the Global Industry Classification System, with data provided by Main Data Group, a division of Pearl Meyer.

CYBERSECURITY – BOARD OVERSIGHT

Lona Nallengara and
Emma Maconick

Cybersecurity remains a key focus for boards of public companies. Ransomware attacks, the theft of personally identifiable information and "zero-day" vulnerability exploits continue to fill the headlines, and directors of public companies in all industries should take it as a reminder of their important oversight role in the management of risk and the need to assess both management's ability to properly manage cybersecurity matters and their own capabilities to serve in a meaningful oversight role. The daily media reports are contrasted by a number of past surveys of directors of public and private companies that show staggeringly low responses on questions as to whether the board is getting regular briefings on cybersecurity matters, whether the board has adequate expertise to address cybersecurity and whether directors believe cybersecurity is even a board-level issue. Although it may appear that boards have been slow to focus on cybersecurity, that seems to be changing, and actions of institutional investors and governmental authorities are moving boards along.

Cybersecurity matters have increasingly been the focus of institutional investors. Although institutional investors are focused on those companies with the greatest vulnerability to cybersecurity attacks, they are increasingly concerned with the impact of business interruptions, compromised personal data, stolen intellectual property and the litigation, reputational damage and the loss of management focus that can result from a cybersecurity incident affecting all of their investments. As part of their engagement with public companies, institutional investors are increasingly focusing their board governance questions on risk management generally and cybersecurity in particular. Institutional investors want to know that companies have considered their cybersecurity risk profile and will probe companies on the cybersecurity and data security risks they are facing, who could target them and how their security programs and their boards' oversight have developed around these threats. Institutional investors also want to know that there is expertise both in management and on the board that can execute and oversee, respectively, a comprehensive cybersecurity readiness plan.



Cybersecurity is also an increasingly important issue for governments at all levels. In 2017, the President issued a wide-ranging executive order on cybersecurity, focused on preparedness of federal agencies and critical infrastructure. Congress, through several committees in both the House of Representatives and the Senate, has also been focused on cybersecurity. Over the last year, there have been a number of public hearings where multiple House and Senate committees have called on executive officers of public companies to account for major cybersecurity breaches and compromised consumer personal data. Additionally, members of Congress have proposed a number of pieces of legislation designed to address the cybersecurity preparedness and responsiveness of public companies and impose requirements designed to address the public safety and privacy issues. One such measure would require public companies to appoint a cybersecurity expert to the board or explain to shareholders why one was not necessary. State governments are also focused on cybersecurity matters, with New York imposing new cybersecurity requirements for financial services and insurance companies, adding to the patchwork of industry standards, best practice frameworks and mandatory requirements.

This focus has not been limited to cybersecurity incident preparedness and responsiveness. The increasing collection and use of personal data has led to a growing call for legislative controls and protections focused on personal privacy. Congress has introduced legislation addressing a range of issues from mandating notification to consumers of data breaches, to requiring comprehensive privacy and data protection programs and new liability regimes. Each state has put in place some form of data breach notification legislation. Outside of the United States, the most prominent example is the General Data Protection Regulation (GDPR), which came into effect in the European Union in 2018. The GDPR imposes stringent and complex requirements on any business operating in the European Union related to processing of personally identifiable information. These new requirements have imposed and will continue to impose costs, both in terms of implementation and changes to business models, as well as steep fines for inadequate compliance.

Just as many of the largest public companies were preparing their annual reports and right before the 2018 proxy season was in high gear, the SEC, in February 2018, released new interpretive guidance on public company disclosures related to cybersecurity risks and incidents. This guidance also outlined the SEC's views regarding the importance of appropriate disclosure controls and procedures, insider trading policies and selective disclosure safeguards in the context of cybersecurity incidents.

THE SEC WANTS PUBLIC COMPANIES TO:

Describe the role that the board has in cybersecurity-related risk management

Maintain disclosure controls and procedures so that individuals responsible for disclosure are promptly alerted of cybersecurity incidents

Institute policies that restrict the ability of officers, directors and other insiders from trading before determining the materiality and making any necessary disclosure of a cybersecurity incident

WHAT SHOULD BOARDS (AND THOSE THAT ADVISE THEM) DO NOW?

It is clear that boards need to ensure they have the proper focus and support to properly oversee cybersecurity and data security risks. Even companies that do not have exposure to volumes of customer data are vulnerable to attack. Hackers can target a company to gain access to material unreported financial information to be used for insider trading purposes. Cyberattacks can be used for corporate espionage to steal critical business processes, intellectual property or trade secrets. And individuals may design cyberattacks to freeze a company's networks for a ransom or even just to show it can be done.

The failure to maintain the proper oversight over cybersecurity matters can lead to significant exposure to the company and, if found that the board failed in its oversight function, its directors. In addition, the remediation costs and business interruption and management distraction, coupled with reputational harm, can be incredibly damaging. We have seen recent examples of business combinations being impacted by cybersecurity breaches, and earlier this year the SEC brought the first ever case against a company for failure to properly disclose and oversee a cybersecurity incident.

Although every company has a different cybersecurity risk profile, which demands a level of focus and attention that is appropriate to its profile and the materiality of cybersecurity risks to its business, the following are things that all boards should consider now:

- **Recognize that cybersecurity is not a technology issue, but an enterprise risk management issue**
- **Ensure management develops a framework to address cybersecurity and data security for the whole organization**
- **Understand the type, scope and extent of the cybersecurity risks facing the company and how the company's operations, financial condition and reputation could be impacted by the range of possible breaches**
- **Do not overlook customer and employee data security and privacy-related risk exposure and the exposure posed by critical third-party vendors and service providers**
- **Receive regular briefings from those responsible for cybersecurity and use these briefings to probe management on the experience and expertise and on the adequacy of the budget allocated for this effort**
- **Assess whether the board has the requisite expertise to oversee cybersecurity risk management**
- **Raise cybersecurity and data privacy questions in connection with the development of new products and services, the entry into new jurisdictions and when considering acquisitions**
- **Ensure adequate disclosure controls and procedures are in place so that cybersecurity incidents are reported promptly and to those responsible for disclosure matters**
- **Review management's incident response plans and prepare a board response plan — do not wait for a cybersecurity incident**
- **Ensure that management promotes a cybersecurity risk-awareness culture throughout the company**

ARE BOARD MEMBERS BECOMING MORE CYBER-FOCUSED?

The timing of the SEC announcement – in the thick of the proxy season and followed by months of media reports of executives and public company boards being called to answer for a series of high-profile breaches – may have resulted in a reconsideration of proxy disclosures related to board governance over the last year. Here is how disclosures about board oversight over cybersecurity matters for the Top 100 Companies changed this year:

RESPONSIBILITY FOR CYBERSECURITY MATTERS

The number of Top 100 Companies that indicated that the board and/or a board committee had responsibility for cybersecurity matters:

2017	2018
59	84

DIRECTORS WITH CYBERSECURITY EXPERIENCE

The number of Top 100 Companies that specifically identified directors with cybersecurity or data security experience:

2017	2018
29	35

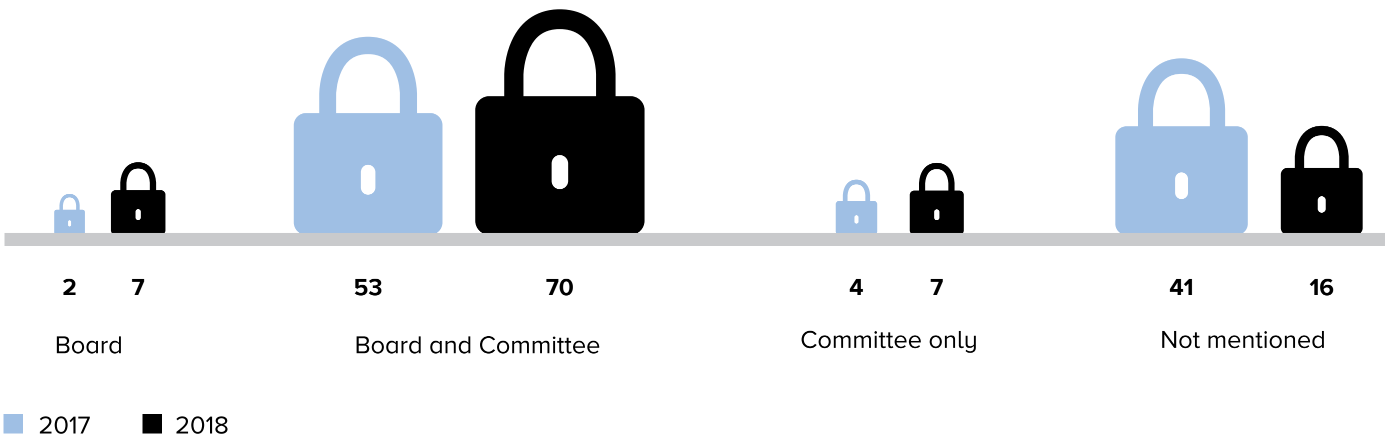
CYBERSECURITY RISK MANAGEMENT

The number of Top 100 Companies that identified cybersecurity as part of the board's oversight role over risk management:

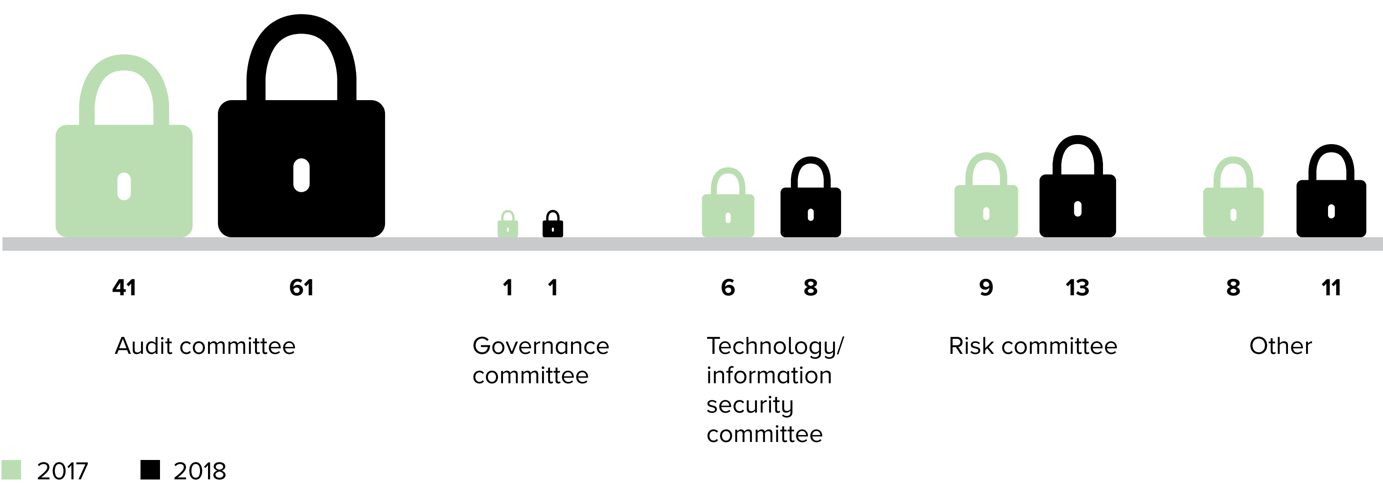
2017	2018
58	85

AT THE TOP 100 COMPANIES:

Who has responsibility for cybersecurity and/or data security/privacy?



If a committee is involved, which committee?



BOARD DIVERSITY AND THE SKILLS MATRIX

Lona Nallengara and Stephen T. Giove

In September 2017, the New York City Comptroller (NYCC) launched the Boardroom Accountability Project 2.0 – an initiative that was designed to put pressure on large public companies to "refresh" their boards to make them "more diverse, independent and climate-competent."

The initial phase of the Boardroom Accountability Project, launched in 2014, focused on bringing proxy access to the mainstream, and, coupled with significant support from other institutional investors, fueled the dramatic increase in the adoption of proxy access by-laws over the last three years. The second phase, which focused on those companies that had adopted (or will soon adopt) proxy access, was designed to use the threat of proxy access to force companies to engage in a discussion on board diversity.

In connection with the second phase, the NYCC sent letters to the chairs of the nominating and governance committees of 151 U.S. public companies asking them to:

BOARDROOM ACCOUNTABILITY PROJECT 2.0

- **Provide the NYCC with enhanced disclosure in the proxy outlining each director's race/ethnicity, gender and sexual orientation, along with each director's skills and experience in a matrix format**
- **Engage in a discussion directly with the NYCC on board refreshment, including reviewing the company's director matrix**
- **Facilitate the NYCC's involvement in the board's process to identify potential director candidates**

A LARGE PERCENTAGE OF THE COMPANIES ENGAGED WITH THE NYCC ON BOARD REFRESHMENT AND MANY COMMITTED TO MAKE CHANGES TO THEIR DISCLOSURES.

A large percentage of the companies engaged with the NYCC on board refreshment and many committed to make changes to their disclosures. And there was little likelihood that they would not. The NYCC's request for a director skills matrix as a tool to promote diversity had broad support among other large public pension funds – eight of them signed a petition asking the SEC for a rule requiring one. Additionally, the prospect of a shareholder proposal or, even worse, a "vote against" campaign directed against nominating and governance committee directors was not something many wanted to take on. The NYCC actually did submit shareholder proposals in 2018 to six targeted companies requesting they include a directors' skills matrix in their proxy – the NYCC withdrew five of those proposals when the companies agreed to disclosure changes.

In June 2018, the NYCC announced the results of this second phase and claimed victory. According to the NYCC, 85 of the 151 companies "adopted improved processes and increased transparency regarding board quality, diversity and refreshment" and that the activities of the NYCC are "changing boardroom culture" that is "leading companies to cast a wider net for directors without sacrificing quality."

In the case of the proxy access effort, success was not only evidenced by the adoption of proxy access by those companies that were targeted by the NYCC but, more significantly, by the number of companies that adopted proxy access in response to a recognition that the tide had changed – proxy access had become a governance best practice to the largest institutional investors.

Will the director skills matrix become a proxy disclosure best practice? The NYCC appears to be pushing it. The NYCC believes it was successful in getting more than half of the targeted companies to improve their disclosures and it is ready to use shareholder proposals (or the threat of one) to push more companies for enhanced disclosure.

The real message for boards, however, is the importance of board refreshment and demonstrating to shareholders that meaningful progress towards achieving diversity on the board has occurred. And it is not just the NYCC pushing for results. Companies are receiving shareholder proposals that would require the board to include qualified women and minority candidates in the list of possible director nominees. And, in the face of consumer, employee and investor reactions to board diversity issues, companies are finding it very difficult to oppose such shareholder proposals. The largest institutional investors have also been increasingly flexing their muscles on board diversity. BlackRock and State Street, for example, actively support shareholder proposals targeting board diversity, such as proposals seeking board reports on efforts taken to nominate diverse candidates to the board. Equally as important, nominating committees that are not making progress towards refreshing their boards with diverse director nominees have seen votes against their members in annual director elections. The proxy advisory firms, Glass Lewis and ISS, have also spoken more forcefully about the importance of boards taking affirmative steps to address diversity on the board. In fact, Glass Lewis has stated that beginning in 2019 it will recommend a vote against the chair of the nominating committee for larger companies with no female directors. Gender diversity is also being fueled by state legislative actions proposing quotas for female representation on the board.

25

companies of the Top 100 Companies were targeted by the Board Accountability Project

Of the 75 Top 100 Companies that were not targeted by the Board Accountability Project:

38

companies already presented some form of director skills matrix in their 2017 proxy statement and

13

companies added a director skills matrix in their 2018 proxy statement

WHAT SHOULD BOARDS DO NOW?

It is important for boards to take meaningful steps towards board diversity in the near term. A director skills matrix or a report will likely only be a short-term fix. Institutional investors will increasingly demand more.

Nominating and governance committees should:

1. **Establish the board's perspective on a strategy toward increasing diversity on the board**
2. **Review proxy disclosures regarding skills and attributes required for board service to ensure that those disclosures reflect the board's view of board diversity**
3. **Review each director's candidate profile to ensure that diversity characteristics are appropriately presented**
4. **Review the search process used to identify new board candidates to assess whether meaningful steps towards board refreshment and increased diversity can be achieved using the current sources of new directors**
5. **Set diversity goals for the board and share those goals, and the efforts that are being taken to achieve them, with key shareholders as part of an active dialogue before the proxy season begins**

BOARD OVERSIGHT OF SEXUAL HARASSMENT AND MISCONDUCT CLAIMS

Doreen E. Lilienfeld

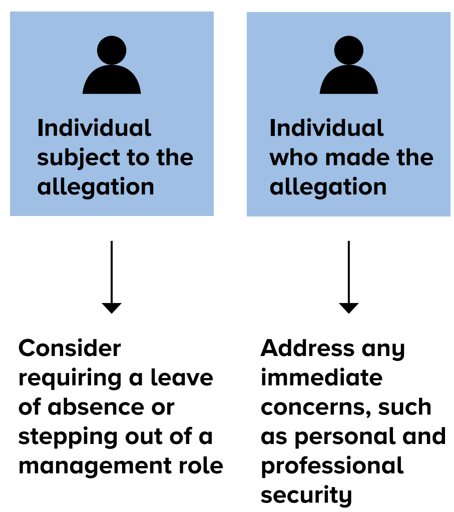
AS WE HAVE SEEN OVER THE LAST YEAR, NO INDUSTRY IS IMMUNE FROM ALLEGATIONS OF WORKPLACE SEXUAL HARASSMENT.

Sexual harassment allegations can not only tarnish a company's – and a board's – reputation and impair shareholder value, and it may even imperil the existence of a company, as can be seen from the fate of The Weinstein Company. Employee morale and consumer goodwill are also at risk, with the potential of lasting consequences. For all these reasons, it is critical for a board to act quickly and decisively in the face of any sexual harassment or misconduct allegations. A perception that a company or its board is failing to act or is not responding seriously to sexual harassment claims will not be viewed favorably by customers, investors, juries and in the court of public opinion. As we have seen over the last year, no industry is immune from allegations of workplace sexual harassment.

DEALING WITH COMPLAINTS

As with any area of board oversight, perceived failures by the board can result in shareholder derivative litigation against the board, as well as securities class actions in the event of a resulting stock price decline. Where the focus of the complaint is against a senior executive who is also a board member, the board should form a special committee to conduct an investigation of the allegation. Whether or not the board is able to maintain its objectivity, it will be important to take steps to reduce the appearance of and the potential for conflicts of interest to help ensure objectivity in the board's assessment of the allegations.

The board should take extra care as to what interim procedures are put in place while the investigation is pending. Consideration should be given to requiring the individual subject of the allegation to take a leave of absence – with or without compensation – or to step out of a direct management role. Additionally, addressing the immediate concerns of the individual who made the allegation, which will likely include personal and professional job security, should also be a focus of the board. All of these immediate actions should be reviewed and either affirmed or modified by the special committee.

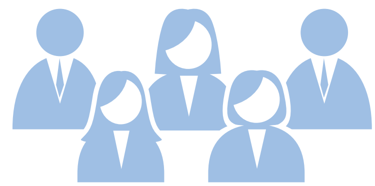


FORMING A SPECIAL COMMITTEE

While Delaware law permits special committees comprised of as few as one director, it is preferable to have at least three disinterested directors serve on an investigative committee. In identifying special committee members, the board should balance the need for active and robust discussions of the issues and a desire for diversity of viewpoints against the need for a prompt and efficient adjudication of the facts. Special attention should be paid to the backgrounds and perceived independence of the special committee members: whether they have long board tenure or if they have a close personal relationship with the party under investigation or the party making the allegation. Gender composition of the committee should also be considered as well, which can be challenging for less diverse boards. The ability of any potential member to devote a meaningful amount of time to the work of the special committee in short order should also be part of the selection criteria. Finally, a committee chair should be appointed to preside over the proceedings, and special care should be afforded to his or her selection as the chair may become the "public face" of the investigation.

In establishing the special committee, the board should determine at the outset whether the special committee has authority to make final determinations, or whether the full board retains such authority.

The board should also decide whether special committee members, and the chair, will receive an additional fee for these extraordinary services, given the amount of time potentially involved and in light of market practice and current director fee packages.



SEEKING LEGAL COUNSEL

It is advisable, and now commonplace, for special committees to turn to outside advisors for assistance in addressing allegations of sexual misconduct in the workplace. Outside legal counsel can add much needed experience and resources to the investigation. Although, typically, their work would be protected by privilege and the attorney work product doctrine, in a highly publicized scenario there will be great pressure on the company from shareholders, the media and, potentially, regulators to release the results of the investigation. The special committee and its outside legal team should remain in very regular contact, and the special committee should actively oversee the status of the investigation.

Independence also needs to be considered in selecting legal counsel, and such counsel generally should not be a firm commonly involved in defending the company or its executives in discrimination or harassment cases. A special committee's use of the company's regular outside legal counsel may, on later review, weaken an argument regarding the committee's independence, depending upon the extent of such legal counsel's relationships with the company generally and the executive under investigation in particular. This should be thoughtfully considered by the special committee on a case-by-case basis.

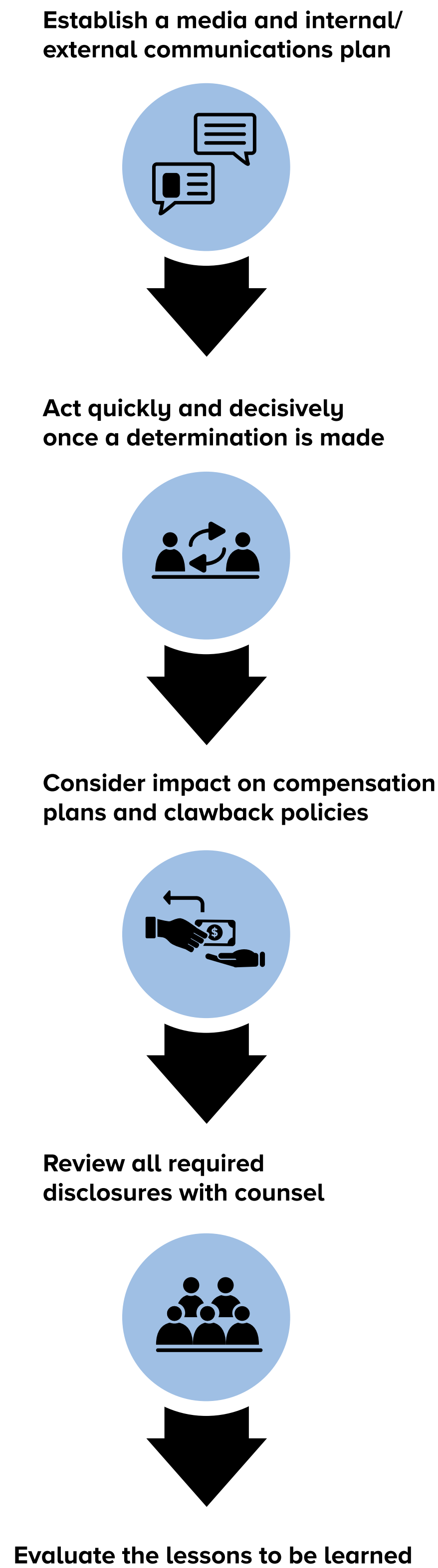
DEALING WITH THE FINDINGS

The special committee should, early on, establish a media and communications plan that not only addresses the press and social media coverage of the allegations and the investigation, but also puts in place a plan for any contemplated announcement of the findings and the special committees decision. Internal and external communication must be delicately handled. Social and traditional media platforms should be monitored to ensure the investigation has not become public knowledge before its conclusion. Engaging a PR firm experienced in dealing with situations involving sexual misconduct is also well advised.

If the claims are substantiated through the investigation, the board should act quickly and decisively once a final determination is reached. Removing the offending employee swiftly may best protect the company's employees and its reputation and may serve to cut off ongoing coverage in the media and social media. If a senior executive officer is removed, the effectiveness of the board's prior succession planning efforts will be at the fore.

The board should also consider the consequences of a termination under compensation plans and agreements. Often, a material violation of company policy constitutes grounds for termination of employment without payment of severance. Clawback policies should also be considered in light of the circumstances.

The board should review with counsel all related disclosures. A termination of an executive officer will trigger a current report filing on Form 8-K with the SEC. If the employee files a lawsuit, disclosure will be required if the proceeding is likely to have a material quantitative or qualitative impact on the company's financial performance. Commencing an internal investigation would not typically necessitate disclosure; however, a shareholder could argue that failing to disclose an internal investigation – or, more often, its cause – is an omission of material fact if the allegations ultimately lead to a drop in share price or if the subject executive is terminated. Finally, the board should consider what lessons have been learned from the incident. The board should evaluate workplace policies, reporting protocols and training programs.



AN OUNCE OF PREVENTION

Many companies have recently reevaluated their sexual harassment policies, and boards may wish to review those policies with the help of advisors. The time is ripe for boards to ask where the company stands on compliance, reporting and employee education.

To be effective, policies must provide clear and effective reporting channels. The board should understand existing reporting protocols, including under what circumstances reports are escalated to the board and, importantly, whether the board thinks that the triggers that prompt board notification are appropriately calibrated. Additionally, the board should ensure that employees can – and feel like they can – report up without fear of reprisal. Outside reporting channels like anonymous hotlines and neutral third parties, and mandatory reporting by senior employees, can increase the effectiveness of any internal reporting program.

Training on proper workplace conduct should not be overlooked – and should be provided on a regular basis at all levels, including to senior executives and board members. Companies should keep records of the training programs that have been instituted and work to ensure full participation. Thorough record-keeping of harassment reports, even those that are ultimately deemed unsubstantiated, may help the company detect patterns and better evaluate claims. Finally, boards must bear in mind their role as stewards of corporate culture. Sending a clear message from the board on the importance of workplace safety, and its zero tolerance of sexual harassment, as a core element of corporate culture is important.

CONCLUSION

Dealing with sexual harassment and misconduct in the workplace is a difficult undertaking for any company and the board. Early engagement by the board through education and advance planning can alleviate those burdens in the event of such a crisis and avoid potential shareholder claims against the company and the board.

INSIGHTS

SHAREHOLDER ENGAGEMENT: USING PROXY STATEMENTS AND CORPORATE WEBSITES

Stephen T. Giove,
Kyungwon (Won) Lee,
Lona Nallengara and
Zachary S. Aries

With rising pressure on companies and their boards to describe and justify their governance practices coming from institutional investors, who are increasingly guided by broad corporate stewardship goals, companies have been looking for ways to enhance shareholder engagement. Companies have intensified their engagement practices and are increasingly holding meetings directly with the governance experts within major institutional investors. These "governance roadshows" are focused solely on describing (and seeking support for) governance policies and practices. The use of the company's proxy statement and its corporate website has continued to emerge as an important tool to supplement these engagement efforts as it provides a direct, efficient and effective way to communicate a company's overall governance philosophy as well as its approach to specific governance issues.

Company proxy statements and the corporate governance sections of company websites have always been the primary source for a view of a company's governance structures, policies and practices, but many companies only disclosed information in order to meet SEC and other disclosure requirements. Many leading companies are no longer limiting their proxy statement and website to mandatory disclosures, but are using both as a vehicle for advocacy by making their governance case and laying the foundation for higher-level discussions during the shareholder engagement process.

In this insight, we explore the practices and trends of the Top 100 Companies in this area.

SHAREHOLDER ENGAGEMENT DISCLOSURES

82%

of the Top 100 Companies made shareholder engagement disclosures in their 2018 annual proxy statements, up slightly from

74%

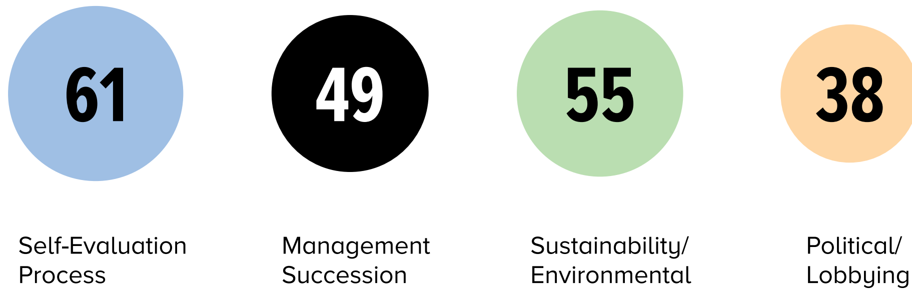
in 2017, and nearly even with the

81%

observed in 2016

Selected "Voluntary" Proxy Statement Disclosures

We analyzed the Top 100 Companies' disclosure practices on four key governance topics, which are not required to be disclosed under SEC rules: the director self-evaluation process, management succession planning process, sustainability and environmental stewardship and political and lobbying contributions. A considerable number of Top 100 Companies are making "voluntary" disclosures in these areas.

