

Client Alert

Corporate Practice Group

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ISS Announces Rebranded Corporate Governance Rating System

Overview

On October 31, 2016, Institutional Shareholder Services (ISS), a proxy advisory firm, announced its rebranded corporate governance rating system. Formerly known as QuickScore, the rating system is now called QualityScore to reflect the qualitative factors considered in the rating analysis. The data verification period will remain open until November 11, 2016. Scores will be released on November 21, 2016, when the new system launches.

QualityScore analyzes more than 220 factors used in determining a company's governance score and will continue to categorize and rate governance attributes in four categories: Board Structure, Compensation/Remuneration, Audit & Risk Oversight and Shareholder Rights & Takeover Defenses. The ratings of each of the four categories, and an overall rating, are combined to create an overall score. That score is then measured against other companies in the relative index or region.

Listed below are the new factors for the U.S. market included in the QualityScore rating system that were not formerly included in QuickScore.

Board Structure

What is the proportion of women on the board?

- This factor considers the proportion of women on the board, not just the number of women. Some studies have suggested that women on boards of directors correlate to improved financial performance. Unofficially, ISS has suggested that the proportion of women should be at least one-third to receive the maximum score.

What proportion of non-executive directors has been on the board less than six (6) years?

- This factor allocates credit for increasing the proportion of directors with less than six years of tenure, with no additional credit allocated when the proportion of non-executive directors with less than six years of tenure exceeds one-third.

Does the board have any mechanisms to encourage director refreshment?

- This factor analyzes whether the company has implemented any devices to encourage board refreshment, such as a mandatory retirement age or term limits.
- This factor does not have an impact on scoring; it is for informational purposes only.

Does the company disclose the existence of a formal CEO and key executive officers succession plan?

- This factor considers whether the company has a succession plan in place. Succession events that cause significant disruption can lead to detrimental impacts on shareholders.

Has ISS' review found that the board of directors has taken unilateral action that materially reduces shareholder rights or the company has had other governance failures?

- This factor considers whether a company's board has taken unilateral action on items such as charter or bylaw amendments, whether the company has adverse charter and bylaw provisions and class structures or whether there have been other governance failures. ISS placed additional emphasis on these matters in its 2016 policy updates, discussed [here](#).

Has the board adequately responded to low support for a management proposal?

- This factor analyzes whether companies listen to their shareholders when shareholder support is low on certain management proposals, including director elections, and non-binding advisory proposals, such as say on pay and the frequency of the say on pay vote. ISS indicates that low support is less than 50% in director elections and less than 70% of the votes cast for the advisory vote on executive compensation.

Compensation/Remuneration

Does the company employ at least one metric that compares its performance to a benchmark or peer group (relative performance)?

- This factor considers whether a company's pre-established metric for performance is set against an external group.

Audit & Risk Oversight

What is the tenure of the external auditor?

- This factor analyzes the length of the auditor-client relationship. Some studies have shown that a shorter auditor tenure leads to more independence from management.
- This factor does not have an impact on scoring; it is for informational purposes only.

Shareholder Rights & Takeover Defenses

Does the company have an exclusive venue/forum provision?

- This factor considers whether a company restricts shareholder litigation by having exclusive venue provisions.

Does the company have a fee shifting provision?

- This factor considers whether there are fee shifting provisions, such as a requirement for the losing party to pay the winner's legal fees. Such provisions may dissuade shareholders from pursuing legal action against the company for financial reasons.

Does the company have a representative claim limitation or other significant litigation rights limitations?

- This factor analyzes whether the company has a representative claim limitation, which prevents small shareholders, unless they act collectively, from suing the company.

Are all directors elected annually?

- This factor considers whether the company has a classified board or whether the company could classify its board without shareholder approval. Classifying the board makes it more difficult for shareholders to remove ineffective directors.

Does the company require a super-majority vote to approve amendments to the charter and bylaws?

- This factor considers whether super-majority votes are required; ISS believes that a simple majority of voting shares should be all that is required to effectuate change in these corporate governance documents.
- This factor also considers whether shareholders have the right to amend bylaws (i.e., submit a binding shareholder proposal under Rule 14a-8) or whether the ability to amend the bylaws is restricted to the board.

Can the board materially modify the company's capital structure without shareholder approval?

- This factor considers whether a company is required to have its shareholders vote on authorized capital increases or reductions.

Questions concerning proxy access bylaw provisions in the U.S. (These will now be scored, previously, they were non-scored factors.)

- What is the ownership threshold for proxy access?
- What is the ownership duration threshold for proxy access?
- What is the cap on shareholder nominees to fill board seats from proxy access?
- What is the aggregation limit on shareholders to form a nominating group for proxy access?

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