SULLIVAN & CROMWELL LLP

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2015 Proxy Season Review

Proxy Access Proposals Most Significant Development of 2015; Significantly Higher ISS Support of Independent Chair Proposals Does Not Translate to Higher Votes; Board Withhold Recommendations Continue to Increase With Board Responsiveness a Key Driver in Resulting Votes

SUMMARY

This Paper summarizes significant developments relating to shareholder proposals to date during the 2015 proxy season. Although shareholder activists pursuing strategic or management changes continue to dominate the headlines, they do not choose to wage those campaigns through shareholder proposals made under Rule 14a-8, which are addressed by this Paper, choosing instead private or public pressure, and often a threatened or actual proxy contest. Nonetheless, the widespread governance changes brought about through successful 14a-8 proposals have played no small part in the continued growth and success of shareholder activism.

During the 2015 proxy season, proxy access has been the most significant development. Far more proposals have been made and support has been substantially stronger. There have been 82 proxy access proposals to date in 2015, as opposed to 17 in all of 2014. In 2015, shareholders have approved 48 proposals to date (as opposed to five for all of 2014), and the average votes cast in favor have risen to 55% from 33% in 2014. Perhaps most significantly, modestly more restrictive management-enacted proxy access provisions apparently did not deter shareholders from proposing, and, in many cases, winning on the now standard shareholder proposal format of 3%/3-year/25% of board.

When proxy access proposals are eliminated, overall governance proposals dropped 6%, with majority election of directors and board declassification proposals in particular being proposed much less frequently than in prior years. This decline, however, may principally reflect the previous adoption of these two governance arrangements by numerous companies. Although ISS support for independent

chair proposals increased significantly this year, based on its new approach to this proposal, average support and the number of successful proposals actually declined somewhat. In light of the SEC's decision to suspend no-action relief for conflicting proposals, conflicting proposals for proxy access and special meeting rights appeared in a number of proxy statements.

ISS recommendations to withhold or vote against directors increased in 2015 with notable increases in the number of withhold recommendations for a lack of responsiveness and for unilateral actions taken by the board that restricted shareholder rights (primarily through bylaw amendments), as well as for independence, compensation and overboarding issues. Average support on advisory say-on-pay votes remained strong, and largely unchanged from prior years.

The data in this Paper incorporates shareholder proposals made at meetings held on or before June 30, 2015. We estimate that about 415 of the S&P 500 companies had held their meetings by that date.

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I. OVERALL TRENDS IN RULE 14A-8 SHAREHOLDER PROPOSALS

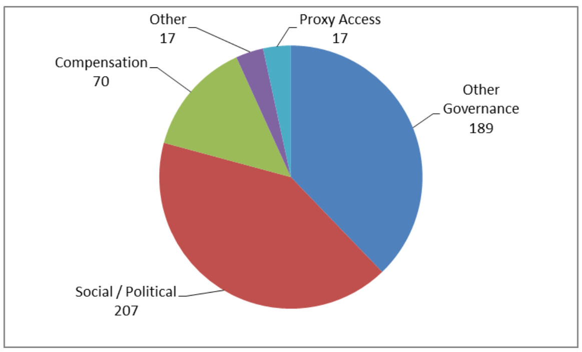
A. OVERVIEW OF SHAREHOLDER PROPOSALS IN 2014 AND 2015

The following table and pie charts summarize, by general category, the Rule 14a-8 shareholder proposals voted on at U.S. companies in 2014 and 2015, and the rate at which they passed.[1,2]

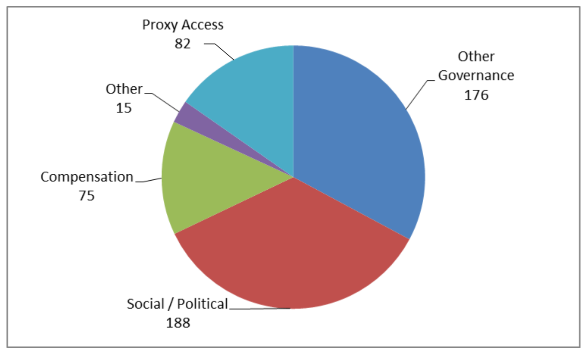
SUMMARY OF 2014 AND 2015 SHAREHOLDER PROPOSALS

	Total Shareholder Proposals Voted On		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
Type of Proposal	*2015*	*2014*	*2015*	*2014*	*2015*	*2014*
Proxy Access	82	17	55%	33%	48	5
Other Governance	176	189	40%	44%	38	53
Social and Political Issues	188	207	21%	22%	1	7
Compensation-Related	75	70	29%	27%	5	5
Other	15	17	16%	28%	2	2
Total	536	500				

Proposals Voted on in 2014



Proposals Voted on in 2015 (YTD)

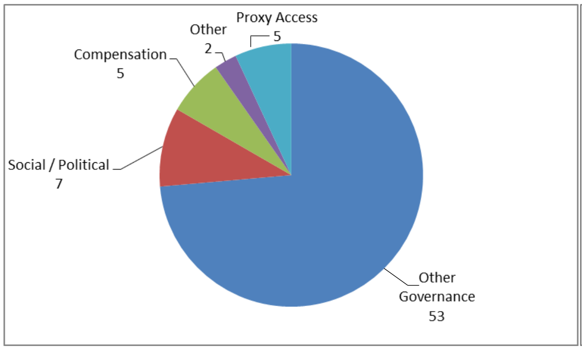


1 By "pass", we mean that the proposal received the support of a majority of votes cast, regardless of whether this is the threshold for shareholder action as a state law matter (including pursuant to the issuer's bylaws). This does not include abstentions in describing whether a shareholder proposal has "passed" or "failed," as this provides a consistent metric across all companies, and is consistent with the terminology used by ISS and many institutional investors and advisory firms. Under ISS's policies and those of other proxy advisory firms and institutional investors, failure to implement a shareholder proposal which was approved by a majority of the votes cast, even if that vote would not constitute passage under state law or the issuer's bylaws, is likely to result in negative recommendations for some or all incumbent directors in the following year due to "non-responsiveness." See Section II below for a discussion of negative recommendations for directors under these circumstances.

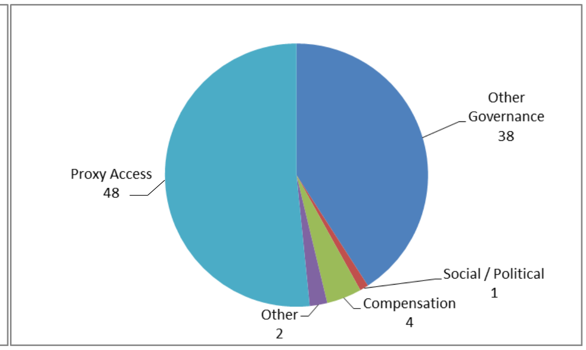
Throughout this publication, information on voting results for 2015 year-to-date generally includes annual meetings through June 30, 2015 and includes U.S. companies in the Russell 3000 index and voting results for 2014 reflect the full year.

2 Given the 400% increase in proxy access proposals, they have been placed into their own category to avoid obscuring developments in other governance proposals.