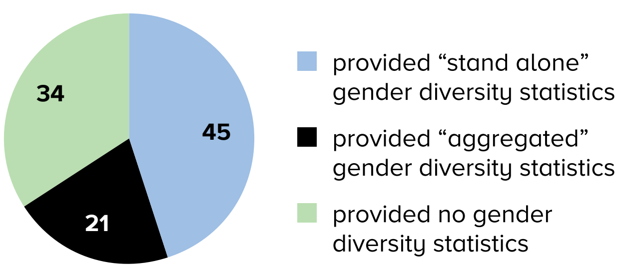


DIRECTOR DEMOGRAPHIC DISCLOSURES

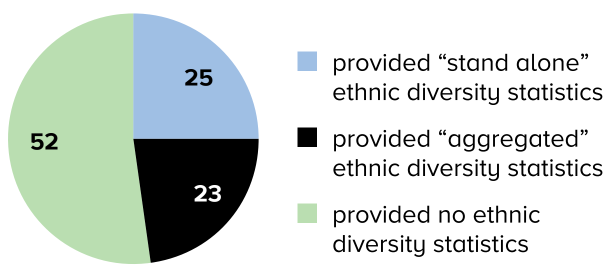
Board Diversity Information

Board diversity remains a hot corporate governance topic, as institutional investors and proxy advisory firms continue to emphasize the importance of well-balanced boards composed of directors of different genders, ethnicities, areas of expertise, ages and tenures. While companies are increasingly presenting information regarding diversity, the specific approaches to disclosure vary. Some companies present the total number or percentage of the board that is gender or ethnically diverse, while others only present this information on an "aggregated" basis (i.e., "X are female, ethnically diverse or hold multiple citizenships").

Presentation of Board Gender Diversity



Presentation of Board Ethnic Diversity

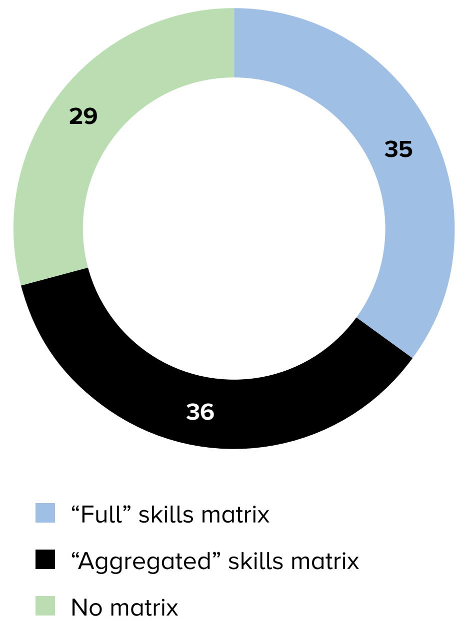


Board Skills Information

SEC rules require companies to disclose the "specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director for the registrant at the time the disclosure is made, in light of the registrant's business and structure." As a result of this disclosure requirement, companies typically discuss director experience, qualifications, attributes and skills as part of each director's biography. As discussed in *Board Diversity and the Skills Matrix* in this Survey, there is a movement toward presenting this information in a matrix format so that shareholders can have a picture of the experience, qualifications, attributes and skills of the board as a whole.

Some companies take the approach of providing a "full" skills matrix format that identifies the specific experience/qualification/attribute/skill of each director in a table format, with totals for each experience/qualification/attribute/skill element presented at the bottom of the table. Other companies only present the aggregate number of directors possessing each experience/qualification/attribute/skill. Some companies do not present this information in either of these formats.

Presentation of Skill Matrix



Director Age and Tenure

While SEC rules require that companies disclose the age of each director as well as the year that the director was elected to the board, they do not require that companies disclose the average age or tenure of their board. While shareholders can calculate age and tenure from information available in the proxy statement, companies have increasingly been providing this information as part of their description of the profile of their board.

Board Age and Tenure

26%

of the Top 100 Companies disclosed their average director age, while

65%

of the Top 100 Companies disclosed their director tenure (48 companies disclosed average tenure and 17 companies disclosed director tenure in bands.)

DIRECTOR PHOTOS

A majority of the Top 100 Companies included director photos in their proxy statements:

79%

21%

ADDITIONAL PROXY STATEMENT DISCLOSURES

Companies provide additional perspectives with respect to their governance practices by providing the point of view of the CEO or the board on governance and by providing a proxy statement summary and/or an overview of the highlights of their governance practices.

Additional Perspectives

26% of the Top 100 Companies included a **letter from the CEO** with their proxy statement

9% of the Top 100 Companies included a **letter from their non-management board chair** with their proxy statement

18% of the Top 100 Companies included a **letter from the lead independent director** with their proxy statement

10% of the Top 100 Companies included a **joint letter signed by more than one of the CEO, non-management board chair and lead independent director with their proxy statement**

Eleven of the Top 100 Companies included more than one of the above letters with their proxy statement.

Summaries

86% of the Top 100 Companies included a **proxy statement summary**

83% of the Top 100 Companies included a **corporate governance highlights section**

87% of the Top 100 Companies included an **executive compensation highlights section**

In addition to the above, a small number of companies included a "voluntary" report from their nominating and corporate governance committee in addition to the required reports of their audit and compensation committees. In addition, some companies also provided additional perspectives on their corporate websites through director videos.

LOCATION OF ANNUAL MEETING DETAILS

56%

of the Top 100 Companies placed their disclosure about the details of the annual meeting at the back of its proxy statement

84%

of the Top 100 Companies provided the details of the annual meeting in a Q&A format

CORPORATE WEBSITE DISCLOSURES

Core Governance Documentation

Applicable SEC rules and the listing standards of the stock exchanges require that companies post their corporate governance guidelines, code of business conduct/ethics and the charters of their audit, compensation and nominating and governance committees on their corporate websites (or publish them at least every three years in their proxy statements). In practice, nearly all of the Top 100 Companies post these documents on their corporate websites.

100%

of the Top 100 Companies post their **corporate governance guidelines** on their website

100%

of the Top 100 Companies post their **code of business conduct/ethics** on their website

100%

of the Top 100 Companies post their **audit committee charter** on their website

100%

of the Top 100 Companies post their **compensation committee charter** on their website

100%

of the Top 100 Companies post their **nominating and governance committee charter** on their website

84%

of the Top 100 Companies post **all of their committee charters** on their website

Many companies that had an executive committee did not post the **executive committee charter** on the corporate website. Of the 36 companies that disclosed they had an executive committee, only 27 companies posted the executive committee charter.

As there is no rule requiring that companies post other core corporate governance documentation to their corporate websites, there is more variability in this practice.

70%

of the Top 100 Companies post their **certificate of incorporation** on their website

80%

of the Top 100 Companies post their **by-laws** on their website

CORPORATE SOCIAL RESPONSIBILITY (CSR) REPORT

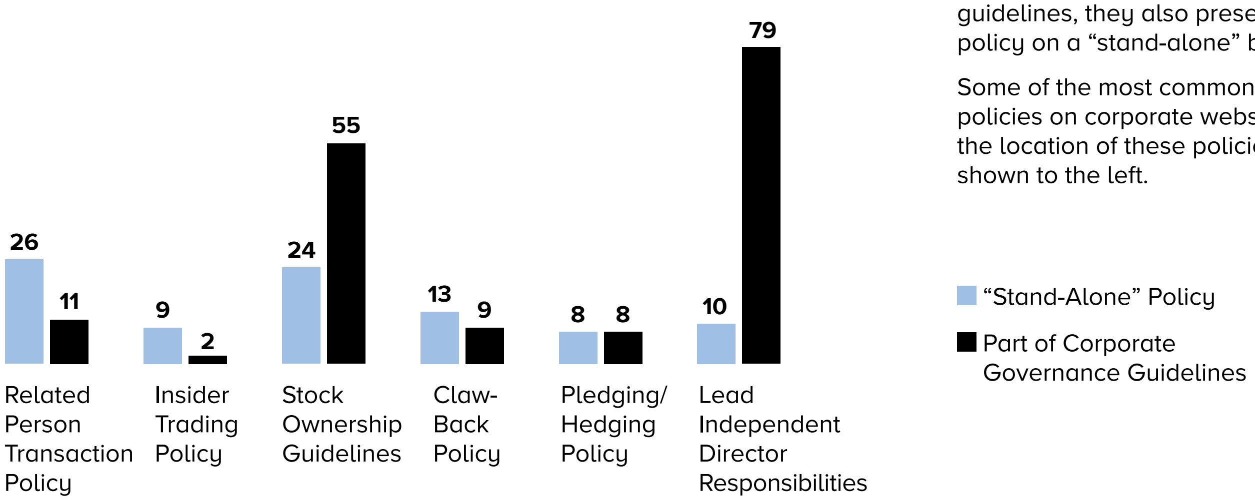
82%

of the Top 100 Companies published Corporate Social Responsibility Reports (CSRs) or devote entire sections of their website to disclosing their role as "corporate citizens"

CORPORATE GOVERNANCE POLICIES

As the movement towards transparency in corporate governance continues, companies have been posting various governance policies on their corporate websites. There is a considerable variability in the extent to which the Top 100 Companies posted their various corporate governance policies on their corporate websites, and many do not post them at all. The Top 100 Companies have also taken different approaches as to whether a particular policy is formulated as a "stand-alone" policy or is embedded into its corporate governance guidelines. Some companies do both — in addition to having a policy set forth in their corporate governance guidelines, they also present that policy on a "stand-alone" basis.

Some of the most commonly found policies on corporate websites and the location of these policies are shown to the left.



Data in the above chart and below commentary is not mutually exclusive, as some companies disclose these policies and/or responsibilities in multiple places.

Eighty-one of the Top 100 Companies have a lead independent director and 19 have an independent board chair. As shown in the above chart, all 81 companies disclose the responsibilities of the lead independent director, including 10 companies that set those duties forth in a separate governance document. Of the 19 Top 100 Companies that have an independent board chair, disclosure of such persons' responsibilities is made in corporate governance guidelines (nine companies), proxy statement (10 companies) or by-laws (13 companies).

POTENTIAL FUTURE ACTIONS

As disclosures in proxy statements and corporate websites continue to evolve as a means to communicate a company's governance philosophy and its approach to specific governance issues, the following items are worthy of consideration:

- Use the proxy statement to describe the board's perspective on key governance matters, such as a description of the board's self-evaluation process and its management succession planning process
- Use the proxy statement to describe how the company defines and addresses relevant environmental and social matters and how the company engages in political spending/lobbying, including the board's oversight role of these matters
- Provide comprehensive director gender and ethnic diversity and other demographic disclosures on a disaggregated basis in the proxy statement
- Present director experience/ qualifications/attributes/skills information in a matrix format in the proxy statement
- Present average director age and tenure information in the proxy statement
- Include a letter from the CEO, board chair and/or lead independent director that includes a discussion of his or her perspective on the company's governance as part of the annual meeting communications
- Include a corporate governance and executive compensation "highlights" section in the proxy statement that presents an overall picture of the company's governance philosophy and key governance practices

And do not forget the corporate website as a vehicle for communication on governance. Consider updating the corporate website to include downloadable and printable copies of the following:

- Corporate governance guidelines
- All committee charters
- Certificate of incorporation
- By-laws
- Key governance policies

SHAREHOLDER ACTIVISM: WILL 2018 BE A RECORD-BREAKING YEAR FOR ACTIVISM?

George A. Casey,
Scott D. Petepiece and
Richard C. Fischetti

Driven by the momentum of a robust year in 2017, shareholder activism reached record highs in the first half of 2018.

Globally, 610 companies were subject to public activist demands, representing a 9% increase against the same measure for the first half of 2017.

Of those 610 companies,

424

were headquartered in North America (representing 69% of the total)

77

in Europe (13%)

60

in Asia (10%)

42

in Australia (7%)

Geographically, the United States continues to be the focal point of activist activity. However, the number of activist initiatives outside of the United States, particularly in Europe, has been on the rise with activists increasingly willing to navigate through various corporate rules and customs of other countries in search of opportunities in less-crowded markets. The first quarter of 2018 saw $7.2 billion of capital deployed in new campaigns against European companies, including $5.4 billion from U.S. activists, representing the largest aggregate investment by U.S. activists in European companies in a single quarter. The European Union's recent directives aimed at bolstering shareholder participation may encourage further activism in Europe. In addition, activism is gaining traction in Asia, a region previously considered to be impervious to activist demands. As activists advocate for improvements in capital efficiency and corporate governance in particular, a growing number of Asian companies are seeking advice on how to efficiently respond to such demands.

A record 145 activist campaigns were launched

As of June 30, 2018, these 145 new activist campaigns were launched against 136 companies. Underpinning this surge in activity was a parallel increase in the amount of capital deployed by activists. With the aggregate value of new activist positions reaching $40.1 billion in the first half of 2018, the amount of capital deployed this year is likely to eclipse last year's record-setting $62 billion figure. Notably, the first quarter of 2018 witnessed the highest amount of capital deployed in any quarter on record at $24.8 billion.

Activists are increasingly turning their attention toward influencing business strategy. Campaigns aimed at seeking change in companies' operational and managerial plans accounted for 25% of all campaigns in the first half of 2018, compared to 11% in 2017. Additionally, activists continue to call for greater transparency and action on environmental, social and governance matters, aspects of which include board diversity, gender pay gap and climate change. In response, boards are increasingly focused on taking a critical eye to their respective business practices and governance policies and actively engaging with shareholders.

As in 2017, the top demand sought by activists in the first half of 2018 was board representation. With 119 board seats obtained as of June 30, 2018, activists have won more board seats in the first half of 2018 than they did in all of 2017 (100 board seats). Almost 85% of the 119 seats were won by settlement, which reflects companies' continuing reluctance to engage in proxy fights. Notably, "long-slate" nominations, in which activists seek to replace at least 50% of the board, accounted for one-third of all board nomination campaigns in the first half of 2018, the highest level since 2014. Meanwhile, M&A-related campaigns, including pushing for sales processes, intervening in announced transactions or initiating break-ups and divestitures, remain on the rise, continuing a trend from last year.

The cost of building a significant position from which to influence management and board decisions is lower in smaller-cap companies. Therefore, smaller targets continue to attract activist attention. For example, 31% of all activist demands in the first half of 2018 targeted companies with a market cap below $250 million and 55% targeted companies with a market cap below $2 billion. However, activists are increasingly leveraging their reputations, track records and relationships with institutional shareholders to pursue larger targets: companies with a market cap above $10 billion accounted for 27% of all targets in the first half of 2018, compared to 21% in 2017. This trend illustrates that larger-cap companies are now firmly within the activists' crosshairs.

ACTIVISTS ARE INCREASINGLY TURNING THEIR ATTENTION TOWARD INFLUENCING BUSINESS STRATEGY.

With shareholder activists further solidifying and expanding their influence in the market in the first half of 2018, boards of public companies should expect a continued high level of attention from activists. Ongoing engagement with shareholders and anticipating and understanding potential areas that are susceptible to scrutiny by activists are important strategies that every public company board should be considering.

Recent trends highlight the fact that no company, regardless of jurisdiction or size, appears to be beyond the scope of activist attention.

Data referenced in this article is from *Activist Insight*, *FactSet* and public filings as of June 30, 2018.

INSIGHTS

DIRECTOR COMPENSATION AND THE DELAWARE COURTS

Doreen E. Lilienfeld and
Matthew H. Behrens

The Delaware courts have recently rendered a series of decisions, culminating with the Delaware Supreme Court's December 2017 holding in *In re Investors Bancorp, Inc. Stockholder Litigation, No. 169* (Del. 2017) ("*Bancorp*"), limiting the extent to which the business judgment rule protects directors when determining their own compensation. Although the law is still developing, the *Bancorp* decision has already led some Top 100 Companies to change their director compensation approval processes.

IMPACT ON STOCKHOLDER RATIFICATION

In *Bancorp*, the Delaware Supreme Court reversed the Delaware Court of Chancery and held that awards granted to directors under a stockholder-approved equity incentive plan are subject to "entire fairness" review if the plan gives the directors discretion to determine their own compensation. According to the *Bancorp* complaint, the stockholders of Investors Bancorp Inc. approved an equity incentive plan ("EIP") that allowed the directors to allocate up to 30% of all shares available under the EIP in the form of director awards. Shortly thereafter, the company's compensation committee granted awards to its non-employee directors with grant date fair values that averaged over $2 million each, even though awards at peer companies purportedly average $175,817. The plaintiffs challenged these awards, claiming that the directors breached their fiduciary duties by granting themselves unfair and excessive compensation.

The approval by non-employee directors of their own compensation is a conflicted transaction that enables a plaintiff to rebut the business judgment standard of review. Therefore, unless the directors could assert the affirmative defense of stockholder ratification, the decision would be subject to "entire fairness" review and the directors would have the burden of establishing that the transaction was the product of both fair dealing and fair price.

Unlike the **business judgment standard of review**, which places the burden on the plaintiff to prove that the directors did not act "on an informed basis, in good faith, and in the honest belief that the action was in the best interest of the Company" *(Aronson v. Lewis, 473 A.2d. 805, 812 (Del. 1984))*, the **entire fairness standard of review** places the burden on the directors to show that their decision was the product of fair dealing and fair price *(Weinberger v. UOP, Inc. 457 A.2d 701, 711 (Del. 1983))*.

Following a review of Delaware cases considering the stockholder ratification defense with respect to self-interested compensation decisions, the Delaware Supreme Court noted that the defense had been successfully invoked where stockholders approved:

- **Specific awards**
- **A self-executing plan under which directors had no discretion when making awards**
- **A plan under which directors exercised discretion in awarding compensation, consistent with stockholder-approved parameters**

In *Espinoza v. Zuckerberg (124 A. 3d. 47 (Del. Ch. Oct. 28, 2015))*, the board of Facebook approved non-employee director compensation that shareholders later challenged as excessive. Following the filing of the action, Facebook's controlling shareholder, Mark Zuckerberg, expressed his approval of the non-employee directors' compensation in a deposition and affidavit. The Delaware Chancery Court held that this did not constitute valid stockholder ratification. Rather, valid stockholder ratification must be accomplished formally through a vote at a stockholders' meeting, or by written consent in compliance with Section 228 of the Delaware General Corporation Law.

The director defendants in *Bancorp* argued that the business judgment standard should apply as they had exercised discretion within the parameters approved by the company's stockholders. The Court, however, expressed skepticism notwithstanding recent Court of Chancery decisions (such as *Calma v. Templeton, 114 A. 3d. 53* (Del. Ch. Apr. 30, 2015)), which found that awards granted pursuant to stockholder approved plans with "meaningful limits" were properly reviewed under the business judgment rule. The Delaware Supreme Court rejected the stockholder ratification defense in *Bancorp*, stating that the stockholders had "approved the *general parameters* of the [grants to directors]...Because the stockholders did not ratify the specific awards under the EIP, the affirmative defense of ratification cannot be used to dismiss the complaint."

Prior to *Bancorp*, the exercise of director discretion after stockholder approval of general (but meaningful) limits in plans became a standard practice for U.S. companies. Now, companies that previously obtained stockholder approval for annual limits on the equity awards that may be granted to individual non-employee directors (either based on a dollar figure or number of shares) may find that more specific approval is necessary to benefit from the protections of the business judgment rule. Further, it should not be assumed that the Delaware Supreme Court's holding is limited to equity awards. Companies seeking the protection of the business judgment rule should therefore consider soliciting stockholder approval of the cash portion of their director compensation programs as well.

CHANGES IN RESPONSE TO *BANCORP*

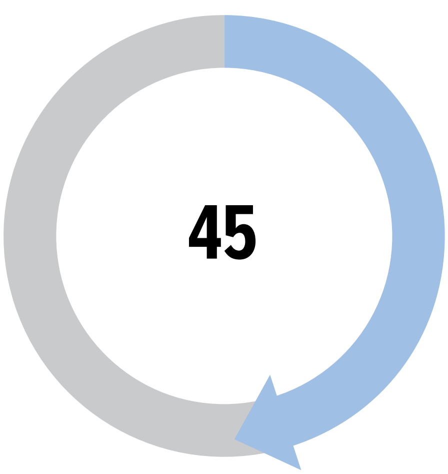
In the 2018 proxy season, shareholders of one Top 100 Company approved an amended equity incentive plan that provides that each director will receive an annual retainer of $350,000, which the board is authorized to increase by up to $25,000 before getting additional approval. The plan also sets lead independent director retainers and committee chair retainers, with the board authorized to increase these retainers by up to $5,000. These discretionary increases may not take place prior to January 2020. Finally, the board has discretion to provide directors with other fees for service on a specific purpose committee or for any other special service.

In addition, shareholders of another Top 100 Company approved a new director compensation plan that includes an annual retainer of $100,000 and an annual restricted stock unit grant with a value of $100,000. New directors will also receive a grant of 2,000 restricted stock units, but in no event will any director receive awards in excess of $500,000 in any year.

The lack of widespread change to stockholder ratification practices following the *Bancorp* decision may be evidence of the fact that companies are confident that their non-employee director awards are entirely fair. To that end, even if "meaningful limits" no longer ensure the application of the business judgment rule, such limits may continue to offer some protection from challenges to discretionary awards. For example, to the extent the range of possible award values within the "meaningful limits" is generally consistent with peer group levels, stockholders would have difficulty alleging the grant of those awards was not entirely fair. Further, enhanced disclosure of the reasons for the director compensation program, including a comparison to peers, may deter litigation. *Bancorp*, where the awards diverged significantly from peer group levels (and the previous year's award levels), is a good example of bad facts making bad law.

OTHER IMPLICATIONS

In addition to the claims related to non-employee director compensation, the plaintiffs in *Bancorp* also challenged awards made to two employee directors. The employee director defendants (the CEO and COO) attempted to have those claims dismissed for failure to make a demand on the board, as the executive compensation decisions were not self-dealing transactions. The Supreme Court rejected this argument, however, noting that plaintiffs need not demonstrate a "quid pro quo" between the non-employee directors and the executive directors to prove a lack of independence. Because the awards made to the employee directors were made nearly contemporaneously with the awards to the non-employee directors, the Court stated that "[i]t is implausible to us that the non-employee directors could independently consider a demand when to do so would require those directors to call into question the grants they made to themselves."



of the Top 100 Companies empower their nomination and governance committee (or similar committee) to make non-employee director compensation decisions, rather than vesting that authority on the compensation committee

67%
of the S&P 500 companies have adopted proxy access

89
of the Top 100 Companies have adopted proxy access

533
of U.S. listed public companies have adopted proxy access

PROXY ACCESS

In our fourth annual review of proxy access practices, we explore recent developments relating to “adopt” and “fix-it” shareholder proposals, headline and key second-tier terms and amendments to adopted by-laws.

PROXY ACCESS — THE MARCH FORWARD CONTINUES BUT AT A SLOWER PACE

Stephen T. Giove,
Arielle L. Katzman
and Daniel Yao

The proxy access adoption trend continued in 2018, although at a more modest pace. An additional 53 companies adopted proxy access by-laws in the first six months of 2018 compared to 87 in the first six months of 2017. In total, well over 500 companies, and over two-thirds of the S&P 500, have adopted proxy access by-laws. While the New York City Comptroller and other prolific shareholder proponents, including John Chevedden and James McRitchie, submitted fewer proxy access shareholder proposals in 2018 than in 2017, the volume of proxy access proposals was still substantial as compared to other corporate governance proposals. After three extremely active years, it appears that proxy access no longer leads the list of governance topics of shareholder proponents, but it still remains a significant area of focus.

PROXY ACCESS ADOPTION

303 OF THE **337***

companies that received "adopt" proposals in 2015-2018 adopted a proxy access by-law

This represents a

90%*

adoption rate

*Excludes companies that received an "adopt" proposal and were acquired or filed for bankruptcy before adopting (12 companies) or had such a proposal receive a majority vote in favor for the first time in 2018 but have not yet adopted a proxy access by-law (one company).

All data in this article is for all U.S. listed public companies and is as of June 30, 2018, unless otherwise noted.

NUMBER OF COMPANIES THAT HAVE ADOPTED PROXY ACCESS

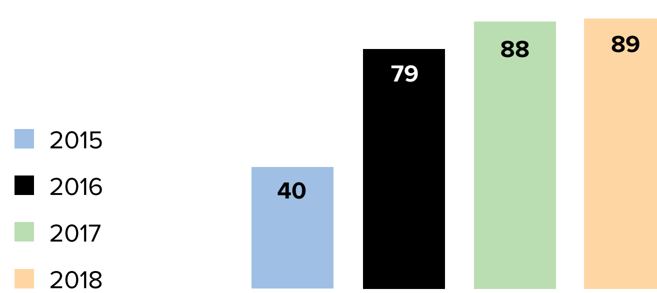
533

U.S. Listed Public Companies

67%

of the S&P 500

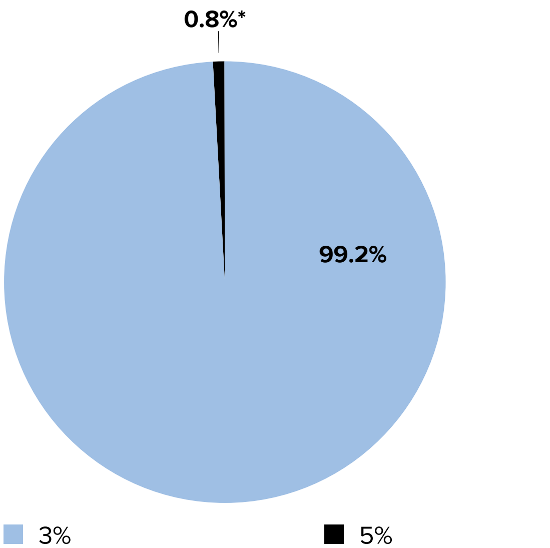
Top 100 Companies



HEADLINE TERMS OF PROXY ACCESS BY-LAWS

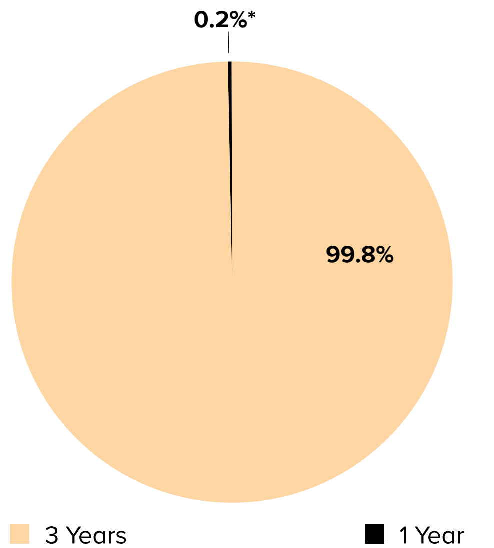
The most common formulation of the headline terms permits shareholders owning at least 3% of company stock for at least three years to submit proxy access nominees up to a maximum of 20% of the board/minimum of two directors with up to 20 shareholders being able to aggregate their holdings to meet the minimum ownership requirements. The short hand for proxy access by-laws with this formulation is 3/3/20/20.

Minimum ownership amount (%)



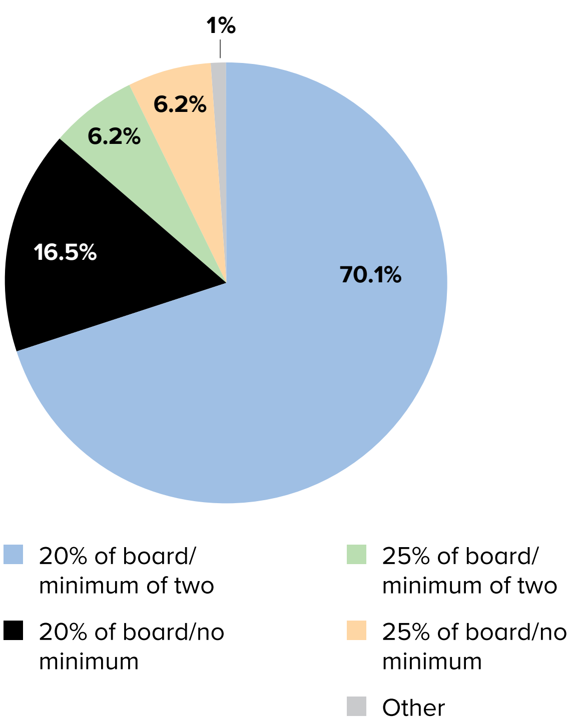
*Four companies have 5% minimum ownership thresholds.

