November 21, 2018

Heads Up for the 2019 Proxy Season:

New and Revised ISS and Glass Lewis Policies May Impact Director Elections

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ISS and Glass Lewis have released updates to their proxy voting policies for the 2019 proxy season, which for the most part are not controversial, but reflect a continued effort by the proxy advisory firms to influence governance policies and practices through the director election and annual meeting voting process. Although many of the policy updates refine existing policies, others focus on the accountability of the board of directors, and in many instances, the nominating and governance committee, for what ISS and Glass Lewis could view as governance and oversight deficiencies. Companies should familiarize themselves and their boards of directors with the new and updated policies, which could influence the results of director elections and support for shareholder proposals as well as affect the company's governance profile and reputation.

The policy updates will apply to annual meetings held on or after February 1, 2019 in the case of ISS, and after January 1, 2019 in the case of Glass Lewis, and are available here and here. In this Alert we provide guidance for U.S. companies on addressing these developments and practical tips for "***What to do Now?***" on page 5.

Key Developments

Policies Implicating Director Elections

- Board Diversity – ISS and Glass Lewis
- Company Ratification Proposals – ISS and Glass Lewis
- Virtual-Only Meetings – Glass Lewis
- Director Attendance – ISS
- Environmental and Social Risk Oversight – Glass Lewis

Other Policy Updates

- Director Performance – ISS
- Evaluating Environmental and Social Proposals – ISS
- Reverse Stock Splits – ISS
- Auditor Ratification – Glass Lewis
- Executive Compensation – Glass Lewis

Director Election Vulnerabilities

Boards of directors continue to face scrutiny on issues such as board diversity, risk oversight and accountability. Against the backdrop of institutional investors' heightened focus on these issues, ISS and Glass Lewis have updated and adopted new voting policies. Although a negative recommendation from ISS and/or Glass Lewis may not necessarily result in directors failing to receive sufficient votes to be elected, negative attention, investor criticism and reputational issues are sufficient reasons for companies and their directors to understand the circumstances in which ISS and Glass Lewis may recommend voting against a director.

1. ISS and Glass Lewis Push for Board Gender Diversity – *NEW*

Both ISS and Glass Lewis have adopted new voting policies, which hold the nominating and governance committee chair accountable for a lack of board gender diversity. The Glass Lewis policy will apply to shareholder meetings held in 2019 and the ISS policy will apply beginning in 2020.

ISS. In 2018, ISS began noting a lack of board gender diversity in its voting recommendation reports. Under its new policy, ISS will recommend against the election of the nominating committee chair (or other directors responsible for the nomination process) at Russell 3000 and S&P 1500 companies when there are no women on the board, effective for annual meetings on or after February 1, 2020. ISS will consider certain mitigating factors, including the company's disclosed commitment in its proxy statement to appoint at least one female to the board in the near term or the presence of a female on the board at the preceding annual meeting.

Glass Lewis. Glass Lewis' policy will apply for any annual meeting held on or after January 1, 2019. Under its new policy, Glass Lewis will recommend that shareholders vote against the election of the nominating committee chair at Russell 3000 companies when there are no women on the board. Glass Lewis will also consider recommending against the election of other nominating committee members in certain circumstances taking into account the company size, industry, location and governance profile. Glass Lewis stated that it may not recommend against directors of companies outside the Russell 3000 index, or when boards have provided a sufficient rationale for not having any female directors or disclosed a timetable for addressing the lack of diversity on the board or any notable restrictions in place regarding board composition (e.g., nomination agreements).

2. Spotlight on Management Proposals to Ratify Existing Charter or Bylaw Provisions – *NEW*

Both ISS and Glass Lewis have adopted new policies in direct response to a trend that emerged during the 2018 proxy season involving management proposals to ratify existing bylaw or charter provisions as a way to exclude or block a "conflicting" shareholder proposal seeking a more favorable shareholder governance right. ISS and Glass Lewis cite several instances during the 2018 proxy season where companies obtained no-action relief from the SEC Staff pursuant to SEC Rule 14a-8(i)(9) and Staff Legal Bulletin No. 14H to exclude a shareholder proposal requesting that the company lower the threshold required for shareholders to call a special meeting by submitting a "conflicting" management proposal to ratify an already-existing bylaw or charter provision. Glass Lewis expressed that the exclusion of such shareholder proposals is "especially" problematic because shareholders are denied the opportunity to weigh-in on enhanced shareholder rights.