Proposals That Passed in 2014



Proposals That Passed in 2015 (YTD)

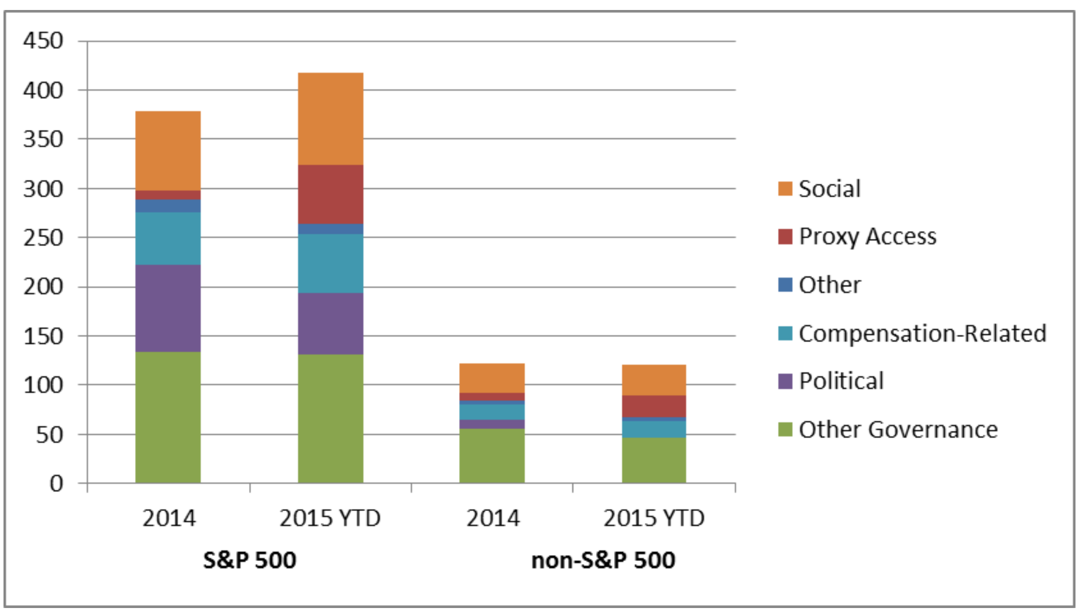


As indicated above, companies still receive a large number of social, political, and compensation related proposals, though it is also still the case that the vast majority of proposals that pass are those relating to governance issues. Only one out of 188 social/political proposals and five out of the 76 compensation-related proposals received a majority of votes cast in 2015 thus far.

B. COMPANIES THAT RECEIVED SHAREHOLDER PROPOSALS

Before turning to a detailed discussion of the various categories of shareholder proposals received by U.S. public companies in 2015, it is worth taking a moment to focus on *which* companies generally receive these proposals. Traditionally, the vast majority of shareholder proposals have been received by large-cap companies. Over time, this has led to a bifurcated corporate governance landscape, with so-called "shareholder-friendly" governance structures, such as destaggered boards, majority election of directors, special meeting rights and simple majority vote thresholds, being much more common at larger companies than smaller companies.

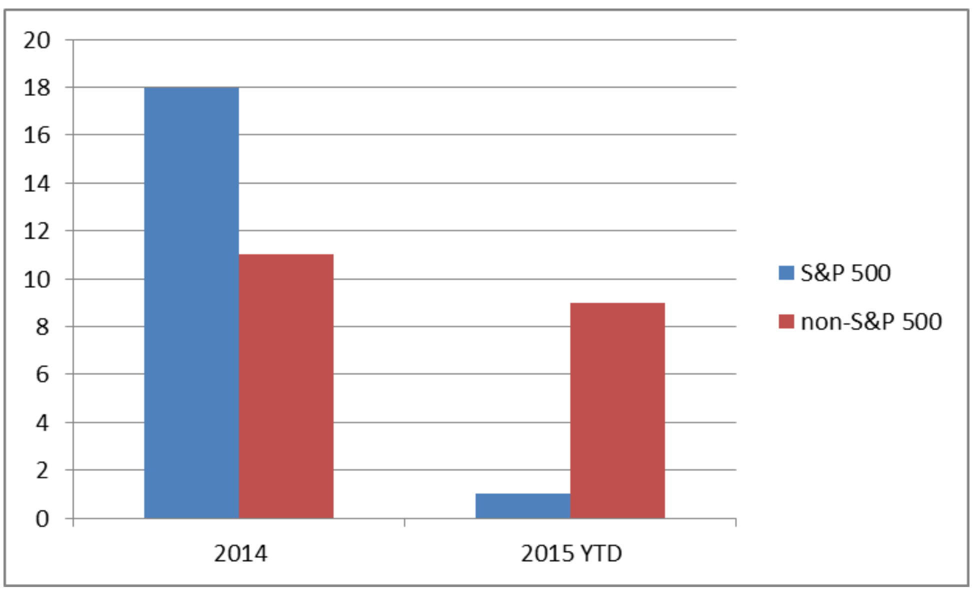
SHAREHOLDER PROPOSALS INCLUDED IN PROXY STATEMENTS (S&P 500 VS NON-S&P 500)



In 2015 so far, non-S&P 500 companies received 20% of all proposals voted on, although large-cap companies continue to be the primary focus of shareholder proposals across all categories of proposals.[3] The number of shareholder proposals at non-S&P 500 companies is substantially similar to 2014 despite the fact that no political proposals were made at non-S&P 500 companies in 2015 (nine were made in 2014).

The overall number of non-proxy access governance proposals at both S&P 500 and non-S&P 500 companies remained relatively constant, although the composition between the two groups has changed. As indicated by the chart below, the 2015 proxy season reveals a significant decrease in proposals for majority voting for directors at the S&P 500 (undoubtedly due to the fact that more than 80% of the S&P 500 now have majority voting for directors), but a much smaller decrease in that proposal at non-S&P 500 companies. The decline in proposals for majority election for directors and declassification at the S&P 500 in 2015 was largely offset by small increases in written consent, cumulative voting, and independent chair proposals. The 2% decline in non-proxy access governance proposals at smaller cap companies relative to 2014 would suggest that many proponents are not electing to direct their attention to smaller cap companies once the larger cap companies have adopted shareholder governance initiatives, with the possible exception of majority voting for directors.

PROPOSALS FOR ADOPTION OF MAJORITY VOTING PROVISIONS INCLUDED IN PROXY STATEMENTS (S&P 500 VS NON-S&P 500)



[3] Data throughout this publication relates to U.S. companies in the Russell 3000, unless otherwise noted, and is based on information from ISS and FactSet Shark Repellent, as well as our own selective review of public filings.

The impact of shareholder proposals is greater than is reflected simply in the numbers of proposals coming to a vote. Many shareholder proposals—or potential shareholder proposals—never make it to a shareholder vote, because the company determines to address the governance matter itself.

C. WHO MAKES SHAREHOLDER PROPOSALS

It is informative to review the identity of shareholder proponents. Based on data provided by ISS's voting analytics with respect to 969 shareholder proposals (including proposals which were withdrawn or excluded), John Chevedden, either alone or in conjunction with others, was associated with almost 200 proposals. In addition to the 75 proxy access proposals discussed below made by the New York City Comptroller on behalf of the New York City Pension Funds (again, often in conjunction with others), other public sector pension funds and entities were associated with over 80 proposals. Labor unions were involved with around 120 proposals. Entities which are often considered active in the shareholder proposal arena were less so this year based on this data—CalPERS made only three proposals, and Norgesbank one; CalSTRS had 11. The data also indicated that "socially responsible" entities were quite active—each of Trillium Asset Management, Calvert Asset Management, Walden Asset Management, and As You Sow Foundation was associated with more than 20 proposals and, as usual, religious organizations were primarily focused on social/political proposals.

D. SHAREHOLDER PROPOSALS ON GOVERNANCE STRUCTURE

Governance matters (board-related and antitakeover concerns) remain the primary focus of shareholder proposals in 2015.

The success of governance proposals remains highly dependent upon whether they are supported by ISS recommendations. As in 2013 and 2014, average support for these proposals in 2015 remains around 50% when supported by ISS recommendations, but only around 20% in cases when not supported. Because of the large increase in proxy access proposals, the overall number of governance proposals increased in 2015, up to 258 total proposals, an increase of 52 proposals from 2014, with proxy access more than making up for a slight decrease in other governance proposals.