Minimum period as shareholder (in # of years)

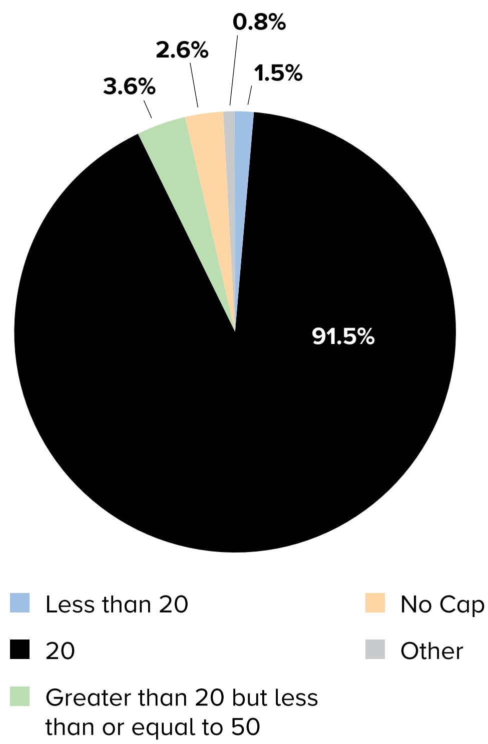


*One company has a one year minimum holding period.

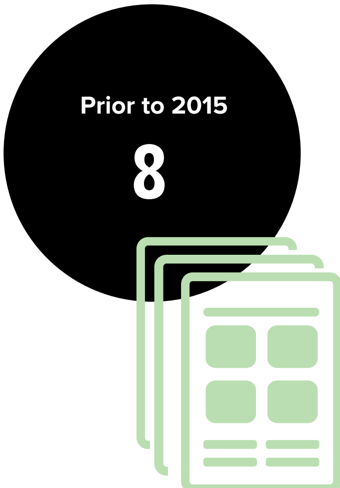
Maximum percentage of board/minimum number of directors



Maximum number of shareholders that can be aggregated



PROXY ACCESS ADOPTION OVER TIME

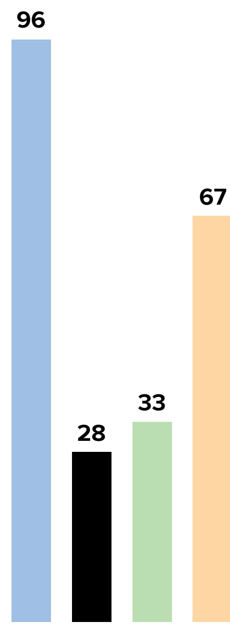


Total in 2015

118 by-laws

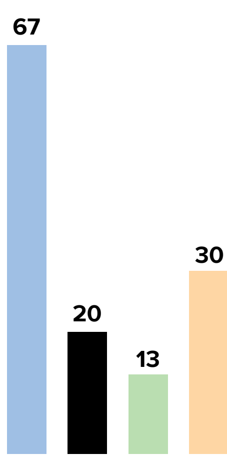
Total in 2016

224 by-laws



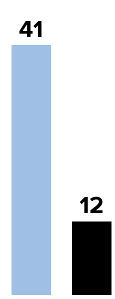
Total in 2017

130 by-laws



Total in 2018 (through June 30)

53 by-laws



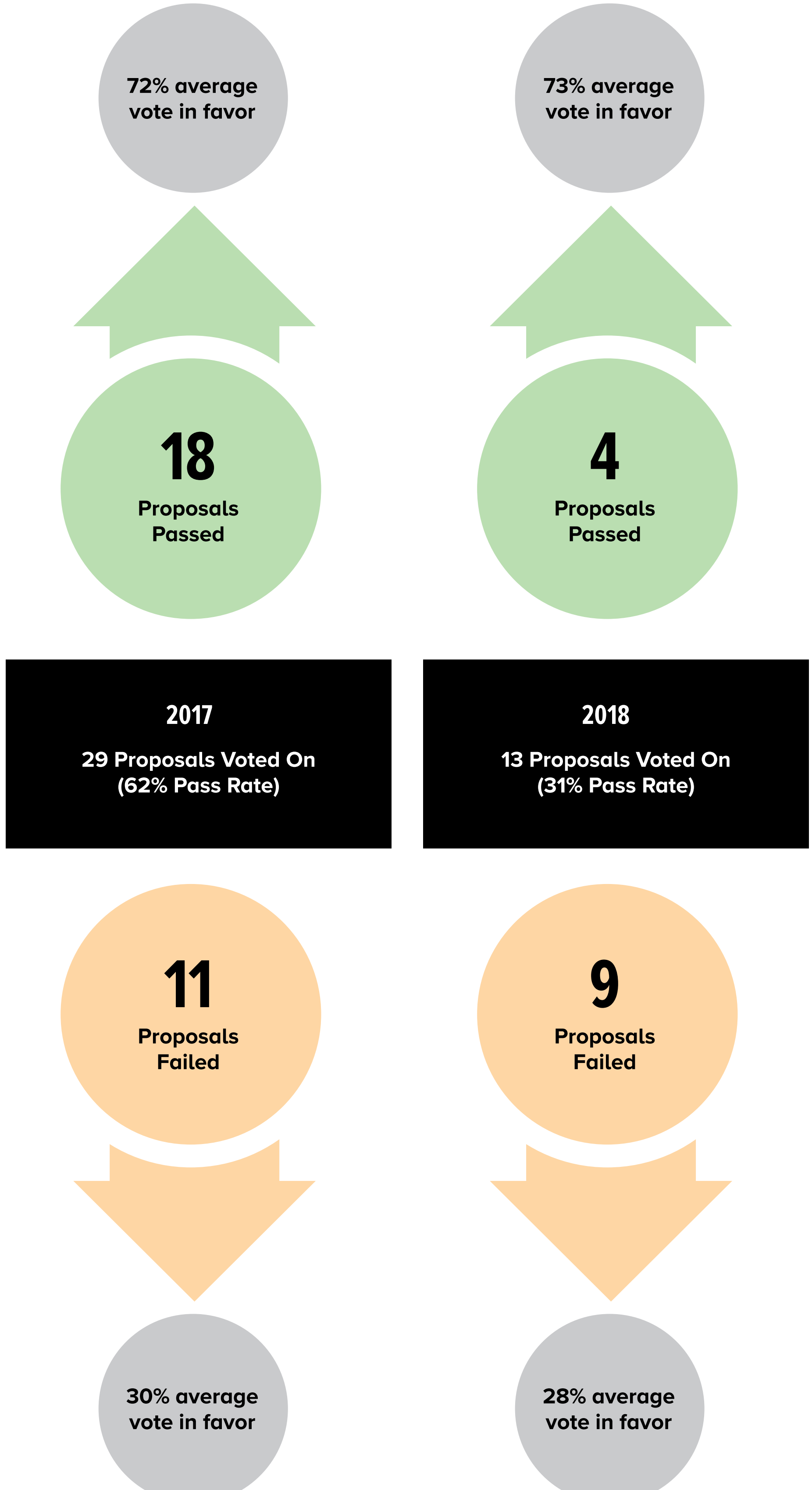
Q1 Q2 Q3 Q4

SHAREHOLDER PROPOSALS

"Adopt" Proposals

Through June 30, 2018, this year had a much smaller number of shareholder proposals seeking adoption of proxy access as compared to 2017 (22 in 2018 through June 30, 2018 versus 100 through August 31, 2017). Of these "adopt" proposals, which are typically precatory, 13 proposals came to a vote in 2018, compared to 29 in the relevant period in 2017. John Chevedden and James McRitchie and their related proponents remained the most prolific proponents with 12 proposals submitted in the aggregate in 2018, which comprised over 50% of adopt proposals. As was the case last year, the number of shareholder proposals voted on compared to the number submitted remained low because many companies adopted proxy access and negotiated withdrawals of the proposal. Of the shareholder proposals that did come to a vote in 2018, four proposals passed with an average vote in favor of 73%, while nine proposals failed with an average vote in favor of 28%; in each case, the voting percentages in favor are essentially unchanged from last year. The low average vote in favor at several of these companies where proposals failed can be explained by the presence of large insider positions.

The decrease in the overall number of "adopt" shareholder proposals was due to a number of factors, including a greater number of companies choosing to adopt proxy access by-laws in the absence of a shareholder proposal and a switch in the focus of individual shareholder proponents from "adopt" proposals to "fix-it" proposals, which seek to amend the terms of a company's existing proxy access by-law.



SECOND-TIER TERMS – OVERVIEW

In this article, we refer to by-law terms beyond the headline terms as "second-tier terms."

Institutional investors have become focused on second-tier terms. In July 2017, the Council for Institutional Investors updated its "Proxy Access: Best Practices" white paper and expanded the number of second-tier terms it considers when assessing a company's proxy access by-law. Some common second-tier terms include:

1

Loaned shares
Whether shareholders are able to count loaned shares towards the minimum percentage ownership requirement

2

Treatment of investment funds
Whether investment funds consisting of multiple entities are able to aggregate their shares and be treated as one shareholder for purposes of the shareholder cap found in most proxy access by-laws

3

Restrictions on renomination
Whether proxy access candidates who fail to achieve a specific percentage of votes (usually 25%) are prevented from being re-nominated for a number of years (usually two years) after their initial nomination

4

Compensation arrangements
Whether proxy access candidates can receive candidacy fees (and director fees) paid by shareholders, and whether such fees need to be disclosed to the company

5

Interplay of proxy access and advance notice
Whether there is a limitation on nominees pursuant to proxy access when nominations are made through advance notice

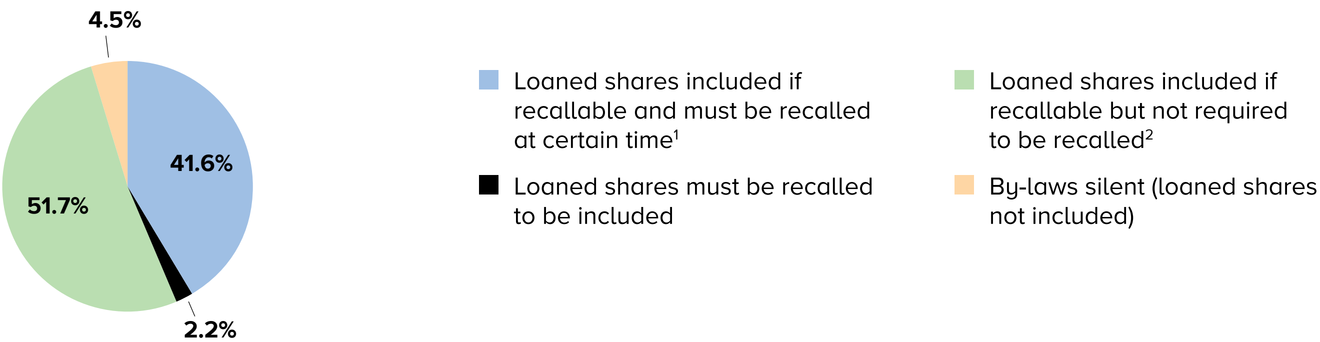
6

Other proxy access interplays
Whether there is a limitation on proxy access nominees when a director previously elected pursuant to proxy access is nominated by the company or when an agreement with a shareholder is entered into pursuant to which such shareholder is granted the right to a board seat

SECOND-TIER TERMS – DEEPER DIVE

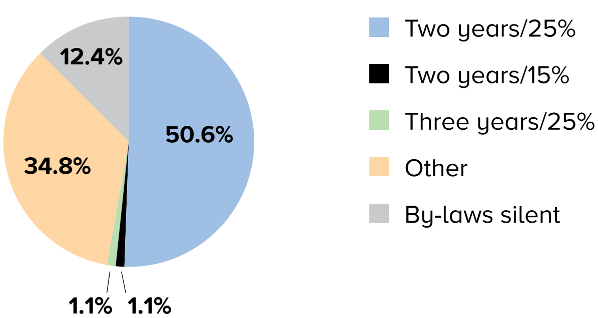
Of the Top 100 Companies, 89 companies have adopted proxy access by-laws. Within those 89 proxy access by-laws, we examined the presence of the following second-tier terms.

Loaned Shares
Extent to which loaned shares are included in minimum percentage ownership calculation

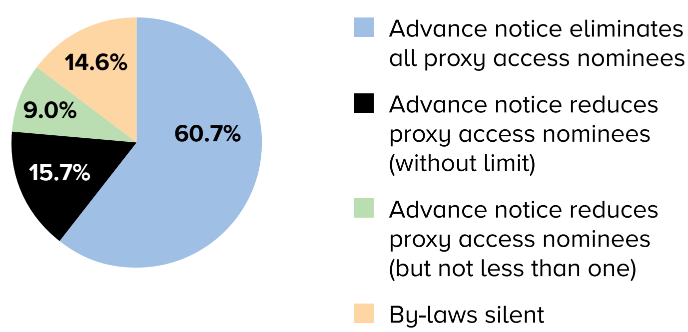


1 Of the 37 proxy access by-laws that permit inclusion of loaned shares if recalled, five companies require recall within three days, 31 companies require recall within five days and one company requires recall within a reasonable period of time.
2 Of the 46 proxy access by-laws that permit inclusion of loaned shares if recallable, 15 companies have a three-day recall period, 27 companies have a five-day recall period, and four companies have no time limit on the recall period.

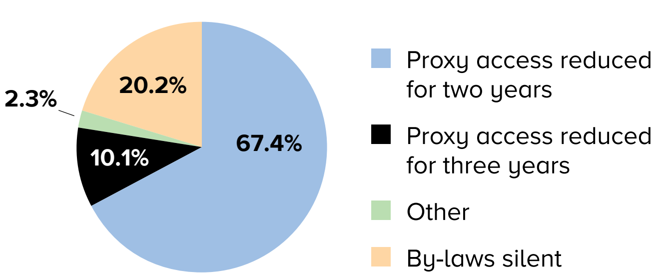
Restrictions on Renomination
Nominee is ineligible for a specified number of years if nominee failed to receive a specified % of votes



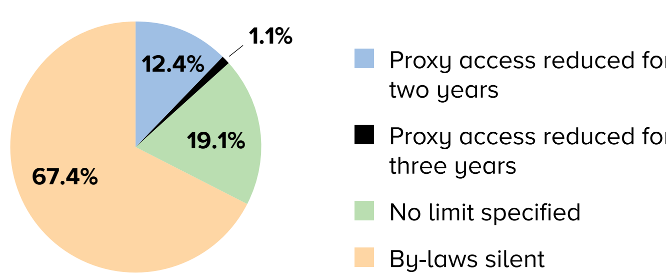
Interplay with Advance Notice
Impact on proxy access if advance notice is used



Prior Election of Nominee
Impact on proxy access if director previously elected pursuant to proxy access is nominated by the company



Agreement with Shareholder
Impact on proxy access if agreement with a shareholder is entered into and such shareholder is granted the right to a board seat



“FIX-IT” PROPOSALS

2018 saw a marked decrease in the number of “fix-it” proposals (proposals that seek to amend the terms of a company’s existing proxy access by-law) as compared to the number of such proposals in 2017, which follows a significant increase in such proposals in 2017 as compared to 2016. Only 28 “fix-it” proposals were received in 2018 compared to 64 proposals in 2017 and 11 proposals in 2016. Although only two “fix-it” proposals have passed (both in 2016), these proposals continue to merit attention as companies commence preparation for the 2019 proxy season and shareholder proponents continue to submit these proposals.

Companies have overwhelmingly adopted proxy access by-laws with 3/3/20/20 terms, in contrast to the “3/3/25/no cap” terms that many shareholders are seeking. Shareholder proponents have not acquiesced to the status quo; they continue to advocate for “fix-it” proposals that are designed to bring 3/3/20/20 by-laws closer to the 3/3/25/no cap by-laws they espouse, as well as requesting more shareholder-friendly second-tier terms. “Fix-it” proposals generally fall into three categories: “tailored,” “two-term”/“three-term” and “shareholder cap” proposals.

“Tailored” proposals request amendments to several (typically four or five) terms of a company’s by-laws. The terms include both headline and second-tier terms, such as the counting of loaned shares or treatment of investment funds. Only 16 tailored proposals have been submitted to date and none were submitted in 2018. Of those 16 proposals, seven were excluded or withdrawn, two passed with a 67% average vote in favor and seven failed with a 33% average vote in favor. The two “tailored” proposals that passed in 2016 were submitted at companies that had adopted by-laws with a 5% minimum percentage ownership threshold and to date, remain the only “fix-it” proposals that have passed. Not surprisingly, both companies subsequently amended their proxy access by-laws.

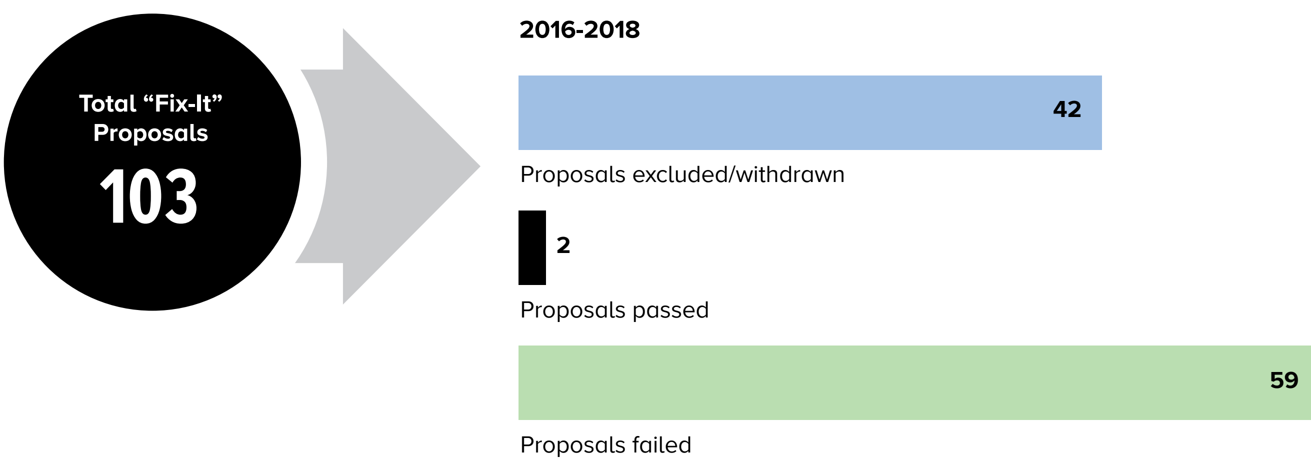
“Two-term” and “Three-term” proposals target companies on two or three issues, which typically include the percentage of the board electable pursuant to proxy access, the shareholder aggregation cap and the restrictions on renominations of failed proxy access candidates. While several companies attempted to exclude these proposals through the SEC’s no-action process, all such attempts have been unsuccessful.

There were 21 two-term proposals between 2016 and 2018. Of those 21 proposals, one was withdrawn while the remaining proposals all failed with a 27% average vote in favor.

There were 12 three-term proposals between 2016 and 2018. Of those 12 proposals, one was excluded, none passed and 11 proposals failed with a 29% average vote in favor.

“Shareholder cap” proposals only seek to amend the limitation on the number of shareholders that can aggregate their holdings to satisfy the minimum percentage ownership requirement. In 2018, shareholder cap proposals sought to remove an aggregation cap (as opposed to 2017 proposals which generally sought to increase the shareholder aggregation cap to 40 or 50 shareholders). All 10 proposals voted on in 2018 failed with a 26% average vote in favor.

There were 54 shareholder cap proposals between 2016 and 2018. Of those 54 proposals, 33 were excluded or withdrawn, none passed and 21 failed with a 27% average vote in favor.



AMENDMENTS

To date, 37 companies have amended their proxy access by-laws, although only one of these amendments occurred in 2018. While some amendments have been made prior to an upcoming vote on an "adopt" or "fix-it" proposal and some have been made in response to shareholder proposals that have passed, it is likely that at least a few amendments have been made in response to behind-the-scenes pressure from institutional investors seeking more favorable terms.

EXCLUSIONS AND WITHDRAWALS

The rate of exclusions/withdrawals of shareholder proposals declined precipitously in 2018 as compared to 2017 (from approximately 70% to approximately 20%). In 2018, among the 28 "fix-it" proposals, one was excluded and one was withdrawn. Among the 22 adopt proposals in 2018, six were excluded and three were withdrawn.

This decline in withdrawals/exclusions may be attributed to a refinement in shareholder proposals prior to submission, leaving a pool of proposals less vulnerable to exclusion and withdrawal. For example, the decline in "fix-it" proposals can be attributed to the SEC's decision in 2017 to generally allow companies to exclude "shareholder cap" proposals requesting an increase to 40 or 50 shareholders under Rule 14a-8(i)(10), so long as the company's proxy access by-law already had an aggregation cap of 20 shareholders and the company could represent as to certain facts about its shareholder base.

THE RATE OF EXCLUSIONS/ WITHDRAWALS OF PROPOSALS DECLINED PRECIPITOUSLY IN 2018 AS COMPARED TO 2017

FAST FACTS

TIME FROM ADOPTION TO AMENDMENT

Among the

37

companies that have amended their proxy access by-laws, there was an average of

311

days between the initial adoption of the by-law and an amendment

More than

900

annual meetings have been held by companies with a proxy access by-law since 2011

Only

1

nomination has been attempted (and was disqualified by the company in question)

ZERO

proxy access candidates have appeared in a company proxy statement

75%
of the IPO companies surveyed for 2017 adopted a classified board structure

80%
of the IPO companies surveyed for 2017 required a supermajority vote for certain amendments to the certificate of incorporation

93%
of the IPO companies surveyed in 2017 adopted an exclusive forum provision

IPO GOVERNANCE PRACTICES

Our third annual survey examines the corporate governance practices of newly public companies and includes an analysis of voting recommendations by ISS Governance.

IPO CORPORATE GOVERNANCE

Richard B. Alsop and
Rupa R. Briggs

Over the past two years, we have examined the impact of the new voting policy initiated by ISS Governance (ISS) in 2016 on the corporate governance practices of newly public companies. The voting policy recommends a vote against directors of newly public companies due to the adoption, prior to or in connection with an IPO, of corporate governance policies that adversely impact shareholder rights. ISS updated the policy in 2017 to expand the adverse vote recommendation to directors of IPO companies with a multi-class capital structure with unequal voting rights. ISS also removed as a positive factor in the policy the public commitment by the company to have a shareholder vote on the provision within three years of its IPO. In its place, ISS included a more stringent requirement of a reasonable sunset provision with the intention of ensuring that the adverse practice is eventually eliminated. Last year we analyzed ISS's voting recommendations for 2015 IPOs, the voting impact of the ISS policy and what impact the policy had on governance practices for 2016 IPOs. This year, we continue our review by surveying ISS's voting recommendations for 2015 IPOs and 2016 IPOs and the effect of ISS's policy on the governance practices for 2017 IPOs.

THE ISS POLICY

The ISS voting policy states that for newly public companies, ISS will generally vote against or withhold votes from individual directors, committee members or the entire board (except new nominees, who are considered on a case-by-case basis) if, prior to or in connection with the company's IPO, the company or its board adopted by-law or charter provisions materially adverse to shareholder rights, or implemented a multi-class capital structure in which the classes have unequal voting rights. ISS considers the following factors when making its voting recommendation:

- **Level of impairment of shareholders' rights**
- **Disclosed rationale**
- **Ability to change the governance structure (e.g., limitations on shareholders' right to amend the by-laws or charter, or supermajority vote requirements)**
- **Ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board**
- **Any reasonable sunset provision**
- **Other relevant factors**

Although the ISS policy does not define "charter provisions materially adverse to shareholder rights," the ISS policy on director performance evaluation identifies problematic provisions to include: a classified board structure; a supermajority vote requirement; either a plurality vote standard in uncontested director elections or a majority vote standard contested director elections; the inability of shareholders to call special meetings; the inability of shareholders to act by written consent; a multi-class capital structure; and/or a non-shareholder-approved poison pill.

For subsequent years, ISS recommends that unless the adverse provision and/or problematic capital structure is reversed or removed, votes for director nominees should be on a case-by-case basis.

INVESTOR CONSIDERATIONS FOR IPO COMPANIES

There are a number of key factors that frame the way investors think about IPO companies versus established public companies.

Purchase is Approval
IPO investors have in effect approved the company's corporate governance policies (as detailed in a comprehensive disclosure document) by deciding to purchase stock in the IPO.

Investment Thesis
IPO investors are buying into an investment thesis involving a particular management team and business model, which doesn't rely on a sale or take-out as the most likely path to a successful monetization of the investment. Therefore, they are fairly insensitive to anti-takeover measures.

Control
Many IPO companies remain majority-controlled after going public, making the concerns over anti-takeover measures largely irrelevant.

Vulnerability
An IPO typically involves a business with a projected growth trajectory unlikely to be achieved in a more mature company, and the company is executing the plan when it has significant vulnerabilities relating to, among other things, access to capital, market presence, competition, diversification, personnel and stock price volatility.

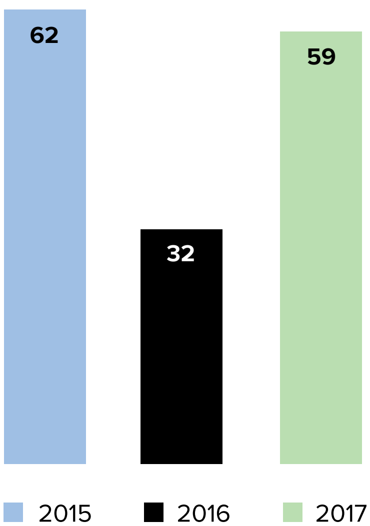
Dual-Track Processes
In many cases, sellers will approach potential strategic and financial acquirers at the same time as they prepare for an IPO. In such cases, the possibility of better value from a strategic or financial buyer has already been tested and reasonable anti-takeover measures are not likely to significantly disadvantage public shareholders.

New and Evolving Board
Under stock exchange rules, there are transition periods for moving to majority independent board committees, which are delayed for controlled companies. As a result, IPO company boards are often in a slow transition to independence. Membership is therefore in flux and the board is still in the process of developing a business and governance culture.

COMPARING 2015, 2016 AND 2017 IPOS

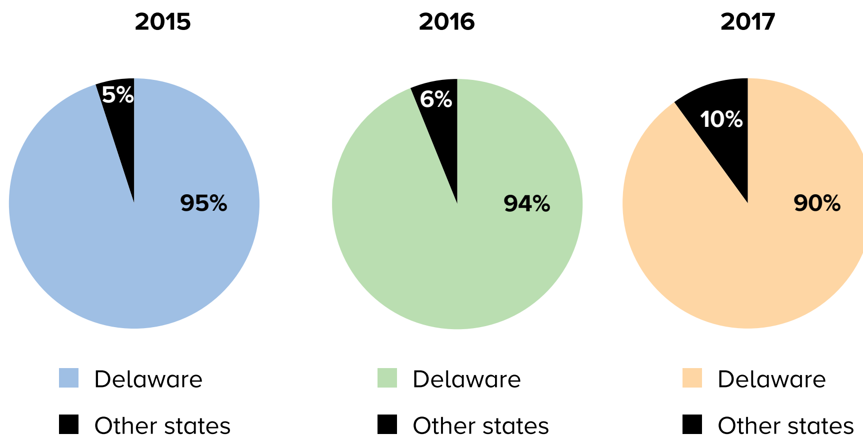
In order to evaluate the impact of the ISS policy and voting recommendations, we examined IPOs that were priced with a size of at least $100 million to analyze governance practices that we would expect to be considered problematic by ISS. Foreign private issuers, special purpose acquisition companies, master limited partnerships and real estate investment trusts were excluded. IPOs were roughly evenly split between the NYSE and Nasdaq.