ISS. Under its new policy, ISS may recommend that shareholders vote against the election of individual directors, members of the governance committee, or the full board, where the board has asked shareholders to ratify an existing charter or bylaw provision with the intent of excluding a shareholder proposal on the same topic, after considering various factors, such as the history of the proposal, shareholder rights and the company's governance profile. Furthermore, ISS will evaluate the underlying management ratification proposal using the same factors.

ISS also revised its responsiveness policy to add that it may recommend voting against directors on a case-by-case basis if the board failed to act on a management ratification proposal that was opposed by a majority of shareholders in the previous year based.

Glass Lewis. Under its new policy, Glass Lewis addresses different scenarios involving management ratification proposals. Where a company excludes a shareholder proposal seeking a reduced threshold for the right to call a special meeting by means of ratifying a management proposal that is materially different from the shareholder proposal, Glass Lewis will generally recommend voting against the chair or members of the governance committee. The new Glass Lewis policy also includes factors that Glass Lewis will take into account when issuing its voting recommendation on "conflicting" shareholder and management proposals relating involving shareholder meeting thresholds and other proposals.

Glass Lewis stated that it generally believes that companies should not limit investors' ability to vote on shareholder proposals that advance certain rights or promote beneficial disclosure and that it will "make note" of instances where a company has excluded such shareholder proposals through SEC no-action letter relief. If after review, Glass Lewis believes that the exclusion of a shareholder proposal is detrimental to shareholders, it may, in certain very limited circumstances, recommend against members of the governance committee. The new policy does not describe the nature of those "limited circumstances."

3. Virtual-Only Meetings – *Glass Lewis NEW*

Glass Lewis's previously announced policy that it will generally recommend voting against the election of members of the company's governance committee when the board plans to hold a virtual-only meeting and does not provide disclosure assuring that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting will take effect for meetings held after January 1, 2019. According to Glass Lewis, examples of robust and effective disclosures include:

- Addressing the ability of shareholders to ask questions during the meeting, including time guidelines for shareholder questions, rules around what types of questions are permitted, and rules for how questions and comments will be recognized and disclosed to meeting participants;
- Procedures, if any, for posting appropriate questions received during the meeting and the company's answers, on the investor page of its website as soon as is practical after the meeting;
- Addressing technical and logistical issues related to accessing the virtual meeting platform; and
- Procedures for accessing technical support to assist in the event of any difficulties accessing the virtual meeting.

4. Chronic Poor Director Attendance – *ISS REVISED*

Starting in 2019, ISS will target not only the director with poor attendance – i.e., a director who attended less than 75% of the meetings of the board and the committee(s) on which such director serves without disclosing an acceptable reason for the absences (e.g., medical issues, family emergencies, or missing only one meeting where there were three or less meetings) – but also the members of the nominating/governance committee in cases of a director's "chronic" poor attendance. ISS defines "chronic" poor attendance as three or more consecutive years of poor attendance without reasonable explanation.

5. Board Environmental and Social Risk Oversight – *Glass Lewis REVISED*

Glass Lewis has clarified its policy on how it reviews board oversight of environmental and social (E&S) risks. Glass Lewis believes that companies should ensure appropriate board-level oversight of material risks to their operations, including E&S issues. For large cap companies and in circumstances where Glass Lewis identifies material oversight concerns, it will review a company's overall governance practices and identify which directors or committees are responsible for oversight of E&S issues. Glass Lewis will also note instances where such oversight has not been clearly defined in a company's governance documents.

Where it is clear, in Glass Lewis's view, that a company has not properly managed or mitigated environmental or social risks to the detriment of shareholder value, or a lack of oversight has threatened shareholder value, Glass Lewis may recommend that shareholders vote against the members of the board who are responsible for such oversight. In the absence of explicit board oversight of E&S issues, Glass Lewis may recommend that shareholders vote against members of the audit committee.

Overview of Other ISS and Glass Lewis Policy Changes

1. Director Performance Evaluations – *ISS REVISED*

ISS's director performance evaluation policy is designed to identify companies that have long-term underperformance and a significant number of board entrenchment features. In an attempt to streamline and strengthen the application of this policy, ISS has more clearly set out a two-step process by moving up the five-year total shareholder (TSR) assessment to the first step of its analysis. Accordingly, step one now involves a five-year underperformance test based on an assessment of one-, three- and five year TSR values. The second step involves the assessment of certain problematic governance provisions, which, if present, may be considered to reflect negatively on the board's performance. ISS believes that moving the five-year underperformance test to the initial screen, as opposed to as part of a secondary step, will appropriately reduce the number of companies that undergo scrutiny under this policy.