1. Proxy Access Proposals

PROXY ACCESS					
Total Shareholder Proposals Voted On		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
2015 YTD	*2014*	*2015 YTD*	*2014*	*2015 YTD*	*2014*
82	17	55%	33%	48	5

a. The Growth of Proxy Access Proposals

As noted, proxy access is the most significant development of the 2015 proxy season. Proxy access proposals increased dramatically during 2015, increasing in number by more than 400%. 58% of the proxy access proposals passed, and ISS supported every proxy access proposal that was made. Companies, as a matter of preparedness, should be aware of proxy access developments and should be considering the different strategies available to them as the pressure for proxy access increases. It should be assumed, given the high success rate, that there will be more proxy access proposals next year.

b. The Terms of Shareholder Proxy Access Proposals

In recognition of the failure in prior years of proxy access proposals with low ownership thresholds, this year all proxy access proposals had an ownership requirement of 3% and a holding period of three years.[4] Almost all proposals provided that the maximum number of directors that could be elected by proxy access was 25% of the board; in two instances, that percentage was 20%. With limited exception, there was no limitation in the proposal on the number of persons who could be considered a group in order to meet the ownership threshold.

c. Marginally More Restrictive Pre-Existing Proxy Access Bylaws

In ten instances, the issuer had a proxy access bylaw in place with a 5% ownership threshold[5] before the proxy statement was mailed (except Marathon Oil, which adopted it a few weeks later). In five instances the 3% proposal was successful and in five instances it failed. In eight of those ten cases, the board only added proxy access after the stockholder proposal was received, but timing did not seem to affect the outcome of the vote (management prevailed half of the time where the proxy access was in effect prior to the proposal being made and half of the time where it was not).

d. Use of Conflicting Proxy Access Proposals by Management

In light of the SEC Staff decision to suspend no-action relief for conflicting proposals under Rule 14a-8(i)(9),[6] seven issuers chose to include competing management proposals in the proxy statement, with the management proposal in six instances raising the ownership threshold to 5% (in the case of Expeditors International, the threshold was left at 3%, but a net long ownership requirement and a limitation of 20 persons constituting a group to hold the required percentage ownership were added, and the number of board seats was limited to 20%). In three instances, the management proposal was successful, in three instances, the shareholder proposal was successful, and, in one case, Chipotle

4 The vast majority (92%) of proxy access proposals were by one proponent, the New York City Comptroller on behalf of the New York City Pension Funds, and these proposals contained the same terms. Given the high success rate, it should be assumed future proposals will follow this format. In choosing 75 companies to make proxy access proposals in 2015, the Comptroller announced the initiative was focusing on three criteria: climate change, board diversity and excessive CEO pay.

5 In the case of Boston Properties, the proxy access provision adopted by management had a 3% threshold, albeit with a five-person group limitation—the shareholder proposal failed in this instance.

6 For a discussion of the SEC staff's decision, and the announcement by SEC Chair White that spurred it, see our publication, dated January 16, 2015, entitled "SEC Staff Suspends No-Action Relief on Conflicting Shareholder Proposals." Keith Higgins, Director of the SEC's Division of Corporation Finance, discussed considerations relating to the treatment of conflicting proposals in a February 10 speech, available at http://www.sec.gov/news/speech/rule-14a-8-conflicting-proposals-conflicting-views-.html.

Mexican Grill, neither proposal passed. In no instance did both proposals pass (nor were the votes particularly close), a point that SEC Chair Mary Jo White stressed in a recent speech.[7] The outcome at Chipotle was presumably largely due to the particular institutional shareholder positions there. These management proposals followed two approaches: five of them were advisory with the broad parameters of the proxy access rights spelled out, and two were binding votes on the proxy access bylaw (one of which was Chipotle's, and both of which failed).

e. Other Management Responses

Many issuers opposed the proxy access proposal, but took no other action. In those cases, the shareholder proposal passed 60% of the time. Where management took no position (one instance), or supported the proposal (two instances), the proposal passed. In four cases, management indicated future plans to adopt proxy access, often after further stockholder engagement, and in three of these cases, the proposal still passed (the fourth proposal at Pioneer Natural Resources received 49.4% of votes cast).

f. Lessons Learned

Why any issuer wins or loses on any shareholder proposal, including proxy access, is highly fact dependent, including the shareholder profile, the issuer's performance, the issuer's governance profile, the solicitation efforts used and the issuer's general policy of engagement with institutional shareholders. What was clear, however, from this year's results is that proxy access has widespread support and is generally likely to be approved, and that a fairly modest increase (from 3% to 5%) in the ownership threshold in a management-adopted proxy access provision is not a guarantee against either receiving a 3% proposal, or winning if such a proposal is made.

It is unclear at this point what parameters an issuer can include in a proxy access provision adopted after the shareholder proposal has been successful and still be considered "responsive." Unlike actual proxy access bylaws, the shareholder proposals are quite short. Issues such as the permissible size of a group of shareholders, whether holdings must be "net long", whether incumbent proxy access directors who are renominated by the board should reduce the number of board seats available for proxy access, and whether a very low vote received in a prior year should disable a proponent from using proxy access in the future are not addressed, and it is unclear whether including such provisions will be deemed by ISS and others to be responsive. A strong argument can be made that following market practice (and therefore including such common limitations as the number of persons that can constitute a group) is responsive and that the shareholder proponent would have specifically required the exclusion of such language had it found it objectionable. It is likely to be a number of months before issuers whose shareholders approved proxy access proposals adopt specific bylaws. Issuers who are planning to adopt

[7] See SEC Chair White Speech, available at http://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html.

bylaws for that reason should review ISS's November policy updates to see if responsiveness is addressed in the proxy access context, as well as any FAQs which may be issued.

In any event, issuers who are implementing proxy access provisions in response to a shareholder vote should be mindful of the following factors listed by ISS in its FAQ on responsiveness in considering less than complete implementation of a successful shareholder proposal:

- Disclosed outreach efforts by the board to shareholders in the wake of the vote;
- Rationale provided in the proxy statement for the level of implementation;
- The subject matter of the proposal;
- The level of support for and opposition to the resolution in past meetings;
- Actions taken by the board in response to the majority vote and its engagement with shareholders;
- The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
- Other factors as appropriate.

There is also no clear answer as to whether it is advisable to proactively adopt a proxy access bylaw today. While last year the New York City Comptroller chose the issuers targeted based on criteria unrelated to specific governance provisions, future proponents may focus on issuers without existing proxy access bylaws. Given that a large number of issuers need to adopt proxy access before next year's proxy season in order to be responsive, the terms they choose, and the reaction to those terms, will provide further guidance as to market practice. Should ISS issue policy guidelines that indicate a particularly narrow view of responsiveness, however, greater consideration should be given to a pre-emptive adoption if the board would otherwise be unduly constrained in adopting a provision following a successful shareholder proposal.

At a minimum, management and the board should consider the various components of proxy access bylaws, consider what they would find acceptable, and stay abreast of these provisions as more are adopted. If the decision is not to adopt a provision in advance of receiving a proposal, having an internally acceptable form of bylaw would be advisable because it will facilitate negotiations with a proponent, or adoption of the bylaw unilaterally after receipt of a proposal. If the decision is to propose a conflicting provision, issuers must consider whether to present the entire proxy access bylaw for a binding vote, or, as most issuers with conflicting proposals did this year, present a summary of the key points for an advisory vote. Absent almost identical competing proposals, it would be difficult, if not impossible, to determine what element or elements caused shareholders to support the shareholder proposal as opposed to management's. A summary of the provisions of proxy access bylaws adopted to date, and a recommended form of bylaw, will be the subject of a future memorandum to clients.

2. Independent Chair Proposals

INDEPENDENT CHAIR					
Total Shareholder Proposals Voted On		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
2015 YTD	*2014*	*2015 YTD*	*2014*	*2015 YTD*	*2014*
62	63	29%	31%	2	4

Proposals requesting that companies separate the roles of CEO and chair[8] continued to be popular in 2015, trailing only proxy access proposals in frequency. 62 such proposals were voted on so far in 2015, nearly tying the number of such proposals for all of 2014. Large companies have regularly received these proposals since the mid-2000s, reflecting the views of certain shareholders that having the CEO (or another member of management) serve as chairperson may undermine the independence of the board as a whole. These proposals tend to receive significant shareholder support, though only 3% passed in 2015.

ISS support for these proposals increased in 2015 by nearly 15% and now ISS supports these proposals in a majority of cases. This increased ISS support is significant, given its impact upon voting results for these proposals—the average level of shareholder support at S&P 500 companies was between 35-40% in 2013, 2014, and 2015 if ISS supported the proposal, but only around 20-25% if ISS did not. However, in 2015, substantially increased ISS support of these proposals did not result in an increase in the average number of votes in favor of the proposals—there was a 2% decline.

The increased support from ISS is a result of their 2015 policy updates regarding independent chair proposals. Previously, absent problematic governance or management issues, ISS would recommend against independent chair proposals if there was a counterbalancing governance structure, including a lead director with specific enumerated duties, a two-thirds independent board, fully independent key committees and established governance guidelines, as long as the one- and three-year total shareholder return was not in the bottom half of the issuer's industry group. Thus, issuers could be fairly certain as to the outcome of the ISS recommendation. For 2015, ISS adopted a "holistic" approach to consideration of factors, added additional factors including the absence/presence of an executive chair, recent board and executive leadership transitions and director/CEO tenure, and added a longer (five-year) TSR performance period. ISS noted at the time that, in backtesting, the new methodology resulted in a higher level of support for such shareholder proposals.