Number of IPOs surveyed



State of Incorporation

Although Delaware continues to be the most popular state of incorporation for IPO companies, the percentage of Delaware-domiciled corporations in 2017 represented a slight decline from prior years.

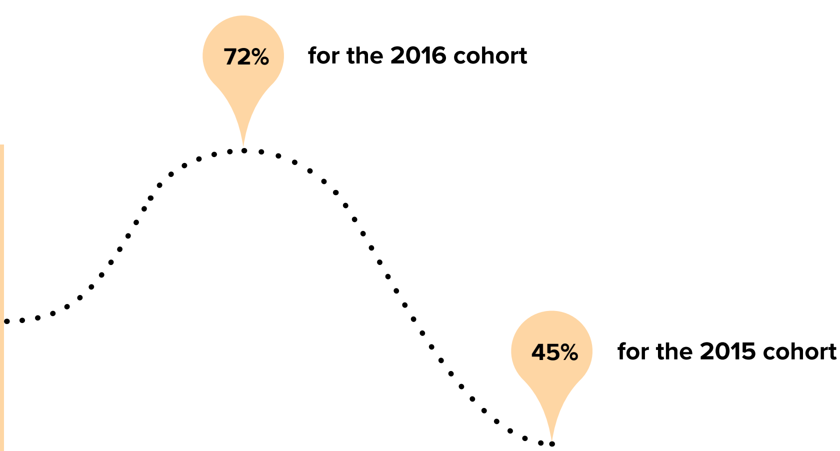


Controlled Companies

Of the 59 companies surveyed for 2017,

53%

remained controlled companies (i.e., more than 50% of the voting power was owned by a single person or group)



GOVERNANCE PRACTICES ADOPTED BY IPO COMPANIES

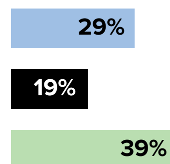
The percentage of companies adopting a classified board and supermajority voting provisions decreased in 2017 as compared to 2016, the first year the ISS policy on newly public companies went into effect. Notably, the adoption rate fell considerably as compared to 2015. In addition, the percentage of IPO companies in 2017 permitting stockholders to call special meetings and act by written consent modestly increased compared to both 2016 and 2015. Although the percentage of companies with multi-class equity structures increased in 2017 as compared to 2016 and 2015, this may have been due to a time lag in impact of the ISS policy given problematic capital structure was introduced into the ISS policy on newly public companies in 2017. It remains to be seen whether the 2017 cohort represents the start of a sustained shift in IPO governance practices.

2015 2016 2017

Adopted a classified board

Required a supermajority vote for certain amendments to the certificate of incorporation

Multi-class equity structure



Did not provide stockholders with the right to call special meetings

Did not provide stockholders with the right to act by written consent

Plurality voting in uncontested director elections

Consistent with the prior years' surveys, many 2017 IPO companies adopted certain other corporate governance practices that may face ISS scrutiny in the future:

Adopted an exclusive forum provision

Stockholders cannot remove directors without cause

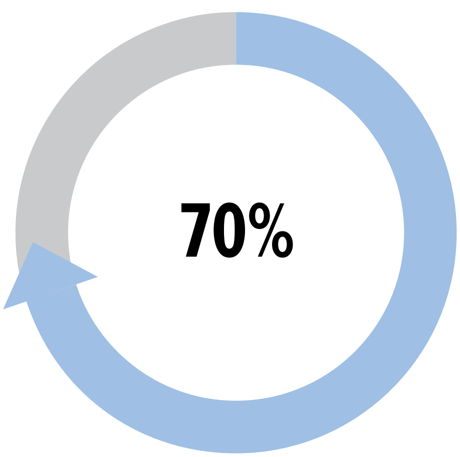
Board can increase the size of the board unilaterally

ISS VOTING RECOMMENDATIONS[1]

We analyzed ISS voting recommendations for director nominees at annual meetings for the 2015 and 2016 IPO companies. Consistent with last year's survey, ISS continued to follow its voting policy for newly public companies by making withhold or against recommendations against director nominees for the 2016 IPO companies. Although there was an impact on the voting percentages for the director nominees, we are not aware of any director that failed to be elected due to negative recommendations.

Consistent with the results for the 2015 cohort, the governance factors most commonly cited by ISS as a basis for a withhold or against recommendation against director nominees was the failure to remove, or subject to a sunset provision, a classified board and supermajority voting requirements to amend certain charter or by-law provisions. The existence of a problematic capital structure in which different classes have unequal voting rights was also cited in the recommendations for companies in the 2016 cohort with multi-class equity structures and differing voting rights. Problematic capital structure was not included as a factor in the recommendations for the 2015 cohort as it was included in the ISS policy after the first annual meeting for these companies. As noted above, for subsequent annual meetings, ISS recommends that votes for directors should be on a case-by-case basis unless the adverse provision and/or problematic capital structure has been removed. Based on our review of the data, ISS recommended withhold or against votes across the board at the second and third annual meetings for companies in the 2015 cohort and the 2016 cohort that had not removed such governance practices or made them subject to a sunset provision.

1 The data in this section was sourced from Voting Analytics.



of the 2016 cohort had at least one independent director receive a withhold or against recommendation from ISS based on the rationale in the ISS policy at their first annual meeting after going public

CHARTER AND BY-LAW AMENDMENTS

In addition to analyzing the ISS voting recommendations, we reviewed proxy statements and other securities filings for the 2015 and 2016 IPO companies to determine if any charter or by-law amendments had been approved or proposed since the company went public. Two 2015 IPO companies and five 2016 IPO companies declassified their board and/or removed supermajority voting provisions since their IPO. In all cases, ISS had recommended a withhold or against vote for director nominees at the previous year's annual meeting due to the companies' classified board and/or supermajority voting provisions. Of the seven companies that removed the adverse governance provisions, six were controlled companies at the time of their IPO. Several of the companies specifically noted the exit of the sponsor or controlling stockholder as the rationale for the charter amendment, while others cited corporate governance best practices for the change. It is possible that for these companies, the combination of the negative ISS voting recommendation and exit for controlled company status encouraged the quick removal of the adverse provisions, perhaps as a move to establish positive shareholder relations as a "new" (non-majority-controlled) public company.

CONCLUSION

While the 2017 survey showed a decrease in the adoption of governance provisions that run afoul of the ISS policy on newly public companies (in particular, classified boards and supermajority voting provisions), it is too early to conclude that the ISS policy prompted the shift in 2017 or that it will be continued in 2018.

Although controlled companies continued to enjoy immunity from the ISS policy and voting recommendations, some companies took action to remove aggressive governance provisions as soon as they were no longer controlled, possibly due in part to the ISS policy and voting recommendations. We are curious to see if additional companies amend their governance structure as they mature as public companies.

Boards of newly public companies should continue to monitor the impact of ISS voting recommendations as they relate to their own company's governance practices. Additionally, boards should give consideration as to whether to establish sunsets for certain governance practices at the time of the IPO and the appropriate time to take another look at corporate governance practices (for example, upon exiting controlled company status).

In 2018, among U.S.-based S&P 500 companies:

24

of 405 say-on-pay management-sponsored proposals received a vote in favor of less than 70%

48

shareholder-sponsored proposals for a political/lobbying report were received — the most common in the environmental, social and political matters proposal category

5

shareholder-sponsored proposals to amend the right of shareholders to call a special meeting passed with an average vote in favor of 39.8%

SHAREHOLDER PROPOSALS

In this section, we provide in-depth analysis of trends we see in shareholder proposals through a review of the management- and shareholder-sponsored proposals voted on by the U.S.-based S&P 500 companies. We also assess what transpired following the SEC's new guidance seeking direct board input in connection with a company seeking to exclude a shareholder proposal.

SHAREHOLDER PROPOSAL SEASON

Commentary provided by
Stephen T. Giove,
Arielle L. Katzman and
Zachary S. Aries

In this section of our Survey, we present an overview of the results of both the management-sponsored and the shareholder-sponsored shareholder proposals voted on at the annual meetings of U.S.-based S&P 500 companies in 2018 (through July 31, 2018). We also highlight some of the key findings based on our review of these results.

The data in this section of our Survey was provided by Proxy Insight, a leading source of information on global shareholder voting

MANAGEMENT-SPONSORED PROPOSALS — ROUTINE MATTERS

	2018 Year-to-Date*			2017			2016		
Proposal Type	**# Props.**	**# Fail**	**Avg. % in Favor**	**# Props.**	**# Fail**	**Avg. % in Favor**	**# Props.**	**# Fail**	**Avg. % in Favor**
Election of Directors	4,171	1	97.2	4,593	1	97.1	4,523	1	97.4
Ratification of Auditors	416	0	97.9	466	0	98.3	465	0	98.6
Say-on-Pay (Advisory)	405	6	91.5	466	6	92.0	443	5	92.2
Approve/Amend Equity Based Plans	94	0	94.4	193	0	93.9	192	0	93.8
TOTAL	5,086	7	N/A	5,718	7	N/A	5,623	6	N/A

*Through July 31, 2018.

Election of Directors

The level of support in director elections in 2018 was consistent with the prior two years. Directors received an average vote in favor of 97.2% and 88% of directors received a 95% or greater vote in favor. Approximately 11.5% of directors received a vote in favor of between 70% and 94%, 25 directors received a vote in favor of between 50% and 69% and, as shown above, one director failed to receive a majority vote.

Say-on-Pay Proposals

The level of support for say-on-pay proposals in 2018 was consistent with the prior two years. These proposals received an average vote in favor of 91.5%, down slightly from 92.0% in 2017 and 92.2% in 2016. A total of six proposals failed to receive a majority vote in 2018 (compared to six in 2017 and five in 2016) and 18 proposals received a vote in favor of between 50% and 69% (compared to 21 in 2017 and 19 in 2016).

MANAGEMENT-SPONSORED PROPOSALS — GOVERNANCE MATTERS

	2018 Year-to-Date*			2017			2016		
Proposal Type	**# Props.**	**# Fail**	**Avg. % in Favor**	**# Props.**	**# Fail**	**Avg. % in Favor**	**# Props.**	**# Fail**	**Avg. % in Favor**
Eliminate/Reduce Supermajority Voting	21	0	97.5	12	0	98.8	13	0	96.7
Authorize Shareholders to Call Special Meeting	15	0	80.5	3	0	91.3	6	0	96.2
Director Remuneration	8	0	96.1	12	0	91.8	9	0	94.2
Declassify Board	5	0	96.2	5	0	99.3	8	0	99.3
Adopt Proxy Access	4	0	94.7	3	0	98.0	11	2	83.9
Adopt Majority Voting	3	0	99.2	3	0	99.1	2	0	98.0
Adopt Forum Selection Provision	2	1	61.3	–	–	–	8	0	65.4
Authorize Shareholders to Act by Written Consent	2	0	94.8	–	–	–	1	0	95.3
Approve Director Removal Without Cause	1	0	99.7	3	0	99.4	6	0	99.3
Adopt/Amend NOL Rights Plan	–	–	–	2	0	88.9	1	0	81.9
Approve Advance Notice Policy	–	–	–	1	0	99.3	1	0	86.0
TOTAL	**61**	**1**	**N/A**	**44**	**0**	**N/A**	**66**	**2**	**N/A**

*Through July 31, 2018.

Management Governance Proposals

There were slightly more management-sponsored proposals regarding governance matters in 2018 as compared to 2017. This increase was driven by an increase in the number of proposals to eliminate or reduce supermajority voting provisions and proposals to provide shareholders with the right to call a special meeting (or to reduce the percentage threshold).

SHAREHOLDER-SPONSORED PROPOSALS — GOVERNANCE "HOT TOPICS"

	2018 Year-to-Date*			2017			2016		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Amend Shareholder Right to Call Special Meeting	48	5	39.8	17	1	45.7	12	1	41.7
Require Independent Board Chair	36	0	32.4	31	0	31.7	38	0	30.1
Authorize Shareholders to Act by Written Consent	34	5	41.9	13	2	44.6	17	1	41.3
Amend Proxy Access**	20	0	28.3	19	1	28.5	11	2	45.5
Adopt Proxy Access**	3	1	35.0	20	11	53.6	32	18	52.5
Adopt Shareholder Right to Call Special Meeting	–	–	–	4	2	44.6	3	0	41.4
TOTAL	141	11	N/A	104	17	N/A	113	22	N/A

*Through July 31, 2018.
**See our discussion on proxy access proposals in *Proxy Access – The March Forward Continues but at a Slower Pace* in this Survey.

Special Meeting Proposals

There was a significant increase in 2018 in shareholder-sponsored proposals to amend the right of shareholders to call a special meeting, with 48 such proposals being voted on in 2018 compared to 17 in 2017 and 12 in 2016. Most significantly, five proposals in 2018 received a majority vote in favor (compared to one in each of 2017 and 2016). While the average vote in favor in 2018 of 39.8% was lower than the average vote in favor in 2017 and 2016, a significant number of 2018 proposals received a higher level of votes in favor. Specifically, in 2018, 12 proposals received between 45-49% support (compared to three in 2017), nine proposals received between 40-44% support (compared to five in 2017) and 10 proposals received between 35-39% support (compared to five in 2017). Notably, in 2018, John Chevedden and his group submitted 50% of these shareholder proposals.

Independent Board Chair Proposals

Both the number of, and the level of support for, shareholder-sponsored proposals in 2018, requesting that the board chair be independent was consistent with both 2017 and 2016. None of these proposals passed in 2018 (as was the case in 2017 and 2016) and only six proposals in 2018 received a vote in favor in excess of 40%, compared with eight in 2017 and five in 2016.

Written Consent Proposals

There was a significant increase in 2018 in shareholder-sponsored proposals to allow shareholders the right to act by written consent, with 34 such proposals being voted on in 2018 compared to 13 in 2017 and 17 in 2016. Most significantly, five proposals in 2018 received a majority vote in favor (compared to two in 2017 and one in 2016). While the average vote in favor in 2018 of 41.9% was lower than the average vote in favor in 2017, 17 proposals received between 40-49% support in 2018, compared with nine in 2017 and 10 in 2016. Notably, in 2016 to 2018, John Chevedden and his group submitted approximately 50% of these shareholder proposals.

SHAREHOLDER-SPONSORED PROPOSALS — ADDITIONAL GOVERNANCE MATTERS

	2018 Year-to-Date*			2017			2016		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Adopt Majority Voting	6	4	57.6	5	3	52.6	3	1	40.2
Adopt One Share One Vote	5	0	30.3	5	0	29.6	9	0	26.2
Adopt/Amend Board Structure Policy	3	0	7.4	4	0	6.9	6	0	8.6
Adopt Cumulative Voting	3	0	9.4	2	0	9.7	1	0	10.9
Create Misc. Company Report	3	0	12.1	7	0	4	7	0	7.5
Adopt Confidential Voting Policy	2	0	3.6	4	0	3.9	–	–	–
Declassify Board	2	2	86.6	1	1	62.9	2	2	89.9
Eliminate/Reduce Supermajority Voting	2	2	75.9	7	6	62.8	14	6	43.9
Board Diversity Report/Policy	1	0	2.0	1	0	4.9	1	0	5.1
TOTAL	**27**	**8**	**N/A**	**36**	**10**	**N/A**	**43**	**9**	**N/A**

*Through July 31, 2018.

Additional Governance Matters

In 2018, shareholders continued to submit proposals to modify a range of governance practices, with success rates comparable to those of prior years. For governance matters which have become best practices for a large number of S&P 500 companies, such as majority voting and not having a classified board or supermajority voting provisions, shareholder-sponsored proposals continue to have an extremely high success rate. For other governance matters, such as cumulative voting and adopting a confidential voting policy, votes in favor of these proposals continue to be very low. Interestingly, there continues to be some interest in one vote per share proposals — and while none of 19 proposals have passed over the past three years, such proposals have received an average vote in favor of approximately 30% in the prior two years.

SHAREHOLDER-SPONSORED PROPOSALS — SELECT COMPENSATION MATTERS

	2018 Year-to-Date*			2017			2016		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Approve Claw-back Provisions	7	0	39.9	5	0	15.1	5	0	15.5
Adopt/Amend Pro-Rata Vesting Policy	7	0	30.4	7	0	33.1	13	0	26.2
Create Remuneration Report	2	0	14.4	3	0	5.6	1	0	9.6
Adopt Stock Retention/ Holding Period	–	–	–	4	0	23.3	9	0	17.4
TOTAL	16	0	N/A	19	0	N/A	28	0	N/A

*Through July 31, 2018.

Select Compensation Matters

The number of compensation-related proposals continued to decline in 2018. The most significant change in 2018 as compared to 2017 was a slight increase in the number of shareholder-sponsored proposals related to claw-backs and the more significant increase, from 15.1% in 2017 to 39.9% in 2018, in the support level for these proposals.

SHAREHOLDER-SPONSORED PROPOSALS — SELECT ENVIRONMENTAL, SOCIAL AND POLITICAL MATTERS

	2018 Year-to-Date*			2017			2016		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Political/Lobbying Report	48	0	28.5	58	0	25.3	64	2	25.8
Industrial Waste/Pollution/GHG Emission Report	9	0	27.5	10	0	25.0	3	0	24.3
Social Issues (Various) Report	9	0	14.1	9	0	6.9	14	0	6.0
Approve/Amend Diversity/ EEO Policy	7	0	35.7	8	0	30.1	7	1	24.7
Environmental Report/Policy	6	1	24.2	8	0	27.0	6	0	26.4

SHAREHOLDER-SPONSORED PROPOSALS — SELECT ENVIRONMENTAL, SOCIAL AND POLITICAL MATTERS (CONTINUED)

	2018 Year-to-Date*			2017			2016		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Human Rights Policy	5	0	5.4	4	0	3.7	5	0	7.8
Sustainability as Perf. Metric	5	0	10.8	5	0	14.7	3	0	17.1
Assess Impact of "Two Degree" Scenario Report	4	2	47.1	15	3	45.1	9	0	37.1
Pay Disparity Report	4	0	16.8	17	0	13.0	7	1	13.9
Sustainability Report	4	1	33.1	4	1	38.0	7	0	28.2
Human Rights Report	3	0	15.6	2	0	15.4	2	0	25.1
Social Issues (Various) Policy	3	0	4.7	5	0	14.7	1	0	26.3
Charitable Contribution Report	2	0	2.1	5	0	2.9	–	–	–
Climate Change Report	1	0	6.8	7	0	12.8	6	0	16
Energy Policy Report/Policy	1	0	29.4	4	0	24.7	8	0	27.9
Adopt Holy Land Principles	–	–	–	11	0	3.1	8	0	3.9
TOTAL	**111**	**4**	**N/A**	**172**	**4**	**N/A**	**150**	**4**	**N/A**

*Through July 31, 2018.

Select Environmental & Social Matters

The number of proposals pertaining to environmental, social and political matters declined meaningfully in 2018 as compared to 2017, although similar to 2017 and 2016, four proposals received a majority vote in favor. In 2018, as was the case in 2017 and 2016, the greatest number of proposals related to political and lobbying expenditures. While none of these proposals have passed in the past three years, these proposals have averaged a 26.4% vote in favor over this period.

Another noteworthy aspect of the 2018 proposal season was the level of support for "two degree" scenario proposals. While only four proposals were voted on in 2018 (compared to 15 in 2017 and nine in 2016), two of these proposals passed, compared to three of 15 proposals which passed in 2017.

SHAREHOLDER PROPOSALS 2018 — WAS 14I REALLY A GAME CHANGER?

Richard B. Alsop,
Lona Nallengara
and Arielle L. Katzman

In November 2017, the staff of the Division of Corporation Finance of the SEC issued Staff Legal Bulletin No. 14I ("SLB 14I"), announcing a new approach for considering requests to exclude shareholder proposals on the basis of the "economic relevance" exception under Rule 14a-8(i)(5) and the "ordinary business" exception under Rule 14a-8(i)(7). This new approach generated a great deal of interest and fueled speculation that it might signal a greater ability to exclude shareholder proposals that in the past were deemed to involve significant policy issues. To determine whether these expectations were realized, we reviewed the 21 SEC no-action letters determined on the basis of the 14a-8(i)(5) and (i)(7) exclusions during the 2018 proxy season, which applied SLB 14I.

BACKGROUND

"economic relevance"
The test for exclusion under the economic relevance exception under Rule 14a-8(i)(5) has the following two requirements to exclude a shareholder proposal:

- **The first requirement is that the shareholder proposal relates to operations which account for less than 5% of a company's total assets, net earnings and gross sales**
- **The second requirement is that the shareholder proposal is not otherwise significantly related to the company's business**

"ordinary business"
The test for exclusion under the ordinary business exception under Rule 14a-8(i)(7) has the following two alternatives:

- **The first alternative allows exclusion if a proposal's subject matter is so fundamental to management's ability to run the company day-to-day that it could not be subject to direct shareholder oversight, unless the subject matter involves "significant policy issues," which are ones that transcend ordinary business and are appropriate for a shareholder vote**
- **The second alternative allows exclusion if the proposal seeks to "micro-manage" the company by probing too deeply into matters of a complex nature on which shareholders would not be in a position to make an informed judgment**

Prior to SLB 14I, the SEC staff took an active role in determining whether the subject matter of a proposal relates to a significant policy issue. While the SEC staff has not demarcated the boundaries of what is a significant policy issue (employing a "we know it when we see it" approach), past experience indicates that the SEC staff considered a number of factors, including the degree of public attention given to an issue, press and other media coverage and recent legislative or regulatory activity, which were adopted to support arguments used by companies and proponents. As a result, there is a well-developed body of specific issues, that has evolved on a proposal-by-proposal basis, that the SEC staff considers to be significant policy issues.

In SLB 14I, the SEC staff indicated that it wanted to consider the perspective of a company's board as to whether the subject of a proposal transcends the ordinary business operations of a company, in the case of the "ordinary business" exclusion, or is significantly related to a company's business, in the case of the "economic relevance" exclusion.

The SEC staff has admittedly struggled with these determinations over the years and in SLB 14I, it referred to these decisions as "difficult judgment calls." In SLB 14I, the SEC staff indicated that it believes a company's board is "well situated to analyze, determine and explain whether a particular issue is sufficiently significant." To that end, it indicated that going forward, when a company relies on either Rule 14a-8(i)(7) or 14a-8(i)(5) in a no-action relief request, the SEC staff would expect to see a discussion of the specific processes employed by the board to assess whether the issue transcends its ordinary business operations or if the issue is significantly related to its business.

For "economic relevance" exclusions, the SEC staff indicated that going forward, proponents must demonstrate that the subject matter of the proposal was sufficiently related to a significant effect on a company's business and that the "mere possibility" of reputational or economic harm would not preclude no-action relief.

Notably, the SEC staff emphasized that there is a presumption that substantive governance matters will be significant to almost all companies, which likely forecloses the possibility of using the "economic relevance" exclusion for corporate governance proposals.

THE 2018 PROXY SEASON

During the 2018 proxy season (through June 30, 2018), 21 no-action letters[1] were decided on the "ordinary business" and/or "economic relevance" exceptions as the basis for exclusion, with 11 no-action letters[2] resulting in exclusion of the proposal in question. The following is a summary of our observations on these letters:

Virtually all of the companies involved discussed the proposal with the board or a board committee and disclosed the process and analysis performed by the board with respect to the policy issues raised by the subject of the proposal

Despite the stated intention in SLB 14I, the SEC staff has not really deferred to the determination of the board on policy issues, particularly in areas where the SEC staff historically has taken a consistent position on social policy issues, like political contributions and lobbying

Exclusion under (i)(5) economic relevance/5% test is viable again, but not easy, and successful requests citing both (i)(5) and (i)(7) were mostly granted under (i)(7)

The SEC staff gave more weight to significant shareholder support in a prior shareholder vote on the same social policy issue than to any analysis and determination by the board

The micro-management prong of (i)(7) as a basis for exclusion is alive and well

1 *Apple Inc.*, SEC No-Action Letter (Dec. 21, 2017) (incoming letter Oct. 9, 2017); *Apple Inc.*, SEC No-Action Letter (Dec. 21, 2017) (incoming letter Nov. 20, 2017); *AmerisourceBergen Corp.*, SEC No-Action Letter (Jan. 11, 2018); *Allergan plc*, SEC No-Action Letter (Feb. 7, 2018); *Dunkin' Brands Group, Inc.*, SEC No-Action Letter (Feb. 22, 2018); *JPMorgan Chase & Co.*, SEC No-Action Letter (Feb. 28, 2018); *Eli Lilly and Company*, SEC No-Action Letter (Mar. 2, 2018); *Citigroup Inc.*, SEC No-Action Letter (Mar. 6, 2018); *Citigroup Inc.*, SEC No-Action Letter (Mar. 7, 2018); *Goldman Sachs Group*, SEC No-Action Letter (Mar. 12, 2018); *Entergy*, SEC No-Action Letter (Mar. 14, 2018); *American Airlines Group Inc.*, SEC No-Action Letter (Mar. 23, 2018); *JPMorgan Chase & Co.* SEC No-Action Letter (Mar. 29, 2018); *Alliant Energy Corporation*, SEC No-Action Letter (Mar. 30, 2018); *JPMorgan Chase & Co.* SEC No-Action Letter (Mar. 30, 2018) (incoming letter Jan. 12, 2018, discussing report on risks with corporate lending); *JPMorgan Chase & Co.* SEC No-Action Letter (Mar. 30, 2018) (incoming letter Jan. 12, 2018, discussing human rights); *NextEra Energy, Inc.*, SEC No-Action Letter (Mar. 30, 2018); *Amazon.com, Inc.*, SEC No-Action Letter (Apr. 10, 2018); *RH*, SEC No-Action Letter (May 11, 2018); *Red Hat, Inc.*, SEC No-Action Letter (June 12, 2018); *Nike, Inc.*, SEC No-Action Letter (June 22, 2018).

2 See *Apple Inc.*, SEC No-Action Letter (Dec. 21, 2017) (incoming letter Oct. 9, 2017); *Allergan plc*, SEC No-Action Letter (Feb. 7, 2018); *Dunkin' Brands Group, Inc.*, SEC No-Action Letter (Feb. 22, 2018); *JPMorgan Chase & Co.*, SEC No-Action Letter (Feb. 28, 2018); *JPMorgan Chase & Co.* SEC No-Action Letter (Mar. 30, 2018) (incoming letter Jan. 12, 2018, discussing report on risks with corporate lending); *JPMorgan Chase & Co.* SEC No-Action Letter (Mar. 30, 2018) (incoming letter Jan. 12, 2018, discussing human rights); *Amazon.com, Inc.*, SEC No-Action Letter (Apr. 10, 2018); *American Airlines Group Inc.*, SEC No-Action Letter (Mar. 23, 2018); *RH*, SEC No-Action Letter (May 11, 2018); *Red Hat, Inc.*, SEC No-Action Letter (June 12, 2018); *Nike, Inc.*, SEC No-Action Letter (June 22, 2018).

DEFERENCE TO THE BOARD? NOT SO FAST!

When SLB 14I was issued, there was a certain amount of speculation that it could represent a sea change in the way the SEC staff approached social policy-based shareholder proposals. There was a great deal of optimism among companies that a robust process and thoughtful analysis by a board which was clearly described, would be given substantial deference by the SEC staff. Based on the letters we reviewed, however, there was no evidence that the SEC staff has adopted a policy of automatic or even substantial deference to a board's determination.

There were five no-action requests related to shareholder proposals on lobbying that provide a good test case on deference. The SEC staff has traditionally not granted no-action requests in connection with proposals seeking reports or additional disclosures pertaining to lobbying activities. This year, five companies[3] submitted (i)(7) no-action letters relating to lobbying proposals. In each case, the no-action letters provided detailed and comprehensive discussions of the processes their boards followed to make a determination about whether the issue of lobbying transcends ordinary business. None of these no-action letters were successful. In four of the no-action letters[4], the SEC staff cited previous votes relating to the subject matter of the proposal that received in excess of 20% support as a basis for refusing to concur in the exclusion, noting that the board's determinations did not adequately address the shareholder votes. In one of the letters[5], where previous shareholder votes on the topic had never exceeded 10%, the SEC staff indicated that the discussion of the board's analysis, while setting forth several factors the board considered, did not provide a sufficient level of detail to reach a determination that exclusion was appropriate.

3 *Citigroup Inc*., SEC No-Action Letter (Mar. 6, 2018); *Eli Lilly and Company*, SEC No-Action Letter (Mar. 2, 2018); *Goldman Sachs Group*, SEC No-Action Letter (Mar. 12, 2018); *NextEra Energy*, Inc., SEC No-Action Letter (Mar. 30, 2018); *Alliant Energy Corporation*, SEC No-Action Letter (Mar. 30, 2018).

4 *See Citi, Eli Lilly and Company, NextEra* and *Alliant, supra* note 3.

5 *See Goldman Sachs Group, supra* note 3.

WHEN SLB 14I WAS ISSUED, THERE WAS SPECULATION THAT IT COULD REPRESENT A SEA CHANGE IN THE WAY THE SEC STAFF APPROACHED SOCIAL POLICY PROPOSALS, BUT THERE WAS NO EVIDENCE OF REAL DEFERENCE GIVEN TO THE BOARD.

The SEC staff's approach to the lobbying letters raises a number of questions related to how a company should approach prior shareholder votes on the same subject matter of a shareholder proposal, including the following:

- When will the SEC staff defer to the views of shareholders over the conclusions of the board?
- Is a shareholder vote on the subject matter rebuttable? If so, what does a company need to show to rebut it? Does engagement with shareholders on the subject matter suffice?
- Is there a percentage threshold for a prior shareholder vote above which the SEC staff is unlikely to concur with a company as to whether an issue is ordinary business?
- Does all of this really mean that there are certain social policy matters (such as lobbying and political contributions), that the SEC staff believes transcend ordinary business at every company?

NO GOOD DEED GOES UNPUNISHED

One of the lessons from the (i)(7) letters seems to be that world class companies have world class issues

It may seem like a double-edged sword, but to the extent a company aspires to leadership on significant social policy issues and embeds tenets related to these issues in its corporate policies or its way of doing business, it appears less likely that it will be able to convince the SEC staff that such an issue is not significantly related to its business. There are two noteworthy no-action letters from the 2018 season that illustrate this point.

Apple submitted a no-action letter relating to a proposal recommending that it establish a human rights committee to review, assess, disclose and make recommendations to enhance the company's policies and practices on human rights.[6] Clearly not wanting to diminish a policy issue that Apple considers, and demonstrates in its way of doing business, as vitally important, Apple made the clever argument that human rights do not simply transcend ordinary business, but are an "integral component of the company's business operations," noting "the observance of human rights standards factors into every decision made by management in the day-to-day operations of the Company." Despite a thorough discussion of the Apple board's process and conclusions, the SEC staff rejected the request, referencing Apple's own language in its response letter to indicate that human rights transcend ordinary business.

In another example, JPMorgan submitted a no-action letter relating to a proposal requesting that the board provide a report to shareholders on how its published corporate values align with its policies regarding investments in companies tied to genocide or crimes against humanity and specifically explain how a particular investment is consistent with its published corporate values.[7] The proponent cited numerous JPMorgan policies and value statements in opposing the no-action letter. Despite compelling arguments about micro-management and day-to-day business operations, the SEC staff rejected the request. While the SEC staff's response letter is not specific, it seems likely that it felt that JPMorgan's arguments about the significance of the proposal were undermined by its own public statements.

6 *Apple Inc*., SEC No-Action Letter (Dec. 21, 2017) (incoming letter Nov. 20, 2017).

7 *JPMorgan Chase & Co*. SEC No-Action Letter (Mar. 29, 2018).

THREADING THE 5% NEEDLE

The (i)(5) exclusion has, historically, not been relied upon because of the expansive view the SEC staff has taken when applying the“not otherwise significantly related” portion of the exclusion. Where a proposal related to operations that did not meet the 5% test, if a company did any business related to the issue in question and the issue touched upon a matter of “broad social or ethical concern,” the SEC staff has been inclined to deny exclusion of the proposal. Only one no-action letter submitted this proxy season was excluded on the basis of the (i)(5) exception – the “less than 5%” and “not otherwise significantly related” exception. The proposal to Dunkin’ Brands[8] requested a report assessing the environmental impact of continuing to use K-Cup coffee pods packaging. Dunkin’ Brands does not actually manufacture K-Cup coffee pods. In the no-action letter, Dunkin’ Brands noted that it derived most of its revenues relating to K-Cup coffee pods from licensing fees and the remainder from royalties attributable to the sale of K-Cup coffee pods in franchised restaurants. Additionally, Dunkin’ Brands confirmed that the K-Cup-related business did not exceed 5% on any of the relevant financial metrics. The board considered whether the K-Cup business was otherwise significantly related to its business and reasonably concluded it was not, referencing the SEC staff’s statement in SLB 14I that the mere possibility of reputational or economic harm will not preclude no-action relief. The SEC staff granted no-action relief.

Based on the SEC staff’s statements in SLB 14I, an (i)(5) no-action letter was bound to get over the finish line and Dunkin’ Brands was the perfect case, given the policy issue really related to a third-party manufacturer to whom Dunkin’ Brands was only licensing its brand. Nonetheless, given the SEC staff’s approach to other broader policy issues in the (i)(7) context this season, and the absence of any other successes on (i)(5), it remains to be seen whether there will be other fact patterns that can similarly achieve exclusion on the basis of (i)(5).

8 *Dunkin’ Brands Group, Inc.*, SEC No-Action Letter (Feb. 22, 2018).

OF THE 21 NO-ACTION LETTERS WE REVIEWED, ONLY ONE WAS SUCCESSFULLY EXCLUDED ON THE BASIS OF THE “LESS THAN 5%” EXCEPTION.

A WHOLE LOT OF WORK FOR NOTHING?

Based on the no-action letters we reviewed, it is not at all clear that the SEC staff's new policy requiring the board to make a determination on social policy issues has resulted in measurable benefits for companies in terms of excluding proposals implicating social policies. Nearly half of the no-action requests submitted were still rejected under the SLB 14I approach, and of the ones that were granted, most, if not all, were either straightforward ordinary business issues, like choice of products and tax policy, or easy micro-management arguments not implicating any social policy analysis, and would likely have been granted prior to SLB 14I without any board involvement. In light of that conclusion, it has to be asked whether SLB 14I is more of a benefit or burden to companies in the context of (i)(5) and (i)(7) proposals, given the need to prepare and involve the board or at least a committee in the no-action letter process. Without a convincing record of success, the benefits are unclear. One wonders whether, over time, SLB 14I will end up discouraging companies from opposing proposals on the basis of (i)(5) or (i)(7), because a successful no-action letter will need board engagement, or it will, at least, prompt companies to be more discriminating about when they take up the board's time and focus.

Issuers are not the only parties frustrated by failure of SLB 14I to inject greater clarity into the process for exclusion of proposals, and activist investors have also lamented the inertia in this area. In a recent submission with analysis and recommendations to the SEC, the "Shareholder Rights Group," which consists of 15 activist proponents, requested that the SEC increase the predictability of outcomes for no-action letters, noting that "the invitation for board findings under SLB 14I increased expenses and uncertainties for investors and companies without changing decision outcomes."

ONE WONDERS WHETHER, OVER TIME, SLB 14I WILL END UP DISCOURAGING COMPANIES FROM OPPOSING PROPOSALS ON THE BASIS OF (I)(5) OR (I)(7).

CONCLUSION

A single proxy season is hardly sufficient to draw definitive conclusions about the benefits and burdens of the new guidance in SLB 14I, but it seems clear that there will not be the level of deference to board determinations that was expected upon first reading the guidance. Companies considering their options with respect to proposals implicating social policy issues should remember the following:

- ✓ Always look for ways to argue the proposal micro-manages the company, which avoids the entire question of whether the issue transcends ordinary business and avoids interaction with past shareholder votes
- ✓ Build in time to inform the board and help board members arrive at a determination that can be described in detail in the no-action request – for most companies, shareholder proposals arrive at the end of the calendar year and require board engagement during the first part of the new year, which is a notoriously busy time for all boards
- ✓ Take care when advising the board as it considers sensitive social policy issues as the board's deliberations and assessment may form part of a public no-action request
- ✓ Provide sufficient detail and quantitative and qualitative support for the analysis and conclusions made by the board
- ✓ Do not overlook past shareholder votes. Be prepared to address them in the description of the board's process and determination – clearly reflect that the board considered those past votes in its deliberations. Most importantly, have an explanation for any prior vote above 15%
- ✓ Be aware of the policy issues on which the SEC staff has historically not granted no-action relief – look to the reasons cited by the SEC staff and reflect those reasons in the board deliberations

8.25 YEARS

the average board tenure of the Top 100 Companies

70

of the Top 100 Companies have a retirement age policy for non-management directors, with 72 being the most common age and more than half allowing the board to make exceptions to the policy

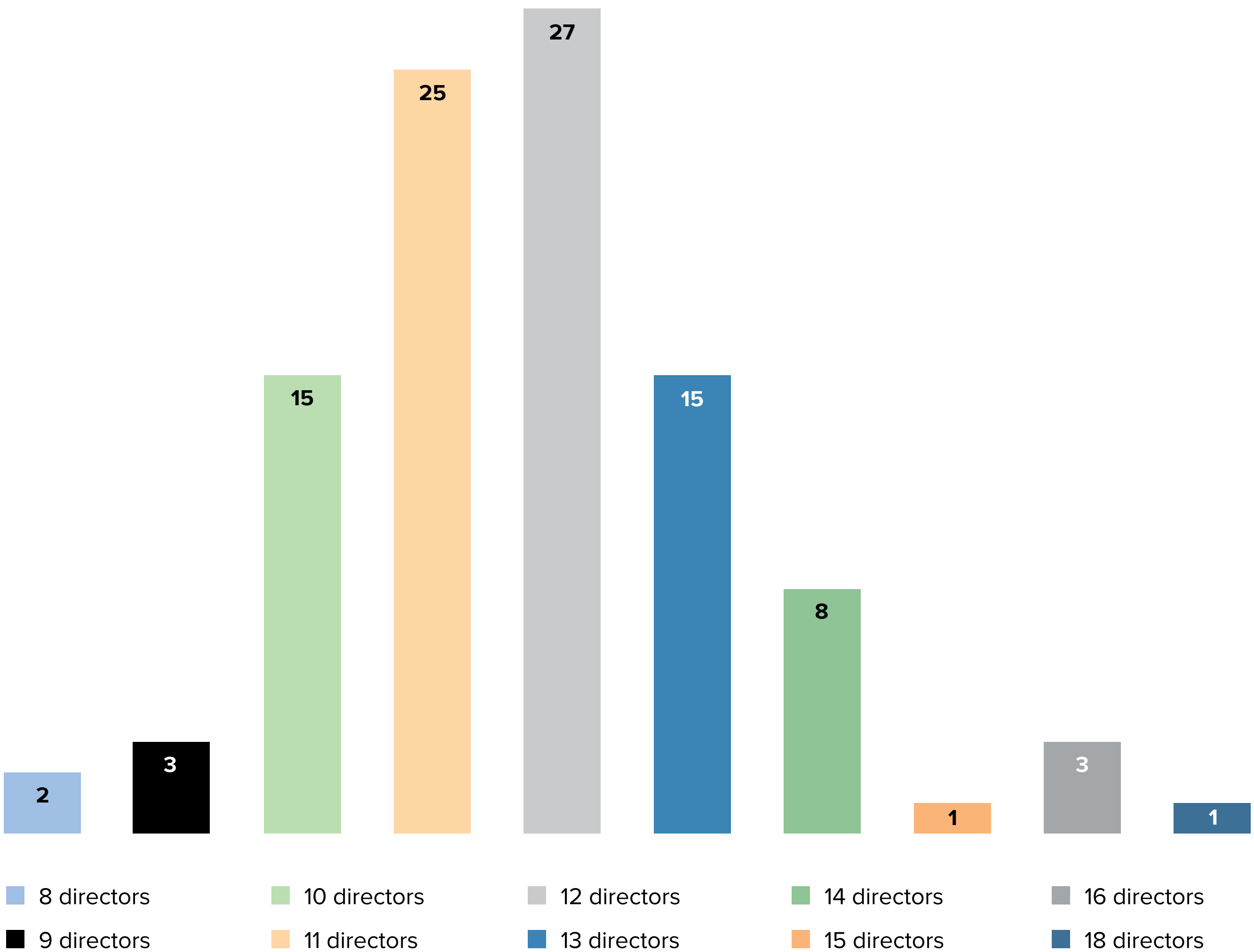
THE SURVEY

BOARD STRUCTURE AND PRACTICES

Over the last four years, the average size of the boards of the Top 100 Companies ranged from

12.5 directors in 2015 to **11.8** directors in 2018

BOARD SIZE OF THE TOP 100 COMPANIES



SIZE OF THE BOARD

The board size of the Top 100 Companies ranged from:

8 to 18 directors with an average of

11.8 directors

The board size of:

90 of the Top 100 Companies ranged from

10-14 directors

SEPARATION OF THE CEO AND CHAIR

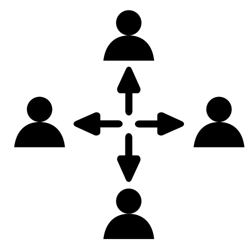
27

of the Top 100 Companies currently have different individuals serving in the roles of board chair and CEO

Of those companies,

19

have independent board chairs



10

board chairs of the Top 100 Companies are women

BOARD REFRESHMENT

Board refreshment is one of the "hot issues" facing nominating and governance committees and boards as a whole as they are increasingly under pressure to change the face of the boardroom by reexamining topics such as director tenure, experience, performance and diversity, with gender and ethnic diversity at the forefront. While director continuity provides many benefits, those benefits must be balanced with the need for fresh perspectives, diverse views, specialized experience and independence.

DIRECTOR INDEPENDENCE

Independent directors constituted

75% **or more**

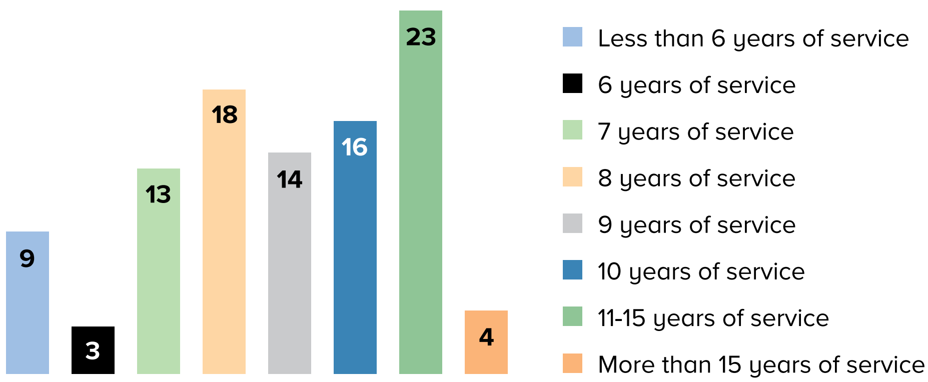
of the directors on the boards of most of the Top 100 Companies. Over the last 10 years, the number of companies at which the CEO is the only non-independent director has increased significantly. COOs served on the boards of four companies and a CFO served on the board of two companies.

91 **of the Top 100 Companies have boards composed of 75% or more independent directors.**

49 **of the Top 100 Companies have the CEO as the only non-independent director.**

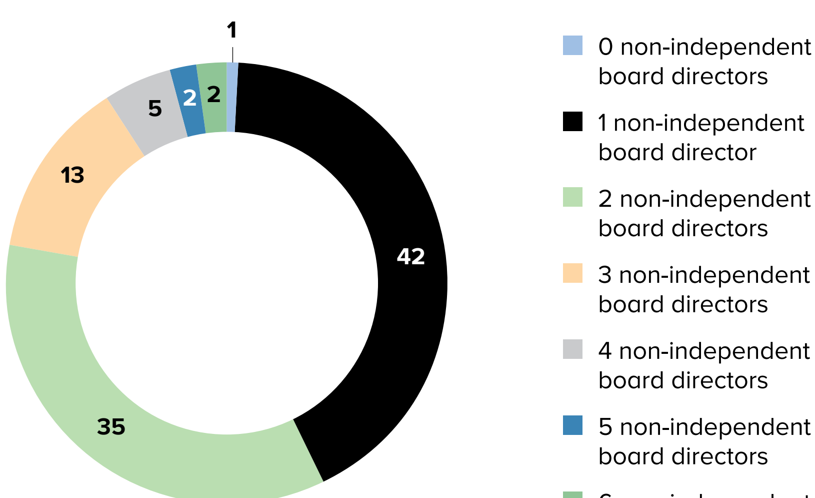
27 **of the Top 100 Companies have non-management directors who are not independent.**

AVERAGE TENURE OF DIRECTORS



The average board tenure at the Top 100 Companies is 8.25 years.

NON-INDEPENDENT DIRECTORS



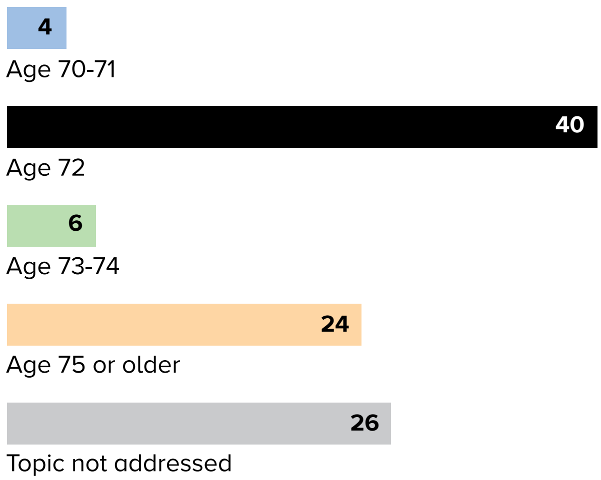
At one company with one non-independent director, that director is not the CEO, and at one company with two non-independent directors, both such directors are co-CEOs.

MECHANISMS TO ENCOURAGE BOARD REFRESHMENT

Refreshing the board is often accomplished by adopting a mandatory retirement age for non-employee directors or, less frequently, by imposing mandatory term limits on service. Bright-line standards can eliminate the need to make difficult decisions about the continued service of an individual director, but they often do not take into account whether the directors are functioning effectively. This can prolong the tenure of under-performing directors or cut short the tenure of directors who continue to make a contribution. The NYSE mandates board self-evaluations and many companies are increasingly relying on them as a more effective means for ensuring board composition is appropriate and the board is functioning effectively.

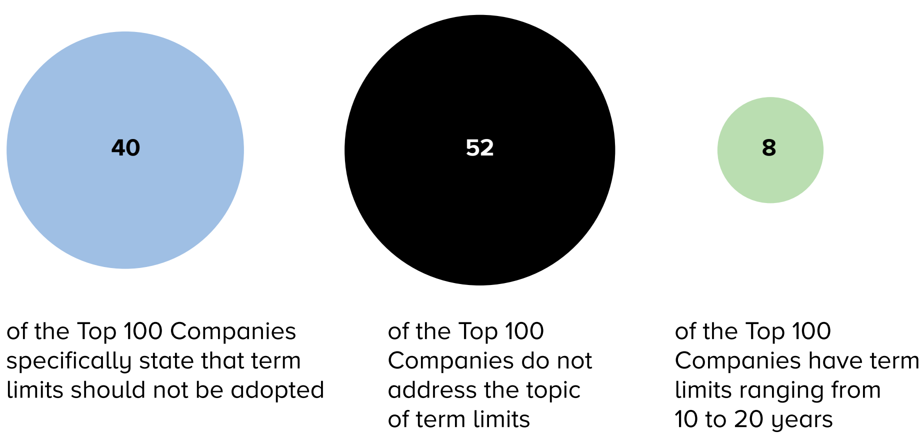
RETIREMENT AGE

Although not required by either the NYSE or Nasdaq listing standards, 70 of the Top 100 Companies have disclosed a mandatory retirement age for their non-management directors. Of these, 35 companies expressly permit the board or a committee of the board to make exceptions to the retirement age policy. Similar to 2017, age 72 continues to be the most commonly selected mandatory age for directors (other than chairs in certain instances) to retire from the board when they retire from employment with the company.



TERM LIMITS

Eight of the Top 100 Companies have adopted mandatory terms for their directors, a slight decrease from 2017. The mandatory term limits apply only to non-management directors at three of these companies. Forty of the Top 100 Companies specifically state that term limits have not been adopted, most citing the value of the insight and knowledge that directors who have served for an extended period of time can provide about the company's business. Many of these companies also state that periodic reviews by the board or a board committee of each director's performance serve as an appropriate alternative to mandatory term limits. One company has a 20-year term limit.



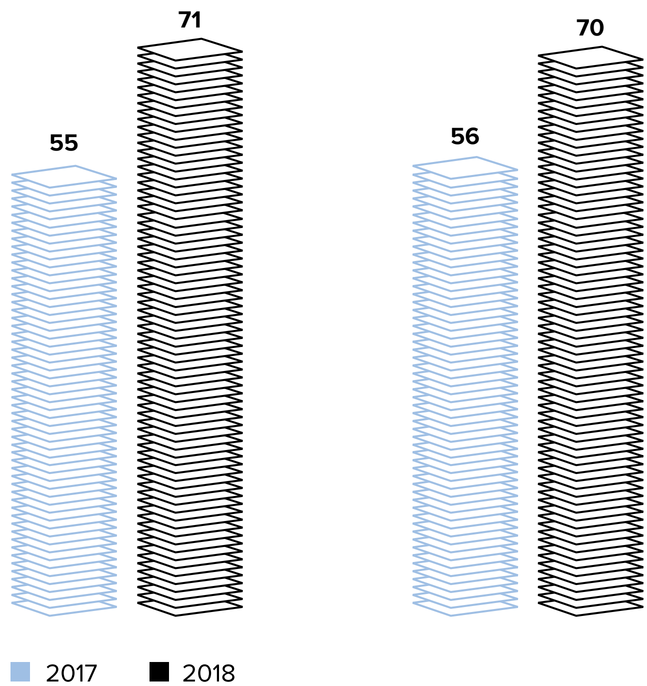
DIRECTOR SKILLS MATRIX

As one of many initiatives to encourage large public companies to promote diversity on public company boards, the New York City Comptroller (NYCC) launched a new phase of its Boardroom Accountability Project in September 2017. The project involved, among other things, asking 151 U.S. public companies to add a director skills matrix as part of their proxy statement disclosures. For more information on the Board Room Accountability Project, see *Board Diversity and the Skills Matrix* in this Survey.

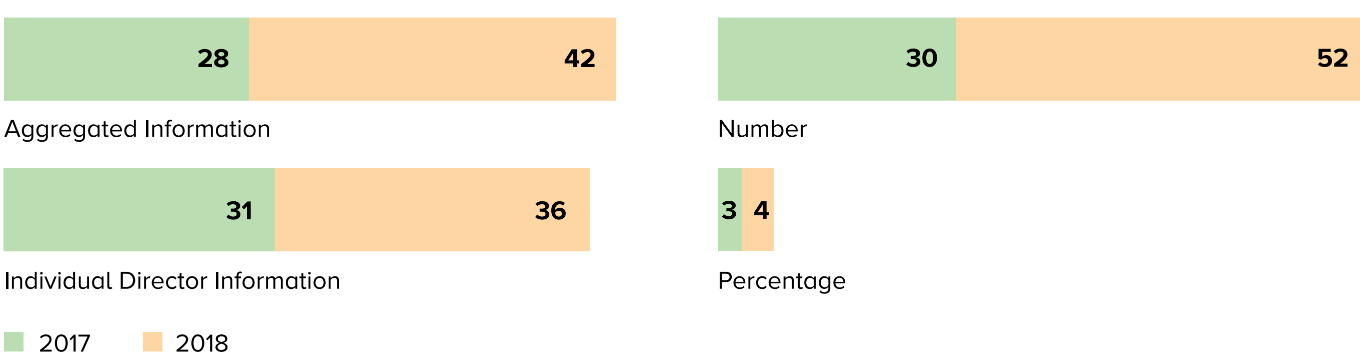
Since the announcement of the NYCC's new project, the number of Top 100 Companies that presented a matrix in their proxy statement that identified the skills, experiences and characteristics of its directors increased from 55 companies in 2017 to 71 companies in 2018. Of the 17 companies that added a skills matrix in their 2018 proxy statement, only four of the Top 100 Companies received the request from the NYCC.

Director skills matrix presented

Skills in matrix consistent with skills identified as important for selection of directors



Companies vary considerably in how they present the skills, experiences and characteristics of directors in the matrix. The information may be presented in the aggregate or identify specific directors who have such skills, experiences and characteristics.* Where the skills matrix identifies directors on an aggregated basis, the information on the directors who possess the skills, experiences and characteristics may be presented as an aggregated number of directors (i.e., "five of our 10 directors have public company board service experience") or as a percentage of the entire board (i.e., "50% of our directors have public company board service experience").** In 2018, there was a notable increase in the number of Top 100 Companies that presented information on an aggregated basis and as an aggregated number of directors.

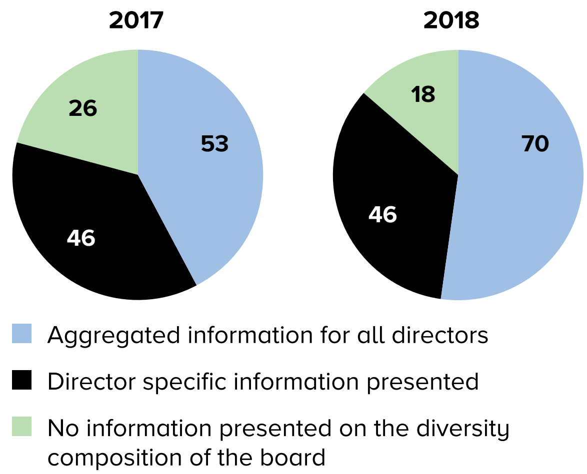


*In 2017 and 2018, four and seven companies, respectively, presented both aggregated and individual director information.

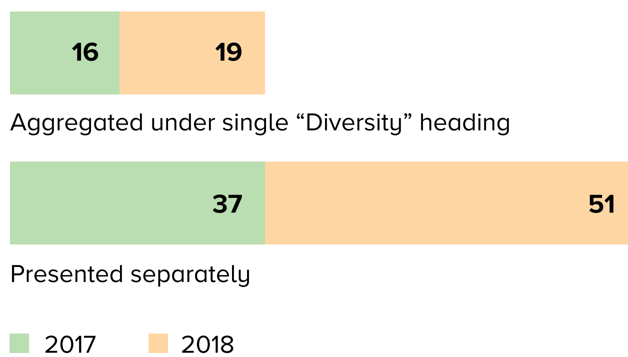
**In 2017 and 2018, five and 14 companies, respectively, presented information as both a number and a percentage.

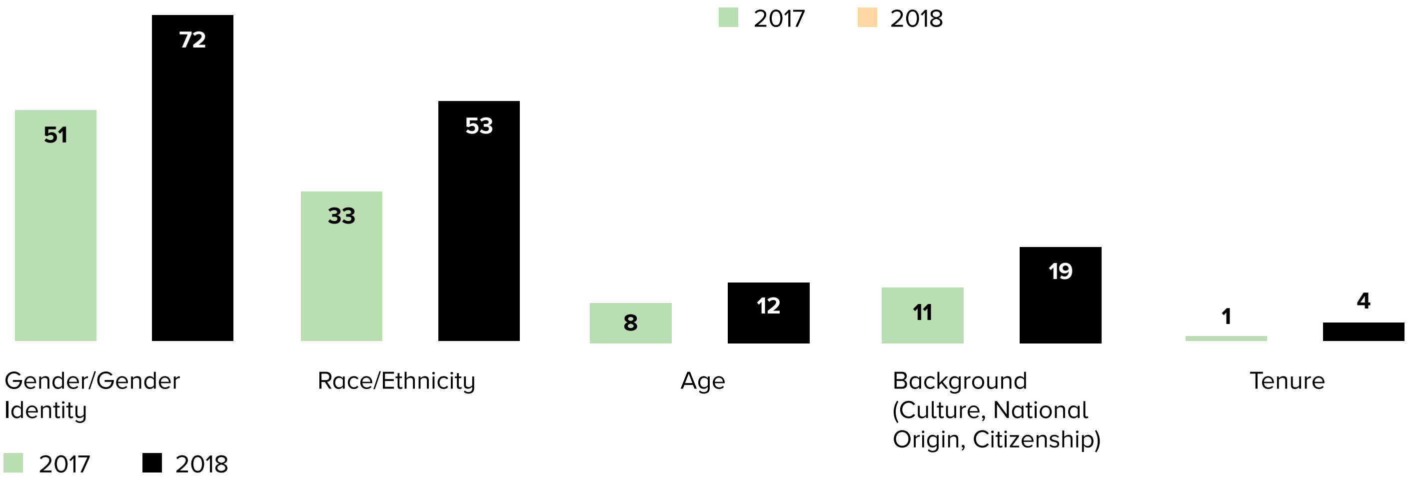
DIVERSITY

Companies vary considerably in how they present information regarding board diversity in the proxy statement. In 2018, the number of Top 100 Companies that presented information about the diversity of its board on an aggregated basis, as opposed to presenting director-specific information, increased from 53 companies in 2017 to 70 companies in 2018, and a few companies included both aggregated and director-specific information. The number of companies that did not present any information on the diversity composition of the board decreased from 26 companies in 2017 to 18 companies in 2018.

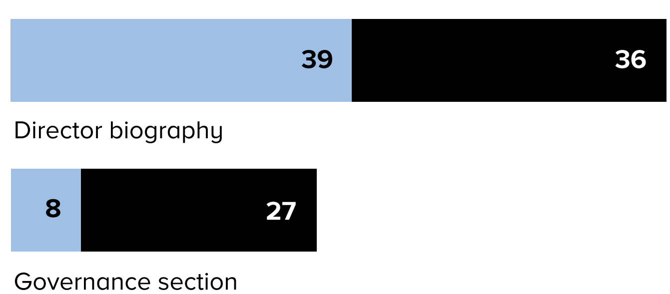


Where aggregated diversity information for the board was presented, 51 of the Top 100 Companies presented separate categories of diversity as opposed to aggregating under a single “diversity” heading. The most commonly identified category of diversity was gender/gender identity and race/ethnicity, which increased from 51 and 33 companies, respectively, in 2017 to 72 and 53 companies, respectively, in 2018. Various other categories were included that identified the cultural background of directors, such as national origin, citizenship and place of birth.





Of the 46 Top 100 Companies that present director-specific information, 36 companies included the information in each director’s biography as opposed to a governance section.*



2017 2018

*In 2017 and 2018, one and 17 companies, respectively, presented diversity information in both the director biography and governance section.

WOMEN IN LEADERSHIP

WOMEN IN THE C-SUITE

A woman served as the CEO at
6
of the Top 100 Companies

A woman served as the CFO at
15
of the Top 100 Companies

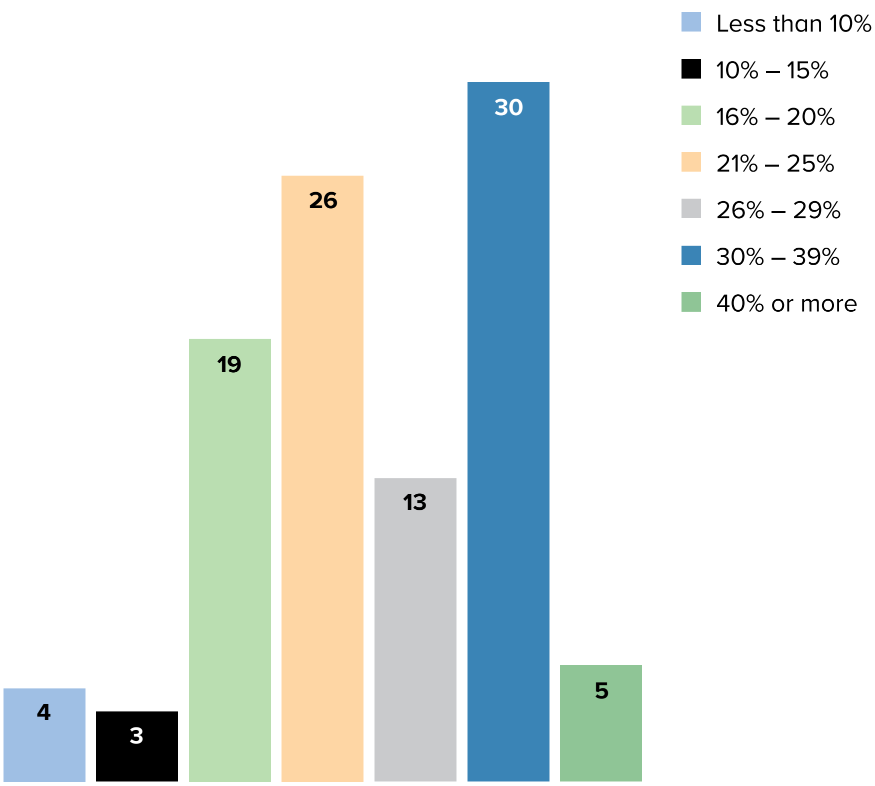
A woman served as the general counsel at
32
of the Top 100 Companies

None of the Top 100 Companies had women serving as both CEO and CFO.

WOMEN IN THE BOARDROOM

Women held approximately 26% of the total number of board seats at the Top 100 Companies in 2018, a 2% increase from 2017. The number of Top 100 Companies with a board comprised of 30% or more women rose from 23% to 30% over the past year. Five of the Top 100 Companies have a board with 40% or more women members, up from two in 2017.

GENDER DIVERSITY ON THE BOARD
(% of women on the board)



FAST FACTS

AVERAGE AGE AND TENURE

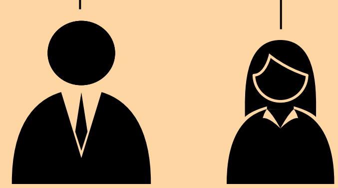
The average age and tenure of female directors is slightly less than male directors

Men
Average Age:
62.9

Tenure:
8.68
Years

Women
Average Age:
60.3

Tenure:
6.93
Years

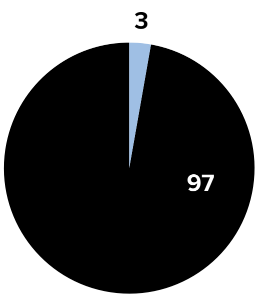


ANTI-TAKEOVER PROVISIONS

The data in this section was sourced from SharkRepellent.net for the Top 100 Companies

Although “poison pills” are often considered the most visible anti-takeover defense, only a small minority of companies have actually adopted such policies. Companies are utilizing many other policies that restrict shareholder rights, which can serve as anti-takeover tools.

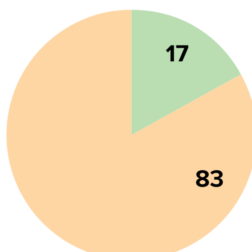
POISON PILL



Yes

No

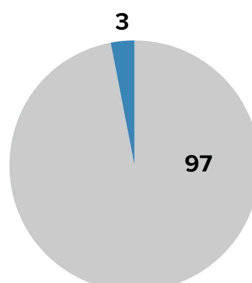
POISON PILL ADOPTION



Shareholder approval required to enact poison pill plan[1]

No

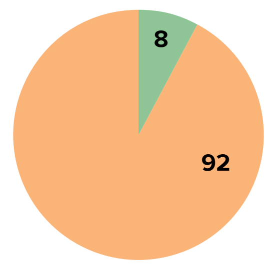
BLANK CHECK PREFERRED



Yes

No

CLASSIFIED BOARD

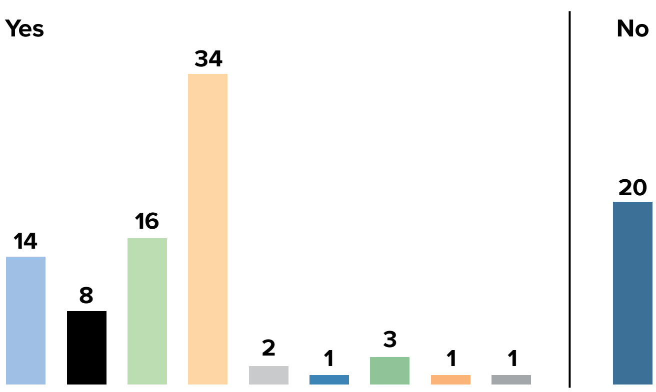


Yes

No

1 Six shareholder approval clauses are subject to fiduciary-out clauses, while six stipulate that a plan adopted by the board without prior shareholder approval will expire within one year of adoption unless ratified by the shareholders.

SHAREHOLDER ABILITY TO CALL SPECIAL MEETING



10%

15%

20%

25%

30%

33%

35%

50%

10%/25%[2]

No

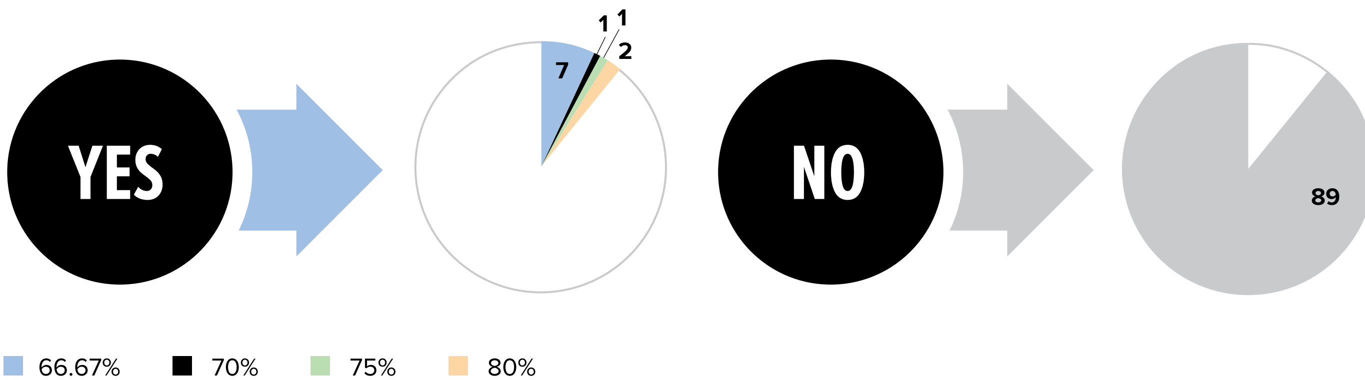
2 This denotes that a single shareholder owning at least 10% or a group of shareholders owning at least 25% in aggregate may call a special meeting.

SHAREHOLDER ABILITY TO ACT BY WRITTEN CONSENT

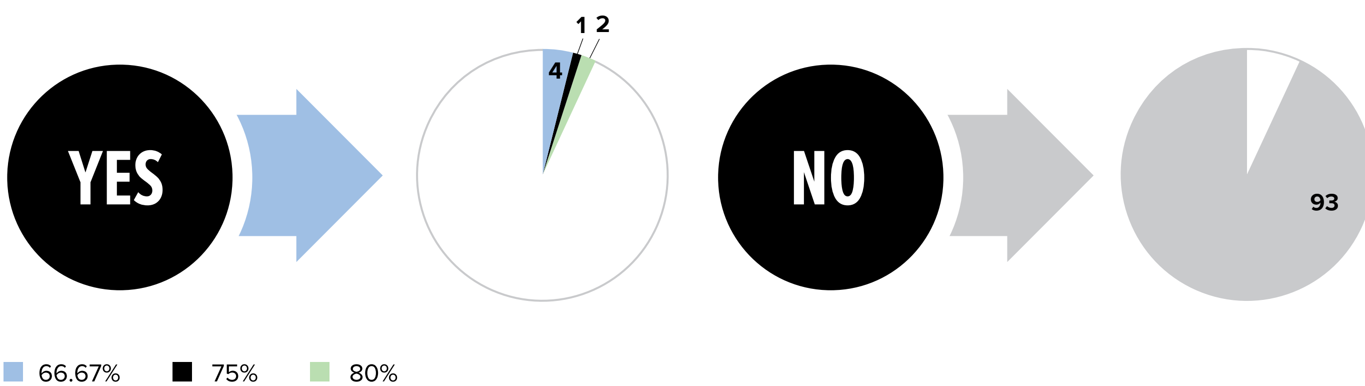
Yes
68

No
32

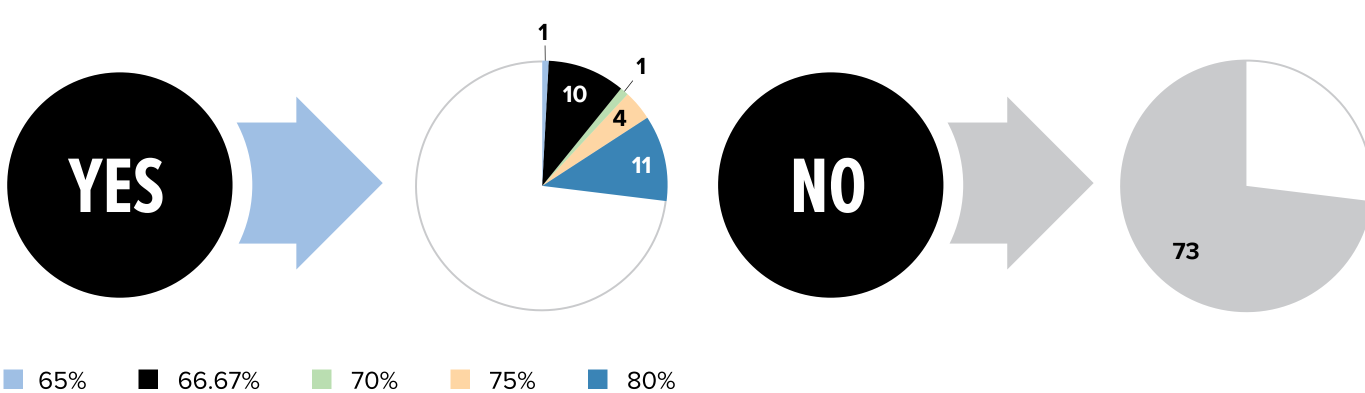
SUPERMAJORITY VOTING FOR MERGERS



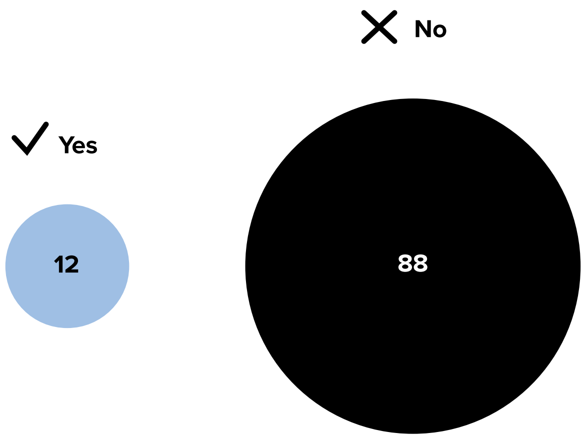
SUPERMAJORITY VOTING FOR DIRECTOR REMOVAL



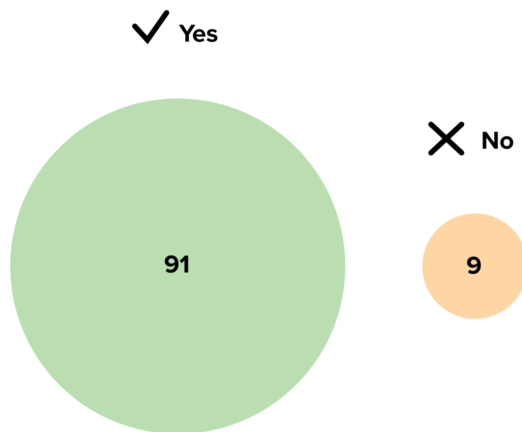
SUPERMAJORITY VOTING TO AMEND CHARTER OR BY-LAWS



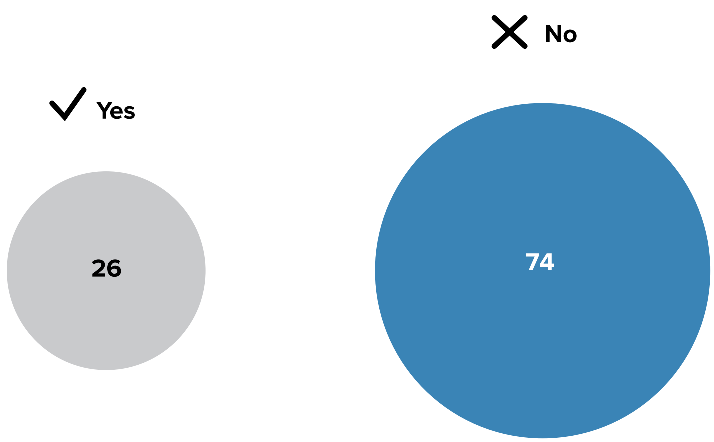
DUAL CLASS STRUCTURE



MAJORITY VOTING



DIRECTOR RESIGNATION POLICY



CUMULATIVE VOTING

Yes	No
2	98

EXCLUSIVE FORUM SELECTION PROVISION

YES

Delaware	37
Indiana	1
Ohio	1
Pennsylvania	1

NO

60

COMPENSATION-RELATED PROXY DISCLOSURES

As proxy statements grow in length, many Top 100 Companies utilize a proxy summary and/or a CD&A Executive Summary to highlight key components of their compensation program.

CD&A EXECUTIVE SUMMARIES

77

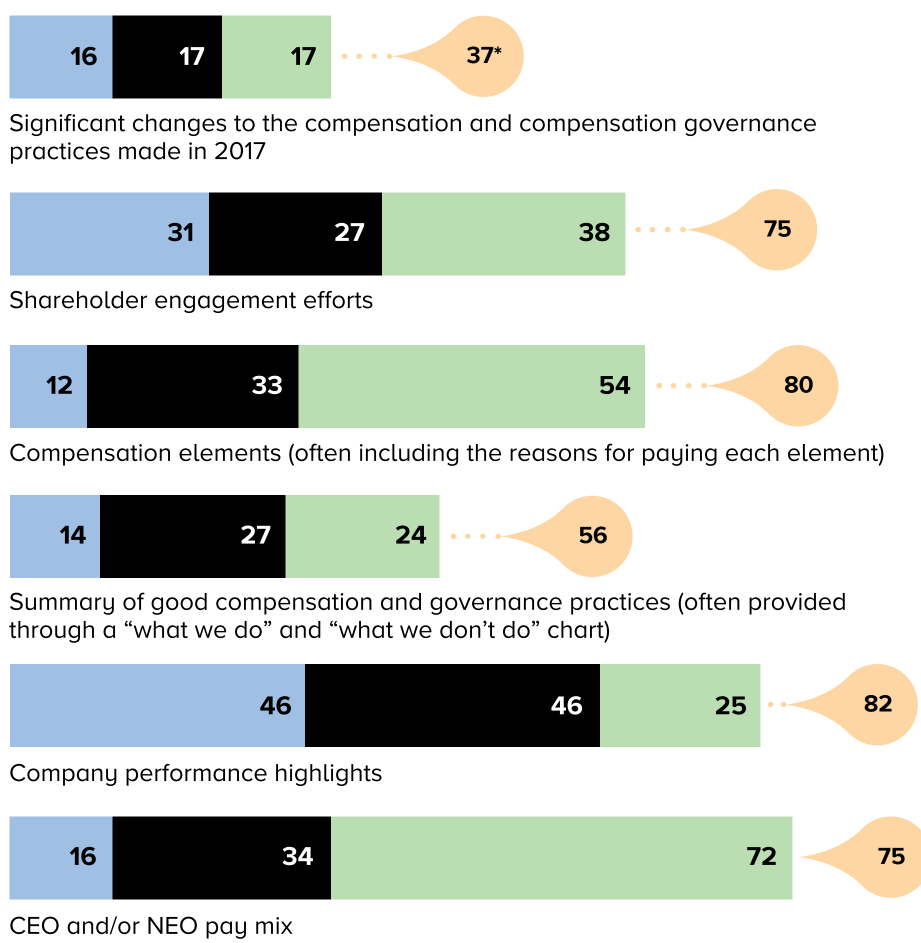
of the Top 100 Companies included an executive summary in their CD&A highlighting company performance, pay versus performance and strong corporate governance policies

80

of the Top 100 Companies provided a summary section highlighting key "selling" points from the entire proxy, including executive compensation disclosures

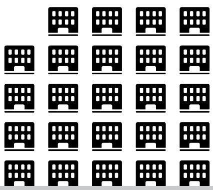
In light of say-on-pay and heightened scrutiny of compensation practices, the need for companies to "sell their compensation story" has become paramount. The following are common disclosures that the Top 100 Companies provide their shareholders as a means of garnering support for their compensation programs:

COMMON PROXY DISCLOSURES INCLUDE:*



*Companies will often repeat in the CD&A information that has been provided in the proxy summary or CD&A executive summary.

ALTERNATIVE PAY DISCLOSURES

24 

of the Top 100 Companies have included some form of alternative pay disclosures in their CD&A

Commonly, these include “realized pay” (i.e., the amounts executives actually received), “realizable pay” (i.e., amounts received plus the value of in-the-money stock options and full-value equity awards), total direct compensation and alternative summary compensation tables.

Of the Top 100 Companies:

11

Provided total direct compensation and similar disclosure

5

Provided comparisons of compensation (often total compensation) and one or more performance metrics (often total shareholder return)

5

Presented “realized” pay disclosure

3

Presented “realizable” pay disclosure

4

Provided an alternate summary compensation table (generally excluding pension values)

SAY-ON-PAY

2018 represented the

7TH

proxy season under the Dodd-Frank Act's mandatory say-on-pay regime

94

of the Top 100 Companies held a say-on-pay vote in 2018

90

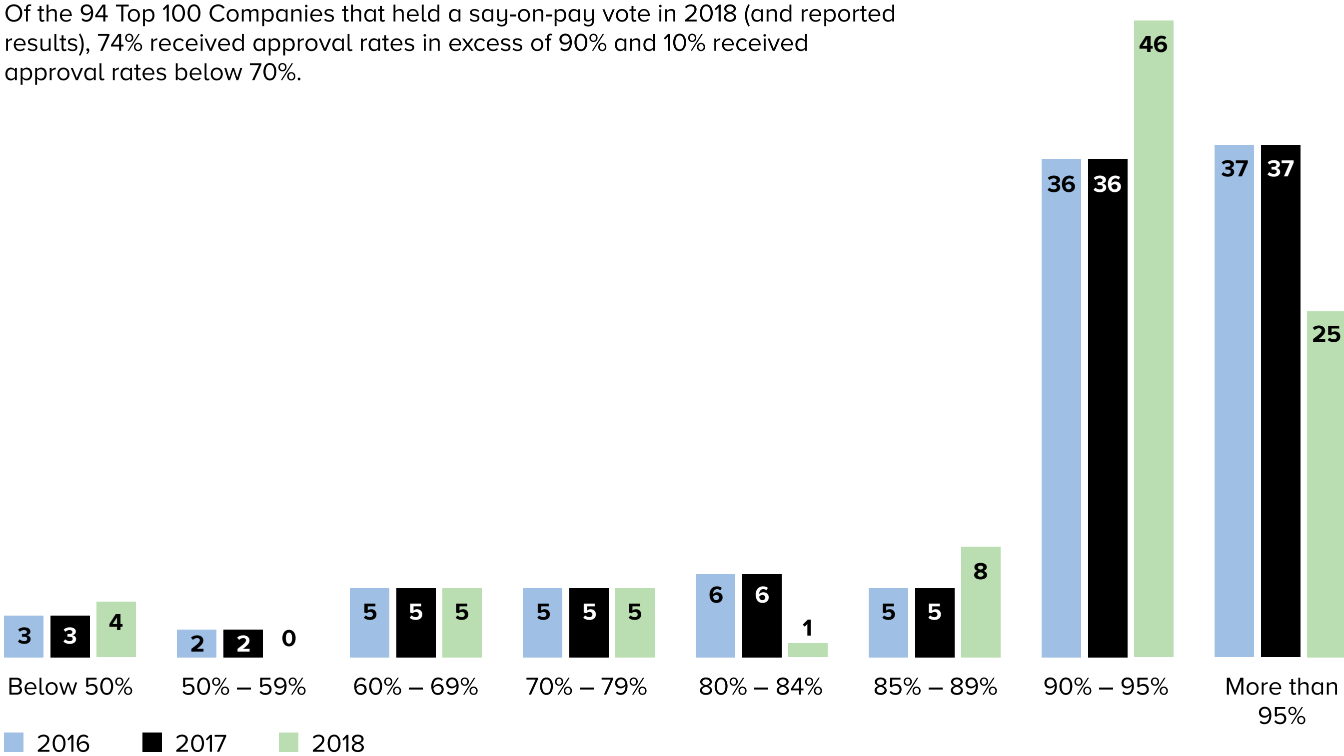
companies holding a say-on-pay vote received approval

4

companies failed to receive approval

SAY-ON-PAY APPROVAL RATES IN 2018*

Of the 94 Top 100 Companies that held a say-on-pay vote in 2018 (and reported results), 74% received approval rates in excess of 90% and 10% received approval rates below 70%.



*Approval rates are calculated on the ratio of votes "for" over the sum of votes cast plus abstentions, as reported in SEC filings. Ranges include fractional percentages, so, for example, the range of 50% - 59% includes all voting results from 50.00% to 59.99%.

SAY-ON-PAY PROXY DISCLOSURES

The Dodd-Frank Act requires companies to disclose whether and how the prior year's say-on-pay voting results were considered in making compensation decisions. Many companies went beyond this requirement.

OF THE TOP 100 COMPANIES:

49

Noted that the company reviewed the results and elected not to significantly change the compensation program

85

Disclosed the approval rate for the previous year's say-on-pay vote

17

Noted changes made to the compensation program in response to the say-on-pay vote

7

Provided no say-on-pay disclosures

FAST FACTS

SAY-ON-FREQUENCY VOTING RESULTS

Of the

10

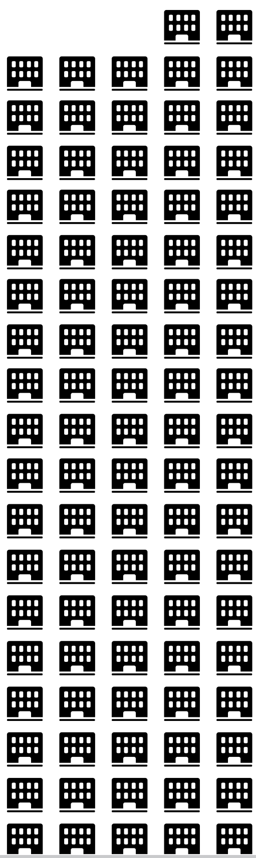
companies that held say-on-frequency votes in 2018

ALL

opted for annual say-on-pay voting

CLAWBACK POLICIES

Although rules implementing Section 954 of the Dodd-Frank Act have yet to be finalized, many of the Top 100 Companies voluntarily maintain clawback policies. Proxy advisory groups strongly encourage public companies to adopt clawback policies as an element of sound corporate governance and risk mitigation. Issuer policies, however, are not uniform, and their application varies as to the events that trigger recovery, culpability standards, the individuals covered, the types of compensation subject to recovery, the level of board discretion as to whether to seek enforcement and the time period covered by the recovery policy.



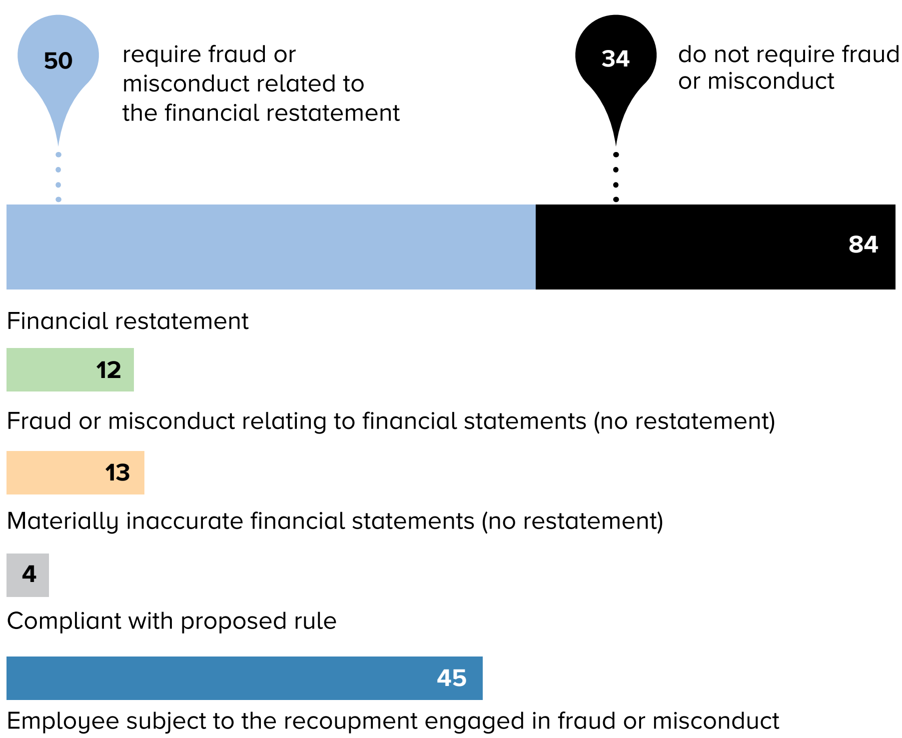
92

of the Top 100 Companies publicly disclose that they maintain a financial-related clawback policy

TRIGGERS

The Dodd-Frank Act requires recoupment of compensation upon an accounting restatement due to material noncompliance with any financial reporting requirement. The SEC's proposed rules interpret material noncompliance to mean any error that is material to previously filed financial statements. The restatement need not result from fraud or misconduct by the issuer or any of its employees.

Triggers at the Top 100 Companies include:*

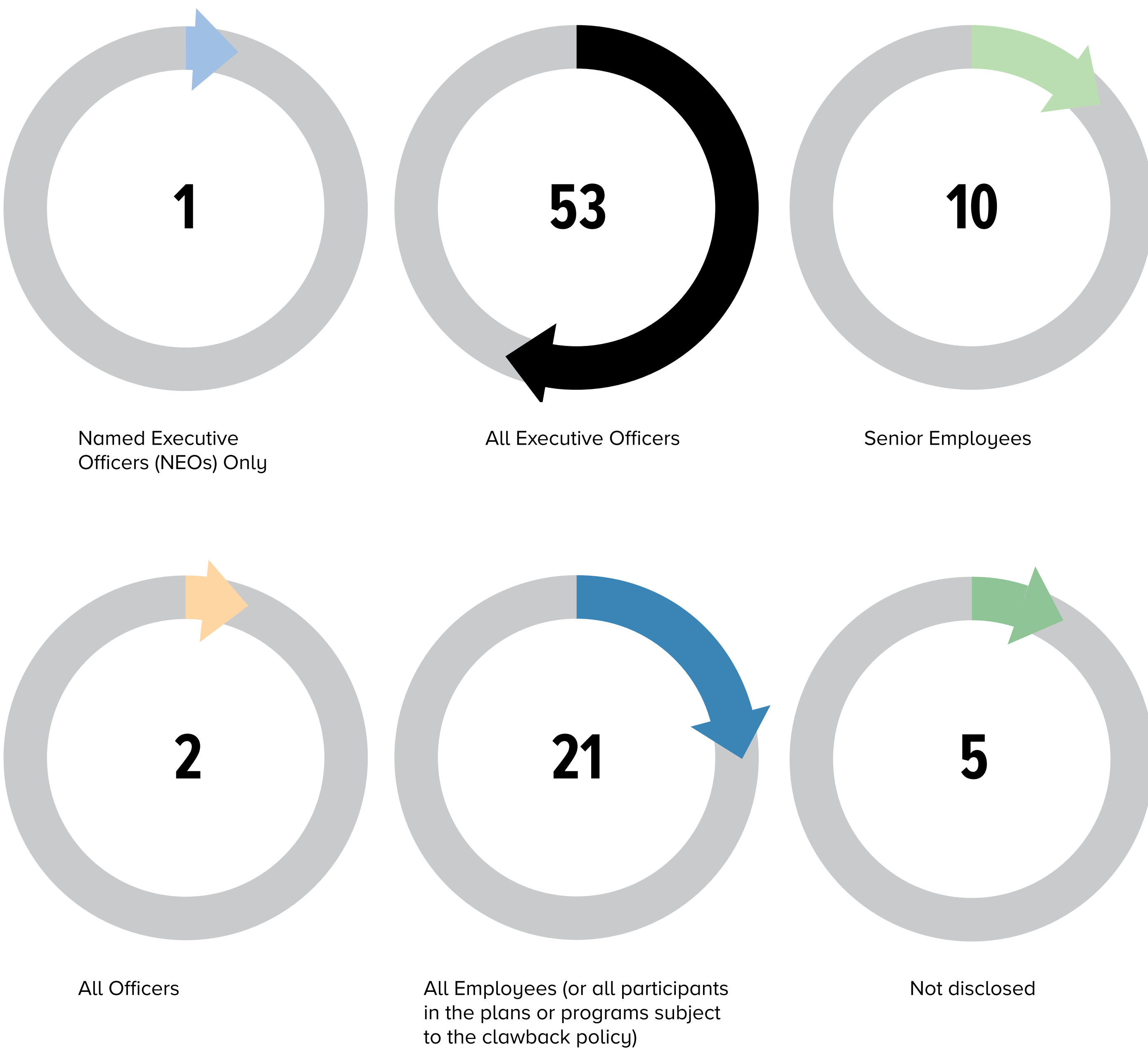


*The policies at 26 of the Top 100 Companies use multiple triggering events.

COVERED PERSONS

The threshold issue is determining whose compensation is subject to a clawback. Clawbacks mandated under the proposed SEC rule will apply to all current and former Section 16 officers. The following individuals are subject to the voluntary financial-related clawbacks at the Top 100 Companies:

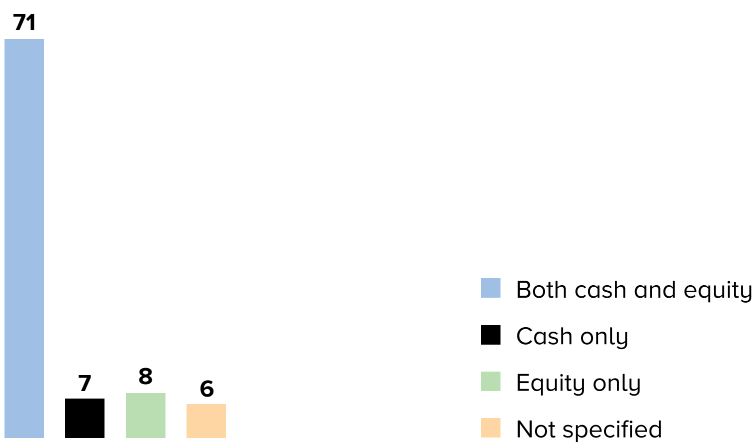
2 **of the Top 100 Companies expressly disclose that the clawback policy applies to former employees or executives**



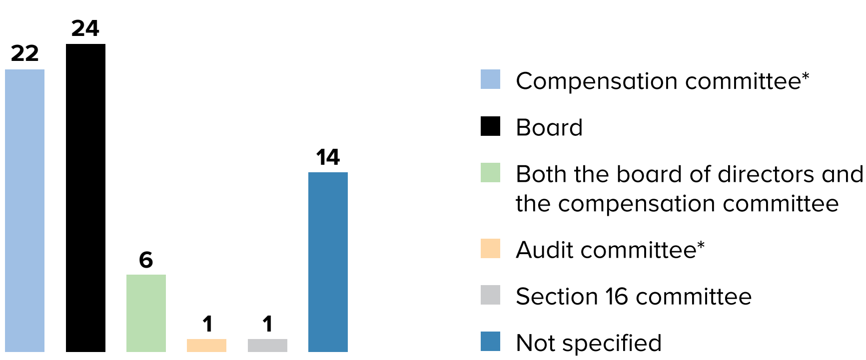
COMPENSATION SUBJECT TO CLAWBACK

The Dodd-Frank Act compliant clawback policies will require companies to recover "certain incentive-based compensation (including stock options)." The SEC's proposed rules define incentive-based compensation as including both cash and equity compensation, but time-vested awards are not covered. While voluntary clawback policies generally permit a company to recoup "incentive compensation," the forms of incentive compensation that may be recouped vary.

Of the 92 Top 100 Companies that maintain a clawback policy, they may recoup:

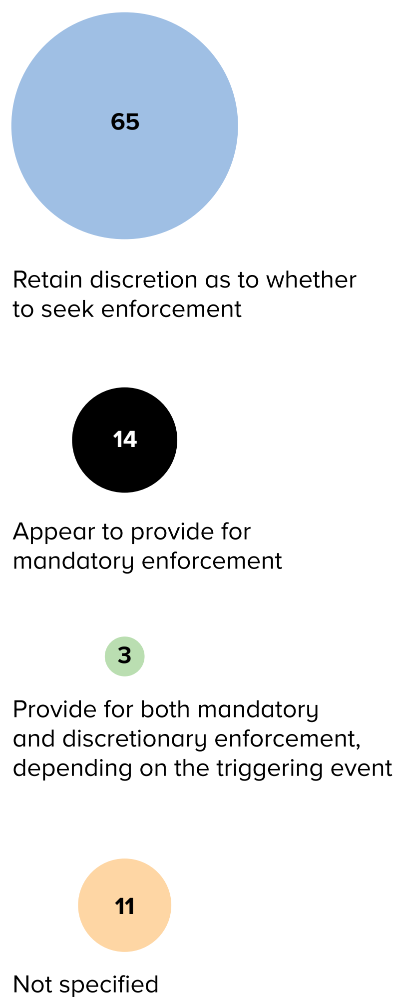


Who maintains the enforcement discretion under the voluntary polices currently in place?



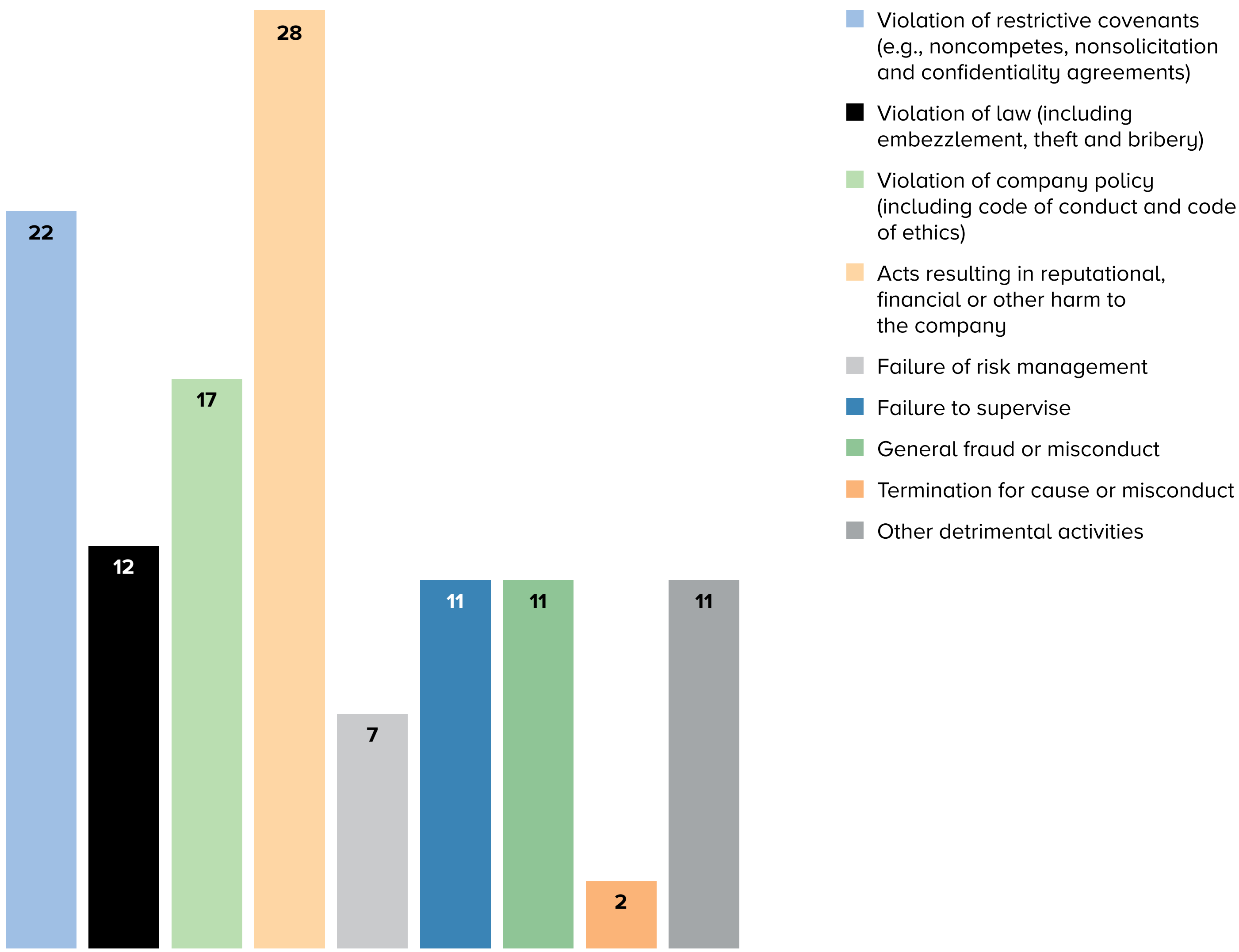
*At one Top 100 Company, both the compensation committee and audit committee retain the discretion.

Of the 92 Top 100 Companies that maintain a clawback policy:



54 of the Top 100 Companies publicly disclose that they maintain a detrimental conduct clawback policy

Common triggering events for the policies at the Top 100 Companies include:

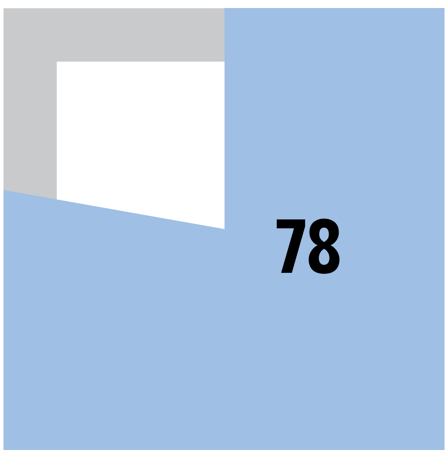


CHANGE IN CONTROL SEVERANCE ARRANGEMENTS

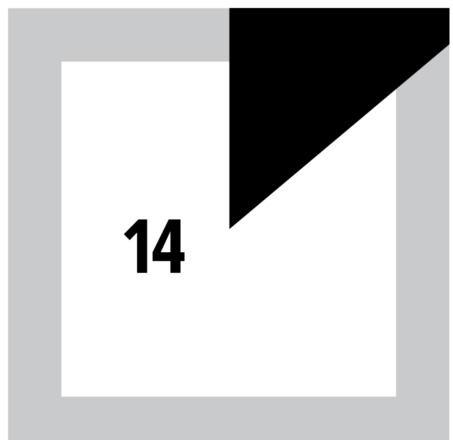
Forty-eight of the Top 100 Companies provided enhanced change in control severance benefits to one or more NEOs. No Top 100 Company provides for payments solely upon a change in control without the need for a termination of employment (a "single-trigger benefit") and no Top 100 Company permits its NEOs to voluntarily resign following a change in control and receive severance benefits (a "walk-away right").

EQUITY CHANGE IN CONTROL VESTING PROVISIONS*

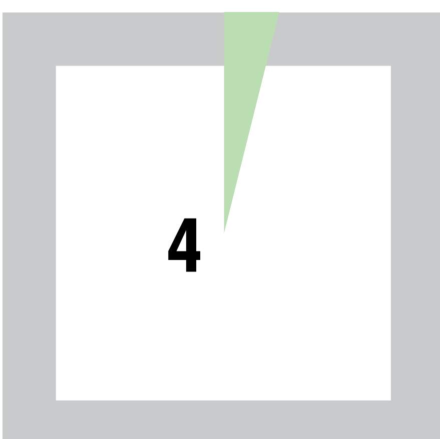
Of the Top 100 Companies:



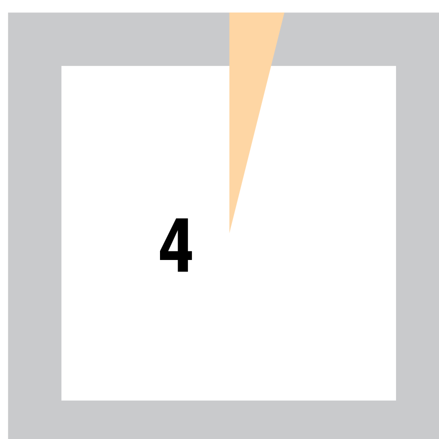
Provide for accelerated vesting of some or all of their equity awards in connection with a change in control



Do not maintain equity change in control vesting provisions



Make accelerated vesting discretionary



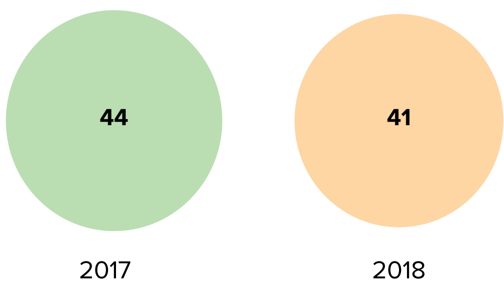
Did not provide disclosure

*Data is based on the provisions applicable to the most recent equity grants. In some instances, the vesting provisions differ for older awards.

TIME-VESTED EQUITY AWARDS

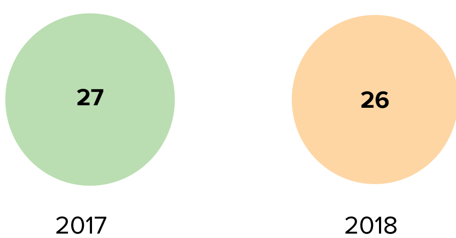
What are the time-vested equity award triggers?

Double Trigger* (change in control and termination)

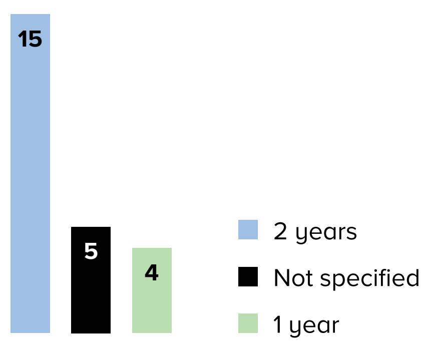


Single Trigger* (change in control only)

Single Trigger, unless successor or surviving entity assumes the award



Twenty-four of these companies provide that the awards will vest if the employee is terminated within a specified time period following the change in control. The relevant time periods are as follows:



*Four of the Top 100 Companies provided for both single- and double-trigger vesting in 2018 depending on the award.

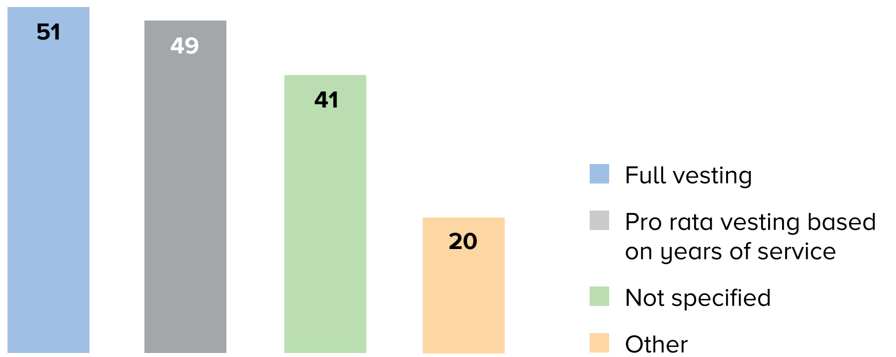
WHAT PORTION OF THE TIME-VESTED EQUITY AWARD WILL VEST?

68 Full vesting

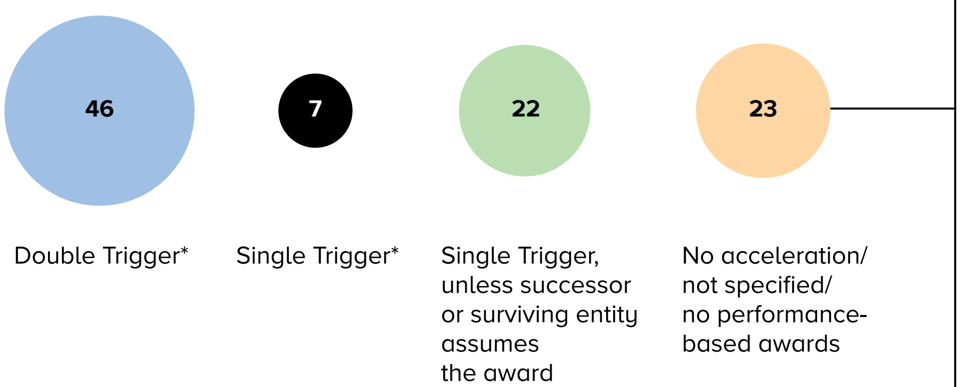
PERFORMANCE-BASED EQUITY AWARDS

Depending on the performance criteria and the acquirer's integration strategy, it is often not possible to continue performance-based equity awards following a change in control. In addition to electing between single-trigger and double-trigger vesting, companies must determine how to treat the performance criteria applicable to these awards at the time of the transaction. Provisions can vary significantly from company to company and among grants at the same company.

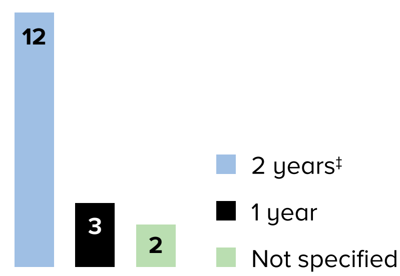
What portion of the performance-based equity award will vest?



What are the performance-based equity award triggers?



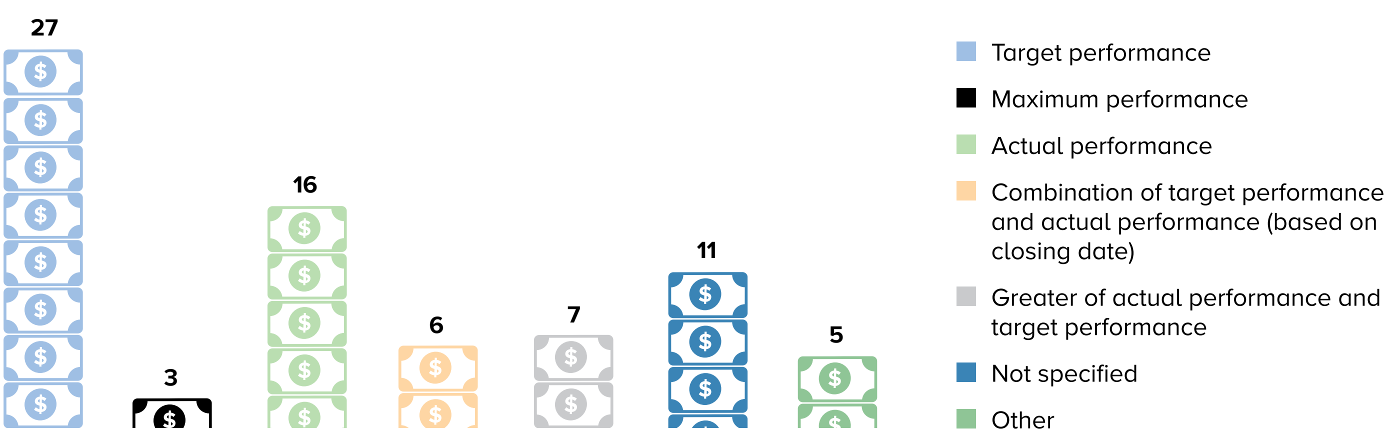
Seventeen of these companies provide that the awards will vest if the employee is terminated within a specified period following the change in control. The relevant time periods are as follows:



*One Top 100 Company provides for both single- and double-trigger vesting depending on the award. One Top 100 Company provides that 50% will vest on the change in control and 50% will vest one year following the change in control.

‡One Top 100 Company will also accelerate vesting if the executive is terminated six months prior to the change in control.

HOW ARE PERFORMANCE-BASED EQUITY AWARDS VALUED?



CHANGE IN CONTROL EXCISE TAX PROVISIONS

Description of Golden Parachute Provisions under the Code

Section 4999 of the Internal Revenue Code (the "Code") imposes a 20% excise tax on the amount of any "excess parachute payments" received by certain executives, and Section 280G of the Code disallows an employer deduction for those payments. Any gross-up payment made in connection with the excise tax will also be subject to the excise tax and will be non-deductible. If the aggregate present value of all parachute payments paid to an executive (including cash and accelerated equity awards) equals or exceeds three times the executive's base amount, then the executive will be considered to have received an excess parachute payment.

Excess Parachute Payment

Code Sections 280G and 4999 are triggered if all parachute payments equal or exceed three times the executive's base amount. The amount of the excess parachute payment that is not deductible under Section 280G, and subject to the excise tax under Section 4999 is any payment in excess of one times the executive's base amount.

Safe Harbor

The safe harbor is three times the executive's base amount, less one dollar. Many companies use a 2.99 multiple in making their calculations to avoid an inadvertent trigger.

Base Amount

An executive's base amount is the average of his or her compensation from the employer that was includible in his or her gross income for the most recent five calendar years ended prior to the year in which the change in control occurs.

Excise Tax Reduction Provisions

Companies are increasingly adopting measures to protect executives from the excise tax without providing tax gross-ups. The two most common measures include a "cut-back" provision and a "better-of" provision.

"Cut-Back" Provisions

Under a "cut-back" provision, the change in control payments are automatically reduced to the safe harbor amount (or, in many instances, 2.99 times the base amount) so that no excise tax applies.

5 of the Top 100 Companies maintain a "cut-back" provision

"Better-Of" Provisions

Under a "better-of" provision, employees will receive change in control payments equal to the greater of (1) the after-tax amount they would have received after the imposition of the Section 4999 excise tax and (2) the "cut-back" amount (i.e., the safe harbor).

15 of the Top 100 Companies maintain a "better-of" provision

GOLDEN PARACHUTE EXCISE TAX GROSS-UPS

For the fourth year in a row, only a small number of companies provide some level of "golden parachute" excise tax gross-up protection.

5

a 58% decrease since last year

of the Top 100 Companies provide a full or modified gross-up to one or more of their NEOs

FULL GROSS-UPS

2017

9

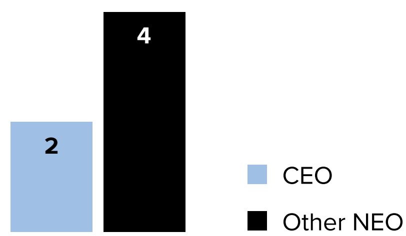
companies

2018

4

companies

Who is subject to the full gross-up?



MODIFIED GROSS-UP

Under a modified gross-up, payment is only made if the change in control payments exceed a specified amount over the safe harbor. For instance, a company may provide that it will only pay a gross-up if the aggregate amount of the change in control payments exceeds the safe harbor amount, generally, by 10% or more. At some companies, if the change in control payments are below this percentage, they will be cut back to the safe harbor amount. Each of the Top 100 Companies that maintains a "modified" gross-up provides for a cut-back.

This year, only one of the Top 100 Companies provides the modified gross-up under existing arrangements only, and the gross-up is eliminated for new arrangements.

2017

3

companies

2018

1

company

All NEOs are subject to the modified gross-up at this one company

SEVERANCE ARRANGEMENTS

65

of the Top 100 Companies provide severance benefits to one or more of their NEOs

25

of these 65 companies provide severance benefits through individual agreements

14

of the Top 100 Companies have adopted policies capping the severance multiple paid to NEOs without shareholder approval. In all but four instances, the severance is limited to 2.99 times the NEO's base salary and annual bonus. In one instance, the multiple is 2.99 for the CEO and 1x base and bonus for all the other NEOs. Two companies utilize a 2x multiple, with one of those companies averaging the annual bonus paid over the three previous years. The fourth company limits the severance to one times base salary.