2. Environmental and Social Shareholder Analysis Approach – *ISS REVISED*

ISS clarified the factors that it takes into consideration in its case-by-case analyses of E&S shareholder proposals. The policy update clarifies that significant controversies, fines, penalties, or litigation are considered when evaluating E&S shareholder proposals.

3. Reverse Stock Splits in Special Circumstances – *ISS REVISED*

ISS has broadened and clarified its policy on management proposals seeking shareholder approval to effectuate a stock split at companies that are not listed on a major stock exchange and are not proportionately reducing their authorized shares where substantial risks exist that the company will continue as a going concern. Under the revised policy, ISS will recommend in favor of the proposal if: (i) the number of authorized shares will be proportionately reduced; or (ii) the effective increase in authorized shares is equal to or less than the allowable increase calculated in accordance with ISS' common stock authorization policy. In the event that neither of the foregoing conditions are satisfied, ISS will make an assessment of the proposals on a case-by-case basis taking into consideration additional factors, including the following: (i) stock exchange notification to the company of a potential delisting; (ii) disclosure of substantial doubt about the company's ability to continue as a going concern without additional financing; (iii) the company's rationale; or (iv) other factors.

4. Auditor Ratification Considerations – *Glass Lewis REVISED*

Glass Lewis has added new factors that it will consider when reviewing auditor ratification proposals in light of new PCAOB disclosure requirements. These factors include the auditor's tenure, a pattern of inaccurate audits, and any ongoing litigation or significant controversies which call into question an auditor's effectiveness. Glass Lewis stated that, in limited cases, these factors may contribute to a recommendation against auditor ratification.

5. Executive Compensation – *Glass Lewis REVISED*

Glass Lewis updated and clarified a number of its policies on executive compensation and its evaluation of the compensation committee. For example, Glass Lewis added the inclusion of excise tax gross-up provisions in executive employment agreements as a feature that could result in a negative recommendation for the compensation committee. In addition, Glass Lewis also added discussion and clarifications to their existing policies relating to executive compensation disclosure for smaller reporting companies, grants on front-loaded awards, and clawback policies with a specific focus on the terms of the policy not just whether a company has such a policy.

What To Do Now?

- **Assess Board Composition, Skills and Diversity, and Enhance Disclosure**. ISS and Glass Lewis, as well as significant institutional investors continue to pay close attention to board composition, individual directors' competencies and diversity. Investors such as BlackRock and State Street have publicly announced policies on boardroom gender diversity. Companies should re-evaluate their disclosures relating to board composition, skills and diversity and consider whether the skills, backgrounds and diversity of the board is presented clearly. Companies with boards that lack gender diversity should make efforts to recruit female directors, make a commitment in their proxy statements to do so in the near term, or provide other rationale for the lack of gender diversity. For information on the recent California legislation on board diversity, see a recent blog post here.
- **Assess Board Responsibility Over Social and Environmental Risks.** In 2018, institutional investors continued to take greater stewardship of the social, environmental and governance aspects of their investments. Companies should review committee charters and corporate governance guidelines to assess whether board-level oversight over the company's environmental and social risks is clearly identified. Companies should also be prepared for shareholder proposals on these issues and should understand the positions of their shareholders in order to inform how to respond.
- **Consider Carefully No-Action Requests for Exclusion of Shareholder Proposals.** Companies should consider the potential reactions of ISS and Glass Lewis to the exclusion of "conflicting" a shareholder proposal in favor of a management ratification proposal. Companies that seek no-action relief to exclude a proposal on the basis of the ordinary business exception (Rule 14a-8(i)(7)) or the economic relevance exception (Rule 14a-8(i)(5)) are reminded to consider the SEC Staff's guidance in SLB No. 14J available here.
- **Enhance Proxy Statement Disclosure for Virtual-Only Meetings.** Companies that are holding their annual meeting by virtual means only, should consider best practices and enhancing proxy statement disclosure.
- **Review and Verify ISS QualityScore Report; Update Peer Group.** Companies should review and verify their new ISS QualityScore report when it becomes available on November 29, 2018. Companies may generally verify data at any time, except between the company's proxy statement filing and shareholder meeting. QualityScore reports will reflect a new board diversity subcategory and several new factors, including the lowest level of shareholder support received by a management-nominated director at the most recent annual meeting, the level of shareholder support received on the most recent say-on-pay vote, and the most recent level of shareholder support for the CEO and the board chair. ISS's compensation peer submission system is open from November 19 through December 7, 2018 and can be accessed here for companies that wish to update their peer group.

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