8 These proposals are typically formulated either as a proposal to split the roles of CEO and chair or as a proposal that the chairperson be an independent director.

3. Decline in Proposals for Majority Voting and Board Declassification

	PRIMARY GOVERNANCE PROPOSALS					
	Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
	2015 YTD	2014	2015 YTD	2014	2015 YTD	2014
Declassify Board	10	17	77%	82%	10	16
Adopt Majority Voting	10	29	69%	58%	8	17

Proposals for the elimination of classified boards and the adoption of majority voting in director elections (rather than plurality voting) declined dramatically in 2015, after having declined in 2014 from levels in 2013. There are two primary reasons for this decrease. First, most large public companies have already enacted these governance changes since 2000, largely in response to shareholder pressure and evolving views of best corporate governance practices.[9] There was only one proposal for majority voting at the S&P 500 companies during 2015. Secondly, and perhaps more importantly, a Shareholder Rights Project clinic at Harvard Law School that was largely driving the momentum for declassification proposals did not make any proposals in 2015.

4. Shareholder Right to Act by Written Consent

RIGHT TO ACT BY WRITTEN CONSENT					
Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
2015 YTD	2014	2015 YTD	2014	2015 YTD	2014
36	28	39%	38%	2	0

Companies have continued to receive a significant number of shareholder proposals requesting that the company grant shareholders the right to act by written consent—the number of these proposals voted on so far in 2015 has already exceeded the total number in all of 2014, a continuation in the trend experienced since 2012. ISS supports these proposals in almost all cases and has recommended voting in favor of 94% of the cases so far in 2015.

In 2015, only 6% of the proposals have passed so far despite the strong support from ISS. This pass rate has increased from the 0% pass rate observed in 2014 but is still quite low given ISS support.

The corporate laws of most states provide that shareholders may act by written consent in lieu of a meeting unless the company's certificate of incorporation provides otherwise. Commonly, public companies provide in their charters that shareholders may *not* act by written consent, or that they may act by written consent only if the consent is unanimous (as opposed to permitting a written consent to be executed by shareholders representing the percentage of the voting power that would be necessary to approve the action at a meeting).

[9] As addressed above, more than 80% of S&P 500 companies have already enacted majority voting in director elections.

Some shareholders assert that companies should permit action by written consent on the basis that shareholder action should not be limited to the normal annual meeting cycle. The concern that companies have about giving shareholders the right to act by written consent is that the written consent process can frustrate an orderly and transparent debate on the merits of the proposed action, as would occur if it were raised at a shareholder meeting. Moreover, action by written consent can be seen as inherently coercive in that consent solicitations may not, in certain instances, give shareholders the benefit of the notice and disclosure requirements applicable to proxy solicitations. In addition, in the context of a hostile acquisition coupled with a written consent solicitation to remove the board, the uncertain timetable created by the fact that the removal is effective upon the delivery of the requisite number of consents could cause potentially interested third parties to be reluctant to enter into negotiations, given the risk that the board they are negotiating with could be removed at any time.

Up until recently, some companies, upon receiving a written consent proposal, have put forth a management proposal to adopt written consent rights, thereby allowing the company to exclude the shareholder proposal as "conflicting" under Rule 14-a-8(i)(9). These management proposals generally included provisions designed to reduce the coercive use of the process and to permit it to work in a more deliberative and organized manner, including provisions governing timing and disclosure requirements similar to those that would apply to a shareholder meeting.

However, as noted above, the SEC staff in 2015 suspended granting no-action relief because a shareholder proposal conflicted with a management proposal. Chair White has indicated that the goal with respect to this issue "is to provid[e] clarity for next year's proxy season."[10] Depending on the outcome of the SEC process, company management could adopt their own provision on a preemptive basis, present a competing proposal or allow the matter to go to a vote, and then propose a charter amendment the following year which includes provisions with the appropriate safeguards. These safeguards, which should be considered for any management proposal, whatever course is followed, include:

- An ownership threshold required to request action by written consent, ranging from 10% to 40%, with 20-25% being the most common, and in most cases conforming to the percentage required to call a special meeting at that company;
- Requiring the solicitation of all shareholders;
- A delay before consents could be delivered (e.g., 50 or 60 days) to ensure that shareholders have sufficient time to consider the matters subject to the consent;
- Timing limitations, such as denying the process if the request was delivered in the 90-day period prior to the anniversary of the prior annual meeting (because the company could have included a shareholder proposal in the annual meeting proxy statement), or if a similar item

[10] See SEC Chair White Speech, available at http://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html.

had been considered within a prior period, ranging from 30-120 days before the request, and, in many instances, if the matter was included in the notice for an upcoming meeting; and/or

- Disclosure requirements calling for the same information to be provided as is required by the advance notice bylaws.[11]

ISS's FAQs have recognized that "reasonable restrictions" on written consent rights are acceptable in determining whether the board has been "responsive" following a successful stockholder proposal, but provide the following guidelines on what restrictions are considered reasonable:

- An ownership threshold of no greater than 10 percent;
- No restrictions on agenda items;
- A total review and solicitation period of no more than 90 days (to include the period of time for the company to set a record date after receiving a shareholder request to do so, and no more than 60 days from the record date for the solicitation process);
- Limits on when written consent may be used of no more than 30 days after a meeting already held or 90 days before a meeting already scheduled to occur; and
- A requirement that the solicitor must use best efforts to solicit consents from all shareholders.

Restrictions beyond these levels will be "examined in light of the disclosure by the company about its outreach to shareholders, the board's rationale, etc. on what they consider reasonable, equity structure of the company, etc." [12] If shareholders vote to support a shareholder proposal on written consent, subsequently proposing for shareholder adoption a more restrictive proposal than the limitations deemed reasonable by ISS could be considered "non-responsive" in ISS's analysis of the recommendation for voting for directors, depending on the terms proposed and the company's disclosure on shareholder outreach. While ISS would recommend a vote *for* the more restrictive written consent proposal, because it is better than no ability to act by written consent, ISS would likely recommend *against* incumbent directors for failure to substantially implement a proposal that received a majority of votes cast in a single year. ISS withhold recommendations on the basis of "non-responsiveness" generally have significant impact on voting results in director elections. Accordingly, given the increase in the number of these proposals, and the fact that two have been successful thus far this year, unless an issuer is relatively

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11 Disclosure requirements, whether contained in the advance notice bylaws, or a special meeting or written consent right, which are so expansive that they effectively prevent the use of the action sought to be taken by shareholders run the risk of being found unreasonable in litigation (in the Allergan/Pershing Square litigation Allergan agreed not to require much of what was contained in the bylaw) and their adoption could result in a negative recommendation for the board of directors by ISS.

12 *See* ISS, "*Frequently Asked Questions on U.S. Proxy Voting Policies and Procedures (Excluding Compensation-Related Questions) (April 30, 2014),*" at question 45, *available at* http://www.issgovernance.com/file/2014_Policies/ISSUSFAQsPoliciesandProcedures04302014.pdf ("ISS FAQs"). ISS gives Amgen as an example of a company that put forth a management proposal at an ownership level of 15%, but was deemed responsive by ISS because of the shareholder outreach disclosure in its 2012 proxy.

comfortable that it will prevail in the shareholder vote, waiting until after shareholders approve a written consent proposal to implement the provision may reduce the Board's flexibility in achieving a written consent provision that differs substantially from the ISS FAQs. It should be noted that, unlike with special meeting rights, no issuers proposed conflicting proposals for written consent in their proxy statement this year.

5. Shareholder Right to Call Special Meetings

	RIGHT TO CALL SPECIAL MEETINGS					
	Total Shareholder Proposals Voted On		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
	2015 YTD	*2014*	*2015 YTD*	*2014*	*2015 YTD*	*2014*
Adopt new right	9	6	50%	48%	3	4
Lower % on existing right	11	7	39%	36%	1	0

Proxy advisory firms and many shareholders support the right of shareholders to call a special meeting because this enables shareholders to act on matters that arise between annual meetings (such as the removal of a director, including in circumstances intended to permit an acquisition offer to proceed, or the amendment of bylaws). The right to call special meetings should be viewed in conjunction with the movement away from classified boards—in Delaware, directors of a non-classified board can generally be removed by shareholders without cause. Thus, given the trend of declassifying boards in the past several years, the ability to act outside the annual meeting to remove directors without cause can be viewed as the dismantling of an effective mechanism to provide directors with additional time to consider hostile takeover proposals and seek superior alternatives. About 60% of S&P 500 companies now provide shareholders with some right to call a special meeting, a development driven largely by shareholder proposals and shareholder support for the concept over the past few years.

In the past, shareholder proposals requesting the board to adopt special meeting rights usually sought to grant the right to call the meeting to holders of 10% of outstanding shares, which is a lower level than most companies and many shareholders see as appropriate. In 2015, however, five of the nine shareholder proposals raised the thresholds to 20% and to 25%. The only shareholder proposals that passed for the initial adoption (rather than amendment) of a special meeting right were those with a 20% threshold.

There were 10 unsuccessful proposals to lower the threshold required to call a meeting, for which existing thresholds ranged from 15-50%, and only one successful proposal to lower a threshold from 50% to 25%.

In light of the inability to exclude conflicting proposals, six issuers proposed alternate special meeting proposals in the proxy statement with higher thresholds than the shareholder proposal, and in all but one instance, the management proposals (five of which were at a 25% threshold and one at a 20% threshold) succeeded. All but one of the management proposals were binding charter (and in certain cases related bylaw) amendments. The vote at BorgWarner, which had an 80% vote requirement to amend its charter, resulted in the anomalous outcome that the non-binding 20% proposal succeeded, while the 25% binding provision did not, although the latter received much higher votes in favor. Absent this supermajority vote, this would have been an instance of shareholders approving conflicting proposals. The issuers differed in their approach to the discussion of the conflict if both were approved, from not explaining what it would do, to saying it would implement the management proposal and consider the shareholder proposal, to saying it would implement the management proposal and *not* the shareholder proposal.

All of the foregoing, together with the fact that no shareholder proposal to lower a threshold was successful in either 2013 or 2014, is a clear indication that shareholders do not support 10% thresholds, and that generally a 25% threshold is acceptable. In particular, shareholders are now proposing higher thresholds, and conflicting management proposals with 25% thresholds defeated two 20% shareholder proposals.

Either the Staff will reinstate no-action on the basis of conflicting proposals, or, given the success of the conflicting management proposals this year, issuers are likely to continue proposing conflicting special meeting rights in the proxy statement, so issuers without such provisions should prepare themselves by considering what terms would be acceptable for a special meeting right, although ultimately any decision to make a conflicting proposal would depend in part on the assessment of the likelihood of success of the shareholder proposal. Terms that companies may wish to consider including in any management proposal for a special meeting right include:

- ***Threshold.*** Though practice varies considerably, 25% has emerged as the most common threshold for special meeting rights at public companies. Both Vanguard and T. Rowe Price have indicated that 25% is an appropriate level in their view. The following table shows the threshold for special meeting rights at the 301 S&P 500 companies that are incorporated in Delaware.[13]

SPECIAL MEETING THRESHOLDS (S&P 500 DELAWARE COMPANIES)	
Ownership Threshold for Calling Meeting	***Number of Companies***
No special meeting right	144
50% or more	31
30-40%	9
25%	***74***
20%	17
15%	13
10%	13

- ***Definition of ownership.*** Many companies require "record" ownership of shares (as opposed to "beneficial" ownership), essentially requiring street name holders to work through their securities intermediaries to become a record holder. This eliminates uncertainty as to

[13] Based on data from FactSet Shark Repellent. We have limited this analysis to Delaware companies, because certain other states provide a statutory default special meeting right at 10%.

proof of ownership, but introduces an additional administrative step for shareholders seeking to use the right. In addition, a number of companies have introduced a "net long ownership" concept into their special meeting provision—essentially reducing the shareholders' actual ownership level by any short positions or other hedging of economic exposure to the shares. Companies that do not include a "net long" concept should nevertheless ensure that the information required to be provided by the requesting shareholders includes details of any hedging transactions, so that the company and other shareholders can have a full picture of the requesting shareholders' economic stake in the company.

- ***Pre- and post-meeting blackout periods.*** In order to avoid duplicative or unnecessary meetings, many companies provide that no meeting request will be valid if it is received during a specified period (usually 90 days) before the annual meeting, or during a specified period (usually 90 or 120 days) after a meeting at which a similar matter was on the agenda.
- ***Limitations of matters covered.*** Special meeting provisions typically provide that the special meeting request must specify the matter to be voted on, and that no meeting will be called if, among other things, the matter is not a proper subject for shareholder action. Generally, the only items that may be raised at the special meeting will be the items specified in the meeting request and any other matters that the board determines to include.
- ***Timing of meeting.*** Companies typically provide that the board must set the meeting for a date within 90 days from the receipt of a valid request by the requisite percentage of shareholders. Often, the special meeting provisions provide that, in lieu of calling a special meeting, the company may include the specified item in a meeting called by the company within that same time period.
- ***Holding period.*** A few companies require the requesting shareholders to have held the requisite number of shares for a specified period of time prior to the request.
- ***Inclusion in charter versus bylaws.*** Companies should consider whether to include the special meeting provisions in the charter, the bylaws, or a combination. In most cases, companies include the critical provisions (such as ownership threshold) in the charter so that shareholders cannot unilaterally amend them, but provide the details and mechanics in the bylaws, so they can be adjusted by the board without a shareholder vote.

6. Other Less Successful Proposals

Some less frequent shareholder proposal types are addressed below. These proposal types are likely infrequent because they have been highly unsuccessful during the past few years of annual meetings. 2015 was no exception and generally those proposals that were brought to a vote failed.

- ***Dual Class.*** Proposals to approve a recapitalization plan where all stock has one vote per share are relatively infrequent, occurring only 11 times in 2015 so far. Despite ISS support in 100% of these proposals, only one of them has passed, and the overall average support rate is only 36%, likely because super-voting stockholders vote against these proposals.
- ***Cumulative Voting.*** Only two cumulative voting proposals were brought to vote in 2015, and neither of these proposals passed, garnering support on average of only 24% of votes cast.
- ***Vote on Poison Pills.*** This year, there was one shareholder poison pill proposal requesting the board to seek shareholder approval for the adoption, maintenance or extension of a pill, which passed. In an unusual decision, albeit not with respect to a shareholder proposal, ISS recommended against a management proposal this year for shareholders to approve a pill which had a 20% trigger, a three-year life and which terminated if shares were bought in a permitted offer. ISS found that the automatic termination of the rights in a permitted offer did not satisfy their requirement for a shareholder redemption feature for a qualified offer.

- ***Board Diversity.*** ISS has supported board diversity proposals in a majority of cases since 2012. 2015 was no exception to this and they supported three out of the five proposals thus far. Yet, only one such proposal has passed since 2012 and none of them have passed so far in 2015. They have only received an average support of 13%.
- ***Director Qualifications.*** Shareholder proposals pertaining to director qualifications have been brought to a vote five times so far in 2015. Despite ISS support in two of these proposals, cumulatively they only have garnered an average support of 10% of votes cast and none of them have passed.

Since the above proposals have had such a low rate of success in recent years, we would expect their infrequency to remain consistent going forward. While companies should be aware of these types of proposals, we do not anticipate many companies facing such shareholder proposals for the next season of annual meetings.

E. SOCIAL / POLITICAL SHAREHOLDER PROPOSALS

	SOCIAL/POLITICAL PROPOSALS					
	Total Shareholder Proposals Voted On		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
	2015 YTD	*2014*	*2015 YTD*	*2014*	*2015 YTD*	*2014*
Political issues	63	97	27%	25%	0	6
Environmental issues	64	47	19%	21%	0	0
Human rights issues	16	19	8%	18%	0	0
Sustainability report	18	15	31%	20%	1	0
Anti-discrimination	10	10	15%	30%	0	0
Animal rights	9	6	7%	15%	0	1
Other social policy issues	8	13	11%	9%	0	0

The landscape for proposals on social and political issues was similar so far in 2015 to that in 2014[14]—these proposals continue to be common, but in almost all cases they fail (only one proposal at Nabors Industries requiring the company to report on sustainability matters has received more than 50% of the votes cast in favor), and usually by a wide margin. In 2015, as in 2014, one of the most common types of proposal related to political expenditures and spending—generally, a request for additional disclosure on political expenditures and/or lobbying costs or, in some cases, calls for an advisory vote or prohibition on political spending. In 2015, there has been a substantial increase in the number of proposals relating to environmental issues, but none of these proposals have passed thus far.

ISS supported 70% of the social and political proposals voted on in 2015, which is consistent with 2014 and higher than years prior, though this likely relates more to the types of proposals submitted than any change in ISS policy. Social and political proposals had an average support level of 28% if ISS recommended in favor, and 5% if ISS recommended against. The continued frequency of proposals on

[14] While the number of proposals reported in the table above varies significantly from year to year, the number of proposals thus far in 2015 is approximately the same number of proposals that were present at the same time during 2014. Thus, these proposals tend to be more scattered throughout the year, rather than clustered during the season of annual meetings like many other proposals.

social policy issues, despite their overwhelming failure to receive majority support, suggests that activist shareholders submitting these proposals are content to use corporate proxy statements as a forum for raising social issues in a high-profile manner.

F. COMPENSATION-RELATED SHAREHOLDER PROPOSALS

	COMPENSATION-RELATED PROPOSALS					
	Total Shareholder Proposals Voted On		*Average % of Votes Cast in Favor*		*Shareholder Proposals Passed*	
	2015 YTD	*2014*	*2015 YTD*	*2014*	*2015 YTD*	*2014*
Limit golden parachutes	32	25	36%	38%	4	5
Clawback	15	3	28%	29%	0	0
Stock retention	11	27	23%	22%	0	0
SERP-related	1	2	36%	35%	0	0
Limit death benefits	0	1	N/A	34%	N/A	0
Other compensation-related	15	10	14%	19%	0	0

Compensation-related proposals continue to be predominantly of one type: proposals to prohibit "golden parachutes" in the form of single-trigger accelerated vesting of performance and other equity awards. 2014 was the first time where "golden parachute" proposals actually received the support of a majority of votes cast—five such proposals passed in 2014, and so far in 2015 four such proposals have passed. An increasing number of companies have begun including "double-trigger" termination provisions (*i.e.*, those that accelerate outstanding awards only if a change in control occurs *and* the person is terminated) into their compensation arrangements, which should help a company avoid or defeat a "golden parachute" shareholder proposal.

The number of claw-back proposals, recommending the board adopt a policy requiring the recoupment of incentive compensation under certain circumstances, increased substantially in 2015, but no claw-back proposal was approved by shareholders. Stock retention proposals used to parallel golden parachute proposals in frequency, but so far in 2015 they have decreased dramatically. Proposals on more fundamental compensation issues (such as enhancing pay-for-performance linkage, avoiding repricing of options, and disclosing supplemental executive retirement plan obligations) continue to be far less frequent than they were in the years immediately before the advent of universal advisory say-on-pay votes. Say-on-pay appears to have provided shareholders with an alternative mechanism for expressing concerns over executive compensation.

ISS supported nearly 90% of the compensation-related proposals in 2015, and shareholder support averaged 32% for proposals where ISS recommended in favor, as compared to 5% for proposals where ISS recommended against.

Following increasing focus on director compensation in light of recent Delaware case law, including the *Calma v. Templeton, et al.* decision,[15] we expect to see more management-driven activity during the 2016 proxy season in the area of director compensation. In particular, we expect to see companies increasingly submitting to a shareholder vote limits on the size of equity awards or even total compensation that can be paid to non-employee directors in any particular year, in an effort to reduce the likelihood that individual director compensation decisions will be subject to the "entire fairness" standard of review. It remains to be seen whether an increase in director compensation-related management proposals will cause ISS and others to focus their attentions on director compensation more generally.

G. NOTE ON RECENT LITIGATION DEVELOPMENTS CONCERNING RULE 14A-8

The most common avenue, by far, for attempting to apply the exclusion criteria of Rule 14a-8 to shareholder proposals has been the SEC staff no-action process. In recent years, however, a number of companies have turned to the U.S. federal courts regarding the application of Rule 14a-8.

Shareholders putting forth a proposal also have recently taken to the federal courts. In a high profile case that began in 2014, Trinity Church challenged an SEC no-action letter which granted the exclusion of its proposal directed at gun sales by Wal-Mart. The district court, although choosing not to interfere with Wal-Mart's 2014 annual meeting, ultimately held that Wal-Mart improperly excluded the shareholder proposal because it related to substantial issues of social policy.

On appeal, the Third Circuit reversed the district court's decision, holding that Wal-Mart properly excluded the shareholder proposal. This decision buttresses the Staff's view that proposals seeking a report or board committee action on a particular subject should be analyzed according to whether the underlying subject matter relates to the company's ordinary business operations and provides a framework to evaluate whether a shareholder proposal "transcends" a company's day-to-day operations.[16]

II. ANALYSIS OF ISS NEGATIVE RECOMMENDATIONS AGAINST DIRECTORS

The widespread adoption of majority voting provisions, along with NYSE rule changes in 2009 that prevent brokers from exercising discretion to vote uninstructed shares in uncontested elections, has given

[15] *Calma v. Templeton*, 114 A.3d 563 (Del. Ch. 2015). In *Calma*, which involved a derivative suit challenging non-employee directors' decisions with respect to their own equity compensation, the Delaware Chancery Court confirmed that grants of equity awards to Citrix Systems' non-employee directors under an equity incentive plan that lacked meaningful limits on individual awards were self-dealing transactions subject to the "entire fairness" standard of review. After determining the appropriate standard of review, the Court went on to find that the plaintiff had raised "meaningful questions" as to the appropriateness of Citrix Systems' peer group and declined to dismiss the case at the motion to dismiss stage.

[16] For a discussion of the Third Circuit's opinion, see our publication, dated July 10, 2015, entitled "Excluding Shareholder Proposals—Trinity Wall Street v. Wal-Mart Stores, Inc."

more potency to negative recommendations on, and votes against, directors. "Withhold" or "against" votes on directors (whether they arise from the application of the voting policies of proxy advisory firms and shareholders or from active campaigns launched by dissident shareholders) can have significant direct and indirect effects on companies and their directors, even in uncontested elections.[17] For companies that have majority voting provisions, negative votes can trigger a director resignation policy but, more broadly, negative votes can cause reputational harm to individual directors and the company, discourage qualified directors from continuing to serve (or new qualified candidates from agreeing to be nominated), raise the company's profile as a target for shareholder activists, and generally impair a company's public and investor relations efforts. If a director receives a majority negative vote, the continued service of that director and/or the failure to address the underlying cause for the negative vote may well result in a negative vote for other directors in the following year. Companies should therefore be aware of the primary reasons that shareholders may vote against specific directors, committee members or the board as a whole, and the likely impact of these reasons on voting results.

ISS's policies provide a number of reasons why they will recommend "withhold" or "against" votes on directors. In 2015, ISS issued negative recommendations against approximately 3,560 directors in total, at over 1,200 different companies.[18] Although this level of negative recommendation is meaningfully higher than last year, less than 2% of these directors (about 50, the same as last year) received more "against" votes than "for" votes in 2015. Only five directors at S&P 500 companies received more "against" votes than "for" votes, which is two more directors than in 2014.

The following table summarizes the frequency of negative recommendations, the resulting shareholder vote, and the number of directors receiving less-than-majority support during 2015 for all U.S. public companies for which ISS offers recommendations, broken down by the rationale given by ISS for the negative recommendation:[19]

[17] SEC rules require that, even in an uncontested election, shareholders be given the opportunity to "withhold" votes from, or vote "against," a director. Typically, the option to vote "against" a director rather than "withhold" applies at companies with majority voting provisions. In this publication, we refer to both types of votes as "negative" votes on the director or "votes against" the director.

[18] Data reflected in this part of the publication includes negative vote recommendations through June 30, 2015.

[19] The ISS director recommendation information reflects all recommendations reported to us by ISS, including many non-Russell 3000 companies. The voting results, however, are largely limited to Russell 3000 companies, as many of the other companies are not SEC-reporting companies. This table omits recommendations for which no rationale was included in the data provided by ISS. In addition, there is some overlap in the categories, because some directors received negative recommendations for more than one reason. Because ISS uses different language across its various negative recommendations it is difficult to formulate exact counts for each category, but the data presented represents a reasonable approximation.