COMPENSATION-RELATED SHAREHOLDER PROPOSALS

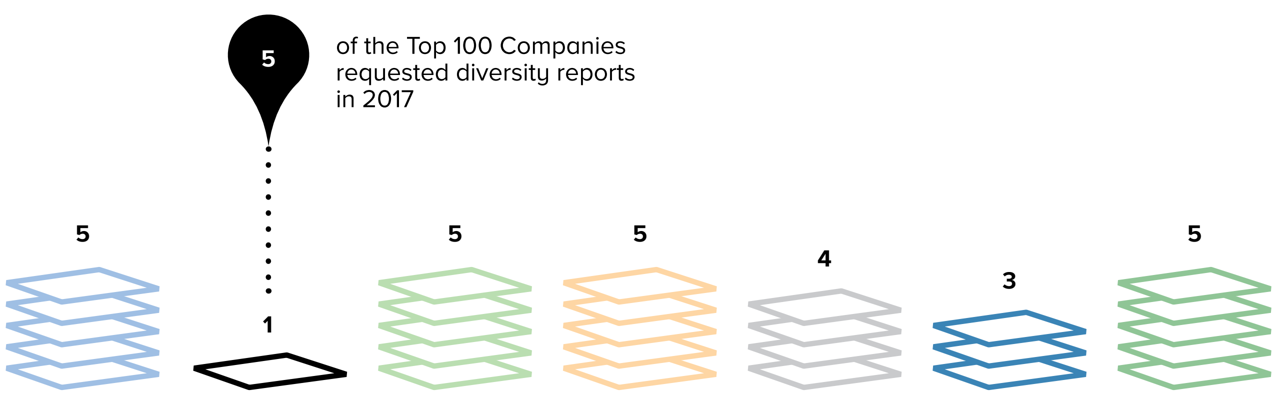
The most common shareholder proposals in 2018 related to clawback policies, pay disparity reports and incentive compensation

28

compensation-related shareholder proposals were submitted at 25 of the Top 100 Companies in the 2018 proxy season

NONE

of the 2018 compensation-related proposals were approved



- Pay disparity reports
- Diversity reports
- Incentive compensation
- Government service golden parachute
- Clawback policies
- Limitations on change in control equity vesting
- Other

TYPES OF COMPENSATION-RELATED SHAREHOLDER PROPOSALS

Pay Disparity and Diversity Reports

Request that the company prepare and disclose reports on gender diversity and the gender pay gap in its workforce. One proposal requested a report comparing the compensation of senior executives to the lowest paid employees.

Incentive Compensation

Includes: (1) deducting the impact of stock buy-backs from incentive compensation, (2) requiring shareholder approval of payments to the named executive officers, (3) requiring an annual report on sustainability metrics on incentive compensation and (4) requiring the elimination of the use of non-GAAP certain performance metrics.

Government Service Golden Parachutes

Request that the company prepare a report to shareholders regarding the vesting of equity-based awards for senior executives due to voluntary resignation to enter governmental service. This proposal was aimed only at financial services companies.

Clawback Policies

Request that the company adopt a policy requiring annual disclosure of any recoupment or forfeiture of executive officer compensation and the circumstances resulting in the recoupment or forfeiture. Certain proposals also request disclosure of the decision not to pursue recoupment. Three of these proposals also request the adoption of an enhanced policy that would permit recoupment if there has been misconduct resulting in a violation of law or company policy that causes significant financial or reputational harm to the company and a senior executive either committed the misconduct or failed in his or her responsibility to manage or monitor conduct or risks.

Limitations on Change in Control Equity Vesting

Request that the company adopt a policy that would prohibit accelerated vesting of equity awards upon a termination or change in control, allowing pro rata vesting for time served.

Other

There are various other compensation-related shareholder proposals, including reports on the impact of incentive compensation on drug pricing and requiring additional steps to ensure compensation committee independence.

STOCK OWNERSHIP AND RETENTION GUIDELINES

95

of the Top 100 Companies maintain stock ownership guidelines for their directors and executives

88 +

Both Director and Executive Stock Ownership Guidelines

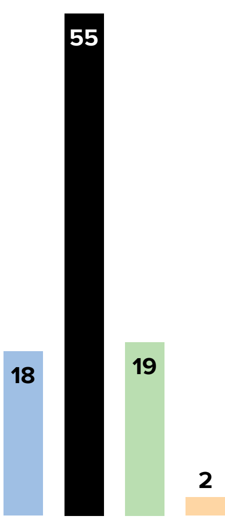
6

Executive Stock Ownership Guidelines Only

1

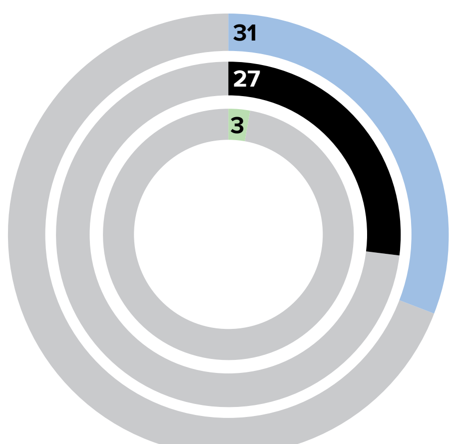
Director Stock Ownership Guidelines Only

WHICH EXECUTIVES ARE SUBJECT TO THE STOCK OWNERSHIP GUIDELINES?

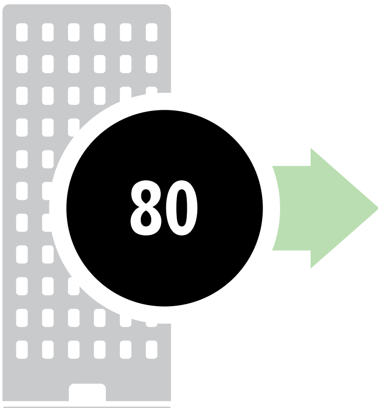


- NEOs only
- All executive officers
- Senior employees
- Other

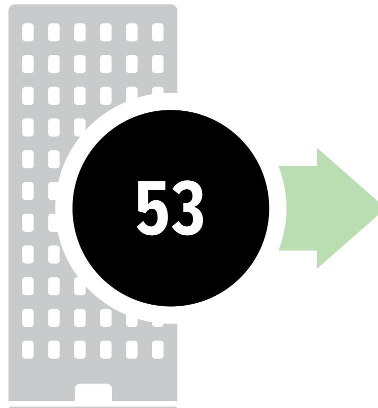
61 OF THE TOP 100 COMPANIES MAINTAIN STOCK RETENTION REQUIREMENTS



- Executive stock retention requirements only
- Both director and executive stock retention requirements
- Director stock retention requirements only

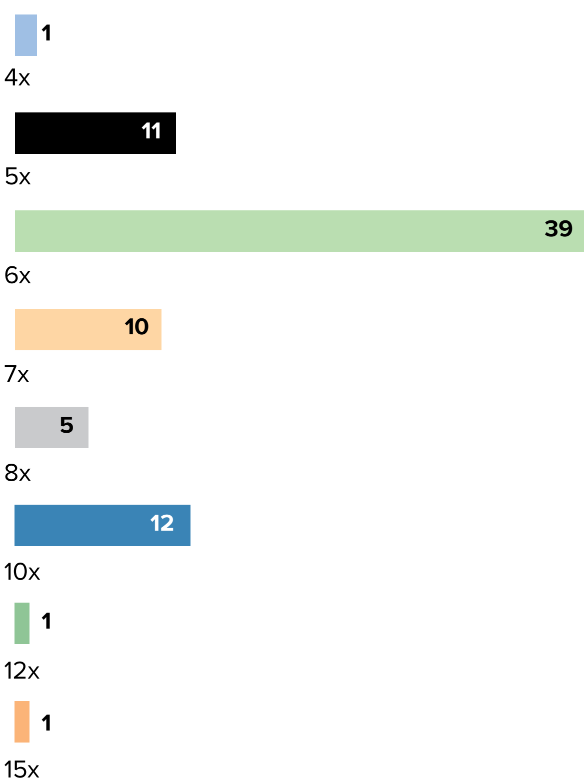


of the Top 100 Companies express their stock ownership guidelines as a multiple of base salary

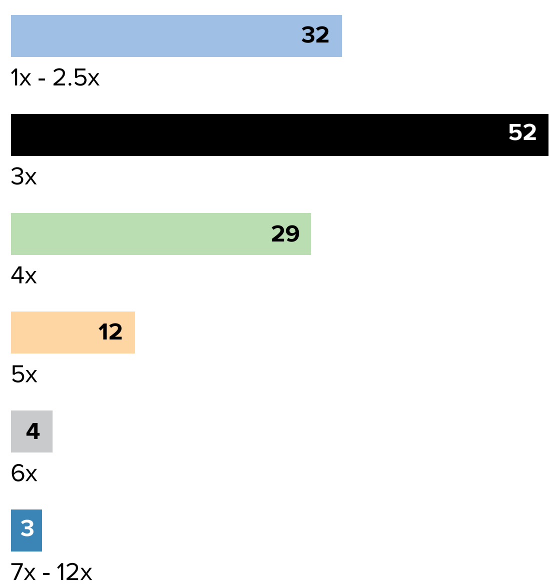


of the Top 100 Companies disclose that they require their executives to satisfy the requirements within five years

CEO AND EXECUTIVE CHAIR BASE SALARY MULTIPLES*

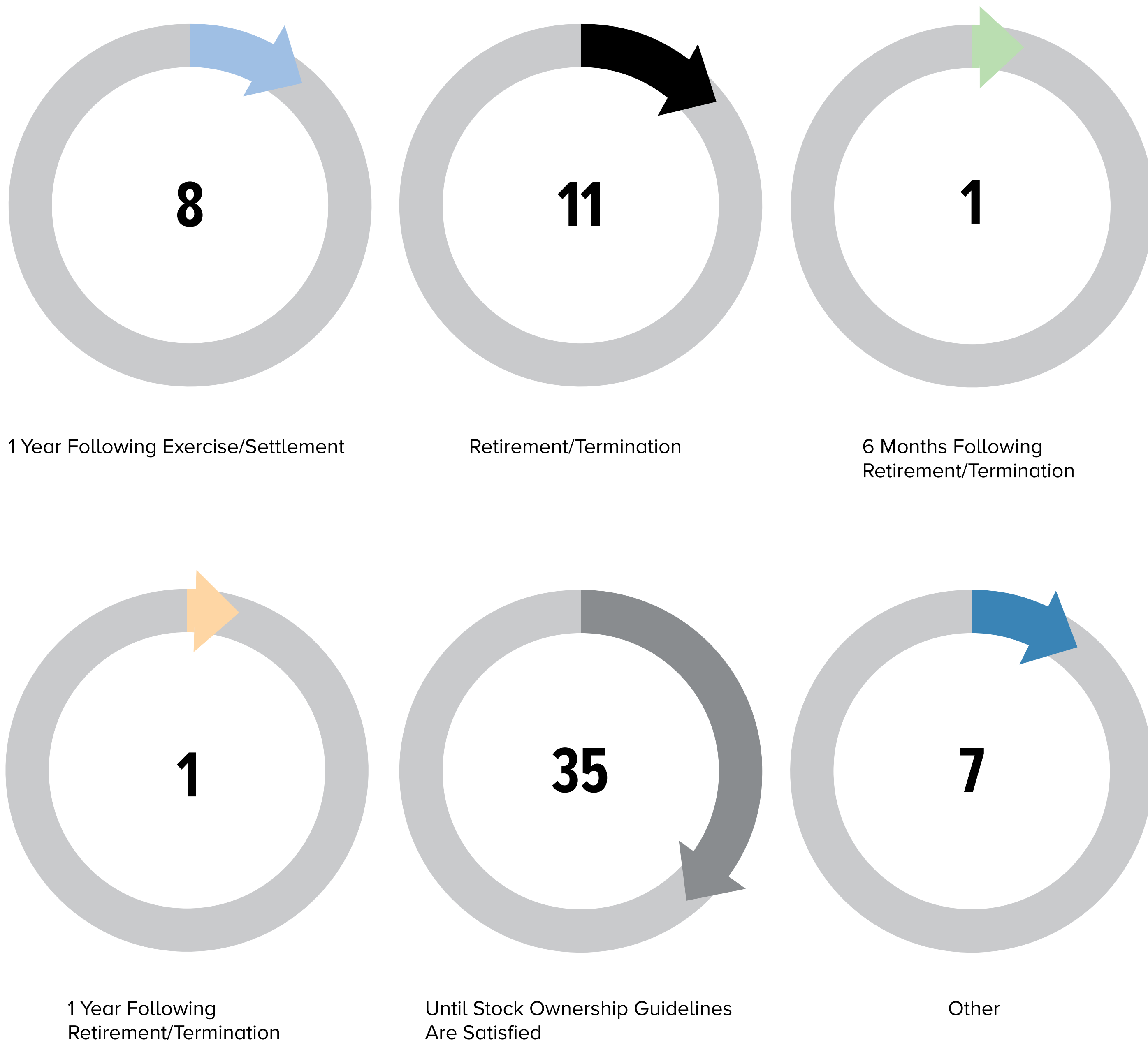


OTHER NEO BASE SALARY MULTIPLES*



*At many of these companies, the multiple will vary depending on position.

LENGTH OF EXECUTIVE STOCK RETENTION PERIOD*



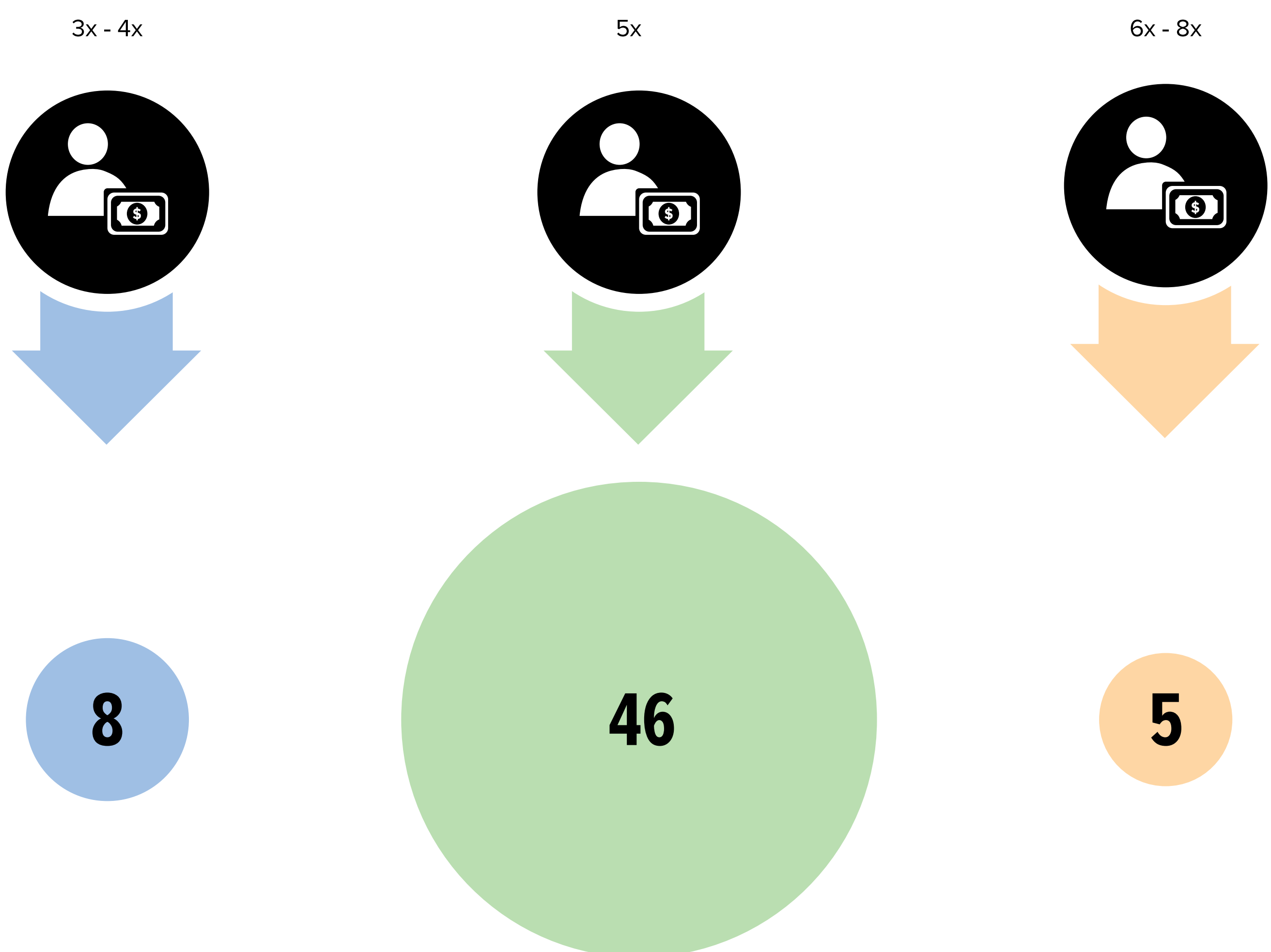
*Some Top 100 Companies have various retention periods for different positions.

DIRECTOR ANNUAL CASH RETAINER MULTIPLES

59 of the Top 100 Companies express their director stock ownership guidelines as a multiple of the annual cash retainer

58 of the Top 100 Companies require their directors to satisfy the requirements within five years

At the 61 Top 100 Companies where directors are required to hold shares with a value equal to a multiple of their annual cash retainer, the multiples range from three to eight times the annual retainer.



HEDGING AND PLEDGING POLICIES

82
of the Top 100 Companies maintain pledging policies

93
of the Top 100 Companies maintain hedging policies

WHAT ARE THE TERMS OF THE PLEDGING POLICY?*

10

Require Approval

67

Outright Prohibition

WHAT ARE THE TERMS OF THE HEDGING POLICY?

93

All 93 of the Top 100 Companies Prohibit Hedging Outright

*Five of the Top 100 Companies provide for an outright prohibition other than in limited circumstances.

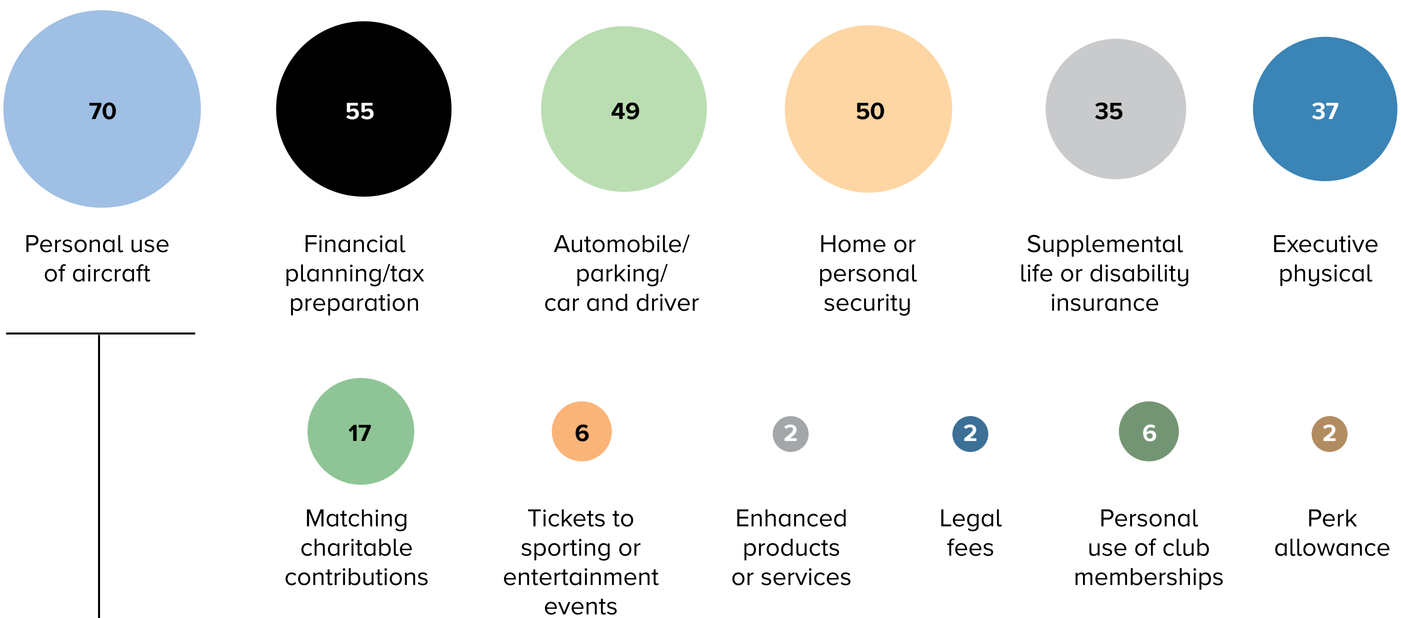
EXECUTIVE PERQUISITES

95

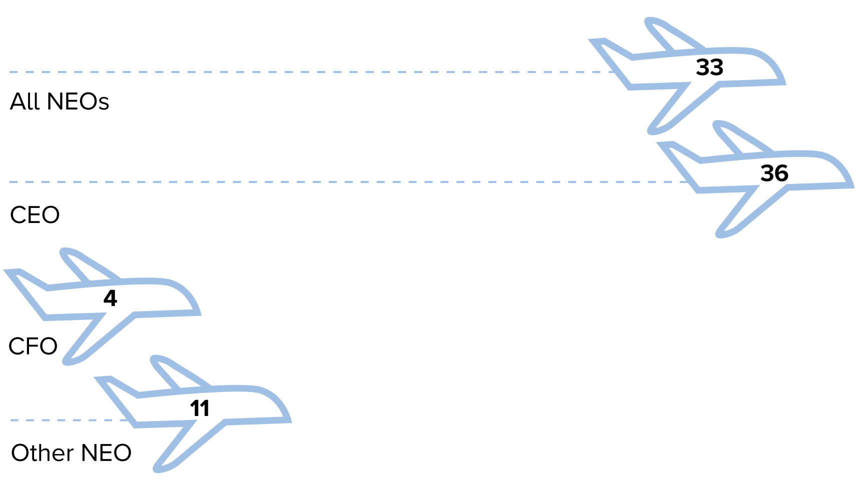
of the Top 100 Companies provide executive perquisites, and personal use of corporate aircraft continues to be the most commonly offered perk

16

of the Top 100 Companies disclosed that they provide tax gross-ups on some or on all perks provided to executives, and 15 of the Top 100 Companies disclosed above-market or preferential earnings on non-qualified deferred compensation



WHO IS ENTITLED TO PERSONAL USE OF CORPORATE AIRCRAFT?



- Twenty-two of the Top 100 Companies required executives to reimburse the company for all or a portion of their personal aircraft usage
- In many instances, personal usage is limited to availability and requires approval by the CEO

SURVEY METHODOLOGY

We reviewed the corporate governance and compensation practices of 100 of the largest U.S. public, non-controlled companies that have equity securities listed on the NYSE or Nasdaq. These companies were selected based on a combination of their latest annual revenues and market capitalizations, and are referred to as the "Top 100 Companies." Generally, we derived the data in this Survey from the annual proxy statements, compensation committee charters and corporate governance guidelines posted on the companies' websites and available as of June 1, 2018 (except where otherwise noted).

SHEARMAN & STERLING WOULD LIKE TO ACKNOWLEDGE THE FOLLOWING INDIVIDUALS FOR THEIR CONTRIBUTIONS TO THIS SURVEY:

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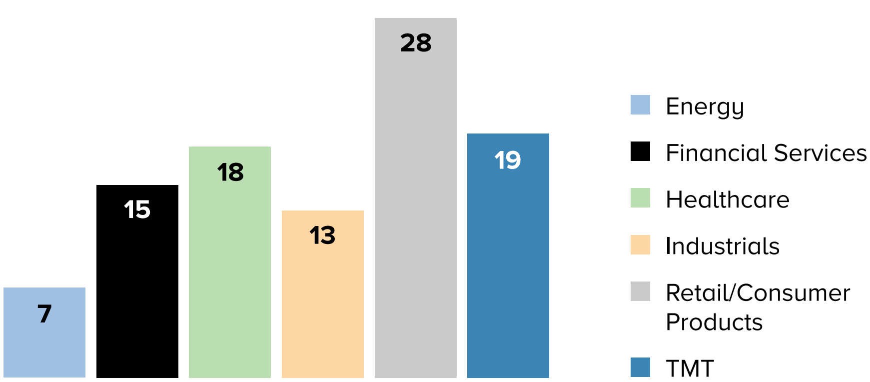
Jai Garg
Svetlana Grigoryeva
Jake Glazeski
Ian Hua
Koye Idowu
Rohan Jain
Karen Jin
Jun Kim
Sonia Khandekar
Natalie Ko
Hyunsok Lee
Jingjing Liang
Janie Martin
Jason Monroe
Alex Muller
Nauka Patel
Nakia Prileau
Polina Pristupa
Jessica Riley
Alessandra Rosales
Ashley Shan
Jae Hyong Shim
Edia Uko
Abir Varma
Matthew Weston
Chris White
Kathryn White

INDUSTRIES OF SURVEYED COMPANIES:



SURVEYED DOCUMENTS:

- **Company charters and by-laws**
- **Annual proxy statements**
- **Corporate governance guidelines**
- **Board committee charters**
- **Corporate websites**

TOP 100 COMPANIES INCLUDED IN THE 2018 SURVEY:

3M Company
Abbott Laboratories
AbbVie Inc.
Adobe Systems Incorporated
Aetna Inc.
Alphabet Inc.
Altria Group, Inc.
Amazon.com, Inc.
American Express Company
American International Group, Inc.
AmerisourceBergen Corporation
Amgen Inc.
Anthem, Inc.
Apple Inc.
Archer-Daniels-Midland Company
AT&T Inc.
Bank of America Corporation
Berkshire Hathaway Inc.
BlackRock, Inc.
The Boeing Company
Booking Holdings Inc.
Bristol-Myers Squibb Company
Cardinal Health, Inc.
Caterpillar Inc.
Charter Communications, Inc.
Chevron Corporation
Cisco Systems, Inc.
Citigroup Inc.
The Coca-Cola Company
Comcast Corporation
ConocoPhillips
Costco Wholesale Corporation
CVS Health Corporation
DowDuPont Inc.
Eli Lilly and Company
Express Scripts Holding Company
Exxon Mobil Corporation
Facebook, Inc.
FedEx Corporation
Ford Motor Company
General Dynamics Corporation
General Electric Company
General Motors Company
Gilead Sciences, Inc.
The Goldman Sachs Group, Inc.
The Home Depot, Inc.
Honeywell International Inc.
HP Inc.
Humana Inc.
Intel Corporation
International Business Machines Corporation
Johnson & Johnson
JPMorgan Chase & Co.
The Kraft Heinz Company
The Kroger Co.
Lockheed Martin Corporation
Lowe's Companies, Inc.
Marathon Petroleum Corporation
Mastercard Incorporated
McDonald's Corporation
McKesson Corporation
Merck & Co., Inc.
MetLife, Inc.
Microsoft Corporation
Mondelēz International, Inc.
Morgan Stanley
Netflix, Inc.
NextEra Energy, Inc.
NIKE, Inc.
Northrop Grumman Corporation
NVIDIA Corporation
Oracle Corporation
PayPal Holdings, Inc.
PepsiCo, Inc.
Pfizer Inc.
Philip Morris International Inc.
Phillips 66
The PNC Financial Services Group, Inc.
Prudential Financial, Inc.
salesforce.com, inc.
Starbucks Corporation
Sysco Corporation
Target Corporation
Texas Instruments Incorporated
Thermo Fisher Scientific Inc.
The TJX Companies, Inc.
T-Mobile US, Inc.
Twenty-First Century Fox, Inc.
U.S. Bancorp
Union Pacific Corporation
UnitedHealth Group Incorporated
United Parcel Service, Inc.
United Technologies Corporation
Valero Energy Corporation
Verizon Communications Inc.
Visa Inc.
Walgreens Boots Alliance, Inc.
Walmart Inc.
The Walt Disney Company
Wells Fargo & Company

Ten companies are new to the 2018 Survey.

75 of the Top 100 Companies are listed on the NYSE and 25 companies are listed on the Nasdaq.

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