

Client Alert

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ISS and Glass Lewis Update their Proxy Voting Guidelines for 2015

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Proxy research and advice entities Institutional Shareholder Services Inc. (“ISS”) and Glass, Lewis & Co., LLC (“Glass Lewis”) recently updated the guidelines each service will use to inform their voting recommendations for the 2015 proxy season. The updates address topics such as amendments to governing documents, director and executive compensation, board leadership structures, and certain shareholder proposals included in proxy materials. We summarize the most notable updates to these guidelines, below.

ISS

The ISS voting policy updates are relevant to shareholder meetings taking place on or after February 1, 2015. The two principal updates highlighted by ISS relate to ISS’s adoption of the “Equity Plan Score Card” for evaluating equity plan proposals and changes to ISS’s methodology for evaluating independent chair shareholder proposals. ISS also updated its policies regarding how it will assess nominees on boards where shareholder rights have been unilaterally limited, bylaw proposals where the bylaws contain exclusive forum and fee-shifting provisions, political contributions shareholder proposals, and greenhouse gas emissions shareholder proposals.

Equity Plan Scorecard. Noting that new accounting standards, greater use of performance-based awards, and growing plan complexity have resulted in significant changes in equity plan design and administration, ISS stated that its new policy will no longer apply “standalone pass/fail tests” when analyzing a proposed plan; rather, ISS will now use a more flexible Equity Plan Scorecard (“EPSC”) policy. While a limited number of issues will continue to result in an automatic negative recommendation (*e.g.*, authority to re-price options without shareholder approval), the EPSC will take a broader, more holistic approach and assess factors within three categories—plan cost (45% weighting), grant practices (35% weighting), and plan features (20% weighting). ISS also will implement separate burn rate thresholds for the S&P 500. Burn rates for the S&P 500 tend to be significantly lower than burn rates for the Russell 3000.

Independent Chair Shareholder Proposals. With regard to independent board chair proposals, which were the most frequent shareholder proposals in 2014, ISS has traditionally applied a “generally for” policy with a list of six criteria that must be satisfied to negate that recommendation. ISS will now use a more “holistic” analysis, which looks at a number of new factors (*e.g.*, the absence/presence of an executive chair, recent board and executive leadership transitions at the company, director/CEO tenure, and a longer (five-year) TSR performance period), and will no longer rely on any single factor in determining the voting recommendation.

Director Elections—Unilateral Bylaw/Charter Amendments. In uncontested elections for directors, a new ISS policy generally provides for a vote against or withhold from directors individually, committee members, or the

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entire board if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights, or in a manner that could adversely impact shareholders. ISS will consider a number of enumerated and other factors to assess the impact of the amendment on shareholders. ISS notes that the updates codify the existing application of its "Governance Failures Policy" to these types of amendments.

Litigation Rights (including Exclusive Venue and Fee-Shifting Bylaw Provisions). Under a new policy, ISS will make a case-by-case assessment of proposals seeking the approval of bylaws or bylaw amendments that impact shareholders' litigation rights (such as when they include exclusive venue and fee-shifting provisions), taking into account factors such as the company's stated rationale, the disclosure of past harm that the bylaw provisions is designed to remedy, the breadth of application and other governance features (e.g., whether shareholders may repeal the provision at a later date). ISS notes that it generally will recommend a vote against bylaw proposals by shareholders or management that would mandate fee shifting whenever plaintiffs are not completely successful on the merits (*i.e.*, in cases where the plaintiffs are only partially successful).

Political Contributions Shareholder Proposals. Consistent with its guidelines, ISS generally will recommend a vote for proposals seeking greater disclosure of a company's political contributions and trade association spending policies and activities, taking into consideration a number of factors. The revised guidelines indicate separately the factors that ISS considers regarding oversight and indirect political contribution activity and clarify ISS's current policy by specifically noting "management and board" oversight mechanisms are reviewed and considered during application of the policy.

Greenhouse Gas Emissions Shareholder Proposals. Consistent with its guidelines, ISS will assess proposals that call for the adoption of greenhouse gas ("GHG") reduction goals from products and operations on a case-by-case basis. Under the revised guidelines, ISS will no longer consider certain factors (such as whether the proposal is overly prescriptive), but will look for disclosure of year-over-year GHG emissions performance data and GHG emission reduction performance as relevant factors of consideration.

GLASS LEWIS

Reduction or Removal of Shareholder Rights without Shareholder Approval. Glass Lewis's 2015 proxy season guidelines expand the circumstances in which it would recommend a withhold recommendation against the governance committee chair, or the entire governance committee, when a board has amended a company's governing documents to reduce or remove important shareholder rights, or otherwise impede the ability of shareholders to exercise such right, and has done so without shareholder approval. As examples of board actions that may justify such a withhold recommendation, Glass Lewis specifies the elimination of shareholders' ability to call special meetings, increase to the ownership threshold for shareholders to call special meetings, increase to vote requirements for charter or bylaw amendments, limitations on shareholders' ability to pursue full legal recourse (such as bylaws that require arbitration of shareholder claims or fee-shifting bylaws), declassification of the board, and elimination of shareholders' ability to remove directors without cause.

Director Independence and "Material" Transactions. Glass Lewis encourages companies to have a board that is at least two-thirds "independent." Glass Lewis considers a director not independent if he or she is

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employed by a professional services firm such as a law firm, investment bank, or consulting firm, and the company pays the firm, not the individual, \$120,000 for services. Glass Lewis's 2015 proxy guidance clarifies that such transactions may be deemed immaterial where the amount represents less than one percent of the firm's annual revenues, and the board provides a compelling rationale as to why the director's independence is not affected by the relationship.

Independent Chairman. Glass Lewis does not recommend that shareholders vote against CEOs who chair the board, but encourages its clients to support separating the roles of chairman and CEO whenever the issue arises in a proxy statement. In its updated guidelines, Glass Lewis expands its position to recommend also voting against the chair of a governance committee when a company has neither an independent chairman nor independent lead directors.

Board Responsiveness to Majority-Approved Shareholder Proposals. In its amended guidelines, Glass Lewis expands the circumstances under which failure to implement a shareholder proposal will justify a withhold recommendation for governance committee members. Glass Lewis notes that such proposals must relate to "important shareholder rights," such as those seeking a declassified board structure, a majority vote standard for director elections, or a right to call a special meeting. Further, Glass Lewis specifies that in determining whether a board has sufficiently implemented such a proposal, it will examine the quality of the right enacted by the board for any conditions that may unreasonably interfere with the shareholders' ability to exercise the right (e.g., overly prescriptive procedural requirements for calling a special meeting).

Exclusive Forum and Anti-Takeover Provisions Following an IPO. Glass Lewis has generally avoided issuing voting recommendations on the basis of corporate governance best practices during the one-year period following an IPO, so that new companies have time to fully comply with market listing requirements and meet basic corporate governance standards. In its update, Glass Lewis identifies two exceptions to this customary practice. In cases where a board adopts an exclusive forum or fee-shifting provision for inclusion in a company's governance documents before the company's IPO, Glass Lewis will recommend voting against the chairman of the governance committee, or, in the absence of such a committee, the chairman of the board who served during the period of time when the provision was adopted. Further, in cases where the board adopts an anti-takeover provision preceding an IPO, Glass Lewis will consider recommending that shareholders vote against the members of the board who served when the provision was adopted, if the board did not also commit to submit the anti-takeover provision to shareholder vote within 12 months of the IPO, or did not provide a sound rationale for adopting the anti-takeover provision.

Advisory Vote on Executive Compensation: One-Off Awards, Employee Stock Purchase Plans, and Clawbacks. Glass Lewis's existing guidelines provide limited discussion of a board's adoption—or lack thereof—of provisions addressing one-off compensation awards, employee stock purchase programs, or the recouping of certain compensation during a three-year look-back period as required under Section 954 of the Dodd-Frank Act. In its updates for the 2015 proxy season, Glass Lewis adopts guidelines that (i) warns shareholders to be wary of compensation awards granted outside of a company's standard short-term and long-term incentive schemes, and (ii) advises companies to redesign their compensation programs rather than make "one-off compensation awards." Companies that do make one-off awards are instructed to ensure that such awards are tied to future

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service and performance whenever possible, and provide a thorough description of such awards, including an explanation as to why the awards are required, why existing awards are not adequate, and how the one-off awards will affect the company's regular compensation arrangements. Further, Glass Lewis reiterates that it is generally supportive of employee stock purchase plans, and described its method for evaluating such plan proposals based upon a primarily quantitative analysis that focuses on equity value creation. In addition, Glass Lewis advises that clawback policies should be (i) triggered upon a restatement of financial results or similar indicators upon which bonuses are based, to allow the company to recoup the bonuses of senior executives if the company failed to achieve performance goals; and (ii) subject to limited board discretion.

ISS's 2015 update to its proxy voting guidelines may be found [here](#), and Glass Lewis's guidelines for the 2015 proxy season may be found [here](#). Companies may consider these revised ISS and Glass Lewis guidelines, and anticipate any likely voting recommendations, as they prepare for the 2015 proxy season.

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