	2015 ISS DIRECTOR "WITHHOLD" OR "AGAINST" RECOMMENDATIONS (ALL U.S. COMPANIES)		
	Number of Directors Receiving Negative ISS Recommendations	Average Shareholder Vote for Directors (% of votes cast)	Number of Directors Receiving <50% of Votes Cast
Independence issues (non-independent directors on key committees or failure to maintain a majority independent board)	1192	89%	4
Excessive non-audit fees paid to auditors, or failure to disclose a breakdown of fees	1065	89%	1
Absence of a formal nominating or compensation committee	869	91%	1
Compensation issues	405	84%	5
Poison pill issues (*e.g.*, maintaining a pill with dead-hand provisions or failing to put a pill up for a shareholder vote)	202	82%	3
Taking unilateral action that reduces shareholder rights (primarily via bylaw amendments)	199	88%	3
Lack of responsiveness to shareholder concerns (*e.g.*, failure to implement a successful shareholder proposal)	171	70%	17
Poor attendance at board and committee meetings (<75%)	145	78%	12
Failure to address material weakness in internal controls	128	90%	2
Overboarding	89	82%	1
Failure of risk oversight due to pledging of shares by executives	88	86%	0
Failure to opt out of amendment to Indiana law resulting in classified board	45	83%	1

A. UNILATERAL ACTION BY THE BOARD

The most significant development in 2015 is more than a doubling in the number of withhold recommendations against directors for taking unilateral action that reduced shareholder rights without shareholder approval. The majority of such actions consisted of bylaw amendments, such as the adoption of a fee-shifting bylaw, the elimination of shareholders' rights to call a special meeting, or adopting supermajority vote requirements for certain changes.[20] Despite this increase, directors in this category received average shareholder support of 88% of votes cast, the fourth highest of the withhold recommendation categories listed above. Further, only three directors in this category received less-than-majority support. While this suggests that shareholders broadly do not view a violation of ISS's standards for these actions as a significant concern, the particular circumstances of the individual issuers may be

[20] This increase is primarily driven by unilateral adoptions of a fee-shifting bylaw, accounting for 84 such withhold recommendations in 2015.

more relevant. For example, issuers with high insider holdings or supportive investors may be more likely to adopt such changes because they are less concerned about the impact of a negative recommendation.

Although ISS indicated in its policy updates for 2015 that its adoption of a formal policy to vote against directors if the board unilaterally amends the company's bylaws or charter "in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders" was just a codification of its current approach under its "Governance Failures" policy, the increased number of negative recommendations indicates greater ISS attention to this area. However, half of the negative recommendations related specifically to the adoption of a fee-shifting bylaw, so absent this particular bylaw, the results would have been the same with 2014.[21]

In February 2015, ISS issued an FAQ elaborating what it considered to be changes materially diminishing shareholders rights:

- Materially adverse unilateral amendments include, but are not limited to:
  - Authorized capital increases that do not meet ISS' Capital Structure Framework;
  - Board classification to establish staggered director elections;
  - Director qualification bylaws that disqualify shareholders' nominees or directors who could receive third-party compensation;
  - Fee-shifting bylaws that require a suing shareholder to bear all costs of a legal action that is not 100 percent successful;
  - Increasing the vote requirement for shareholders to amend charter/bylaws;
  - Removing a majority vote standard and substituting plurality voting;
  - Removing or restricting the right of shareholders to call a special meeting (raising thresholds, restricting agenda items); and
  - Removing or materially restricting the shareholder's right to act in lieu of a meeting via written consent.
- Unilaterally adopted bylaw amendments that are considered on a case-by-case basis, but generally are not considered materially adverse:
  - Advance notice bylaws that set customary and reasonable deadlines;
  - Director qualification bylaws that require disclosure of third-party compensation arrangements; and
  - Exclusive Venue/Forum (when the venue is the company's state of incorporation).

21 Effective August 1, 2015, Sections 102 and 109 of the Delaware General Corporation Law provide that the certificate of incorporation and bylaws may not contain any provision imposing liability on a stockholder for attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim. Half of the issuers which received negative board recommendations because of fee-shifting bylaws were not Delaware corporations; of those that were, only one to date seems to have rescinded the bylaw.

B. BOARD RESPONSIVENESS TO SHAREHOLDERS

Withhold recommendations against incumbent directors for a lack of "responsiveness" nearly doubled in 2015 compared to last year—typically, if the board has failed to act on a successful shareholder proposal from a prior year or failed to address the underlying issue that led to a director receiving a majority "against" vote. Although this is far from the most common reason for a negative recommendation, it is clearly the most impactful. Shareholders as a group seem to take this issue particularly seriously—directors in this category received the support of an average of only 70% of votes cast (the lowest of any category). A total of 17 directors received less than 50% of votes cast in favor for a lack of responsiveness, including three of the five S&P 500 directors who received majority negative votes (the other two S&P 500 directors had withhold recommendations for taking unilateral action reducing the rights of the shareholders). Given that this category composes more than 30% of all directors receiving less than 50% of votes cast in favor, issuers should take such responsiveness concerns very seriously.

C. BOARD INDEPENDENCE

The most common rationale for a negative ISS recommendation against a director in 2015 related to independence issues. The number of such withhold recommendations increased substantially over 2014. In particular, ISS will recommend against directors that ISS deems non-independent if, among other things, they serve on the audit, compensation or nominating committee or if the board is not made up of a majority of independent directors under the ISS "independence" standards (which are, in some circumstances, more stringent than the company's own independence policies under stock exchange rules).

Directors in this category received average shareholder support of 89% of votes cast, and only four directors in this category received less-than-majority support. This suggests that shareholders broadly do not view a violation of ISS's strict independence standards as a significant concern.

That said, given the varying independence definitions used by proxy advisory firms and certain institutional investors, companies should consider including in the board's annual independence review process some discussion of whether any particular relationships are expected to trigger adverse recommendations or votes from proxy advisory firms or from the company's significant shareholders. Boards are, of course, in no way required to comply with the director independence definitions of these parties, but an assessment of perceived independence issues under these definitions can help the company identify and prepare for potential adverse votes from shareholders.

D. AUDITOR FEE ISSUES

Auditor fee issues remained a common reason for an ISS negative recommendation in 2015. These recommendations follow the payment of high levels of non-audit fees to the company's independent auditors[22] or (as was more often the case) the failure to disclose a breakdown of fees. These recommendations primarily came at smaller companies that may not have focused as closely on the disclosure in this context. A negative recommendation for this reason, however, seemed to have a limited effect on voting results—directors in this category averaged support levels of 89%.

E. LACK OF FORMAL NOMINATING AND COMPENSATION COMMITTEES

Another common basis for a negative recommendation at smaller companies is the absence of a formal nominating or compensation committee. Under ISS's policies, this will trigger a negative recommendation for all non-independent directors, even if these responsibilities are undertaken by the independent directors as a group, as permitted for listed companies under Nasdaq rules (though, effective in 2014, Nasdaq rules require listed companies to have formal compensation committees). As noted in the table above, ISS issued a significant number of negative recommendations for this reason in 2015, but directors in this category still generally received high levels of shareholder support, indicating that shareholders generally do not share ISS's concerns in this regard. There was only one director in this category with less-than-majority support in this category from a smaller cap company.

F. COMPENSATION ISSUES

At a number of companies, ISS identified various purported deficiencies in the oversight of executive compensation as a basis for negative director recommendations, including approval of problematic pay practices, failure to be responsive to perceived executive compensation best practices and pay-for-performance disconnects. Under ISS's policies, if a management say-on-pay proposal is up for a vote in a particular year, ISS will not issue negative recommendations against directors for compensation-related reasons, except in "egregious situations." Therefore, all negative recommendations for compensation-related reasons in 2015 were either at companies that did not have a say-on-pay vote in 2015 (because they are on a biennial or triennial cycle) or at companies where ISS deemed the compensation oversight concern to be "egregious."

Approximately 84% of the companies that had a director with a negative ISS recommendation in 2015 for compensation-related reasons were in the first category—that is, they did not have a say-on-pay vote in 2015 and, therefore, ISS directed its concerns on compensation issues toward director withhold recommendations (typically against the compensation committee, though "in exceptional cases" ISS will recommend a vote against the full board). The other 16% of companies where directors received negative ISS recommendations in 2015 for compensation-related reasons did have a say-on-pay vote in 2015, but apparently ISS found the compensation-related issues to be sufficiently egregious to warrant negative

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22 Specifically, ISS will consider non-audit fees to be excessive if the non-audit ("other") fees are greater than the sum of audit fees, audit-related fees and tax compliance/preparation fees. Typically, this leads to a recommendation against all audit committee members.

recommendations against directors anyway. Of these 27 companies, 25 had received less than 70% favorable votes on say-on-pay in 2014, with nine receiving less than 50%, and almost all of the ISS recommendations focused on the issuer's failure to respond to the concerns underlying those results. In three of those recommendations, ISS focused on the lack of disclosure concerning outreach efforts, as opposed to substantive changes in compensation practices. The average level of shareholder support for directors receiving negative ISS recommendations for compensation-related reasons was 84% of votes cast, but was 59% for the directors of companies which had received a lower than 70% approval for say-on-pay in the prior year, and 49% where the say-on-pay result was below 50% in the prior year. These results reflect the importance for companies that had low say-on-pay results to focus their efforts on engaging in shareholder outreach efforts, and disclosing those outreach efforts and any resulting compensation changes, to demonstrate to ISS and shareholders that management has taken action with respect to the prior year's vote.

G. POISON PILL ISSUES

Another relatively impactful, in terms of the resulting shareholder vote, reason for a negative recommendation in 2015 involved poison pill issues. In particular, ISS will recommend against directors if:

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

Shareholders generally tended to follow ISS's recommendation in this situation more than in other situations (other than lack of responsiveness)—directors receiving negative recommendations for this reason had average voter support of only 82% and three directors received less-than-majority support for this reason.

H. POOR ATTENDANCE AND OVERBOARDING

ISS will recommend a negative vote in the case of a director that attended less than 75% of all board and committee meetings in the relevant year. This also appears to be a significant issue for shareholders as nearly 25% of directors who received a majority withhold were in this category. In addition, ISS will recommend a negative vote in the case of directors that:

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

I. PLEDGING BY INSIDERS

2015 was the third year under ISS's new policy under which any amount of hedging or the significant pledging of stock by directors or executives will be viewed as a "failure of risk oversight" that can lead to recommendations against some or all directors. ISS's FAQs provide that "whether pledged securities were 'significant' for director recommendation purposes is determined by measuring the aggregate pledged shares in terms of common shares outstanding or market value or trading volume."[23]

ISS does not provide a bright line percentage that will be considered "significant" for these purposes. However, based on our review of the ISS recommendations, these negative recommendations were made at companies where the amount of stock pledged by insiders ranged from 2.8% to 62.8% of the stock outstanding.

A total of 88 directors received negative recommendations in 2015 due to pledging by insiders, approximately doubling the amount of such withholds in 2014. Voting results for these directors averaged 86%, and none received less-than-majority support. No directors received negative recommendations due to hedging by insiders (due, perhaps, to the fact that, unlike pledging, there is no proxy requirement to disclose specific hedging arrangements by insiders), although such information is available on Forms 4.

III. SAY-ON-PAY VOTES

2015 was the fifth year of say-on-pay votes under SEC Rule 14a-21(a), which was adopted in 2011 to implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The following table summarizes the 2014 and 2015 say-on-pay voting results:

	All U.S. Companies		*S&P 500*	
	2015 YTD	*2014*	*2015 YTD*	*2014*
Total Number of Proposals	1926	2470	415	500
Total Number of Passing Proposals	1848	2397	408	494
Average Support	92%	92%	92%	93%
Negative ISS Recommendations	233 (12%)	317 (13%)	37 (9%)	42 (8%)
Average support with ISS positive recommendation	95%	95%	95%	95%
Average support with ISS negative recommendation	65%	67%	68%	68%
Votes failed (<50% support of votes cast)	39 (2%)	53 (2%)	3 (1%)	5 (1%)
Votes with <70% support of votes cast	136 (7%)	184 (7%)	23 (6%)	25 (5%)

23 ISS notes, however, that it deems *any* pledging of stock by an insider not to be a responsible use of company equity. Any amount of pledged stock by a director or officer will be a negative factor in the company's corporate governance rating under ISS's QuickScore rating system.

U.S. companies, broadly speaking, had similar results on say-on-pay votes in 2015 as compared to 2014. There continues to be significant year-over-year turnover in failed votes—of the three S&P 500 companies that have failed their say-on-pay votes so far in 2015, all had successful votes in 2014, by wide margins. Of the five S&P 500 companies that had failed say-on-pay votes in 2014, four have had their 2015 vote to date, and all of them received majority shareholder support (over 95% support in three of these cases).

The generally low rate of negative results is largely a result of the efforts that companies, particularly larger companies, have made to engage with shareholders, understand their concerns, and address these concerns through changes in compensation practices and/or clearer compensation disclosure. Both companies and shareholders, as well as shareholder advisory firms, have become more adept at effective off-season communications where the company can obtain feedback on the most recent voting results, as well as expectations and concerns for the coming year. These off-season communications, which have become a regular feature of corporate governance and shareholder relations for many large companies, help the company anticipate and address shareholder concerns, whether by adjusting compensation practices, crafting responsive disclosure, or both. Increasingly, these off-season communications serve to facilitate discussion on topics other than compensation as well.

Shareholder outreach takes various forms at different companies, including face-to-face meetings, one-on-one phone calls, group conference calls and web meetings, and, in some cases, includes board members. Companies conducting such outreach must be mindful that company representatives may not disclose material non-public information in these discussions due to selective disclosure concerns under Regulation FD. This is typically not a concern, however, because the purpose of these meetings is for the company to gather information from shareholders—that is, primarily to listen. Companies with largely retail shareholder bases, of course, necessarily must engage in much of these outreach efforts through their ongoing public disclosure.

In addition, companies should ensure that the appropriate personnel at institutional clients are involved in the discussions and the decision process—often institutional investors have both governance experts and investment professionals, each of whom will have critical input into the voting process, but may have differing views.

Companies have increasingly engaged with proxy advisory firms in the off-season as well—for example, to address any misconceptions evident from the prior vote and to discuss issues that may be relevant to the next year's vote. ISS[24] and Glass Lewis[25] post their engagement policies on their websites. The

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

[25] Glass Lewis's engagement policies are available at http://www.glasslewis.com/for-issuers/glass-lewis-corporate-engagement-policy/.

policies of both firms restrict their ability to engage with companies during the solicitation period for the annual meeting, which means broader discussions with these firms can occur in the off-season.

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CONTACTING SULLIVAN & CROMWELL LLP

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CONTACTS

New York

Frank J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Jay Clayton	+1-212-558-3445	claytonwj@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohena@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Matthew M. Friestedt	+1-212-558-3370	friestedtm@sullcrom.com
Joseph B. Frumkin	+1-212-558-4101	frumkinj@sullcrom.com
David B. Harms	+1-212-558-3882	harmsd@sullcrom.com
Alexandra D. Korry	+1-212-558-4370	korrya@sullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Glen T. Schleyer	+1-212-558-7284	schleyerg@sullcrom.com
Marc Trevino	+1-212-558-4239	trevinom@sullcrom.com

Washington, D.C.		
Janet T. Geldzahler	+1-202-956-7515	geldzahlerj@sullcrom.com
Eric J. Kadel Jr.	+1-202-956-7640	kadelej@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Los Angeles		
Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
Palo Alto		
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com
London		
Nikolaos G. Andronikos	+44-20-7959-8470	andronikosn@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
Richard C. Morrissey	+44-20-7959-8520	morrisseyr@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com
George H. White III	+44-20-7959-8570	whiteg@sullcrom.com
Paris		
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Frankfurt		
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
David Rockwell	+49-69-4272-5533	rockwelld@sullcrom.com
Melbourne		
Robert Chu	+61-3-9635-1506	chur@sullcrom.com
Sydney		
Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
Tokyo		
Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
William Y. Chua	+852-2826-8632	chuaw@sullcrom.com
Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
John D. Young Jr.	+852-2826-8668	youngj@sullcrom.com
Beijing		
Garth W. Bray	+86-10-5923-5958	brayg@sullcrom.com