GIBSON DUNN

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GLASS LEWIS ISSUES 2019 PROXY VOTING POLICY UPDATES

To Our Clients and Friends:

On October 24, 2018, Glass Lewis released its updated U.S. proxy voting policy guidelines for 2019, including guidelines for shareholder proposals. The updated U.S. guidelines are available here, and the guidelines on shareholder proposals are available here. The most significant updates to the guidelines are summarized below. The updated U.S. proxy voting guidelines include discussion of two previously announced policy changes that will take effect for meetings held after January 1, 2019, relating to board gender diversity and virtual-only annual meetings.

Board Gender Diversity

As previously announced, for a company that has no female directors, Glass Lewis generally will begin recommending votes "against" the nominating/governance committee chair, and may also recommend votes "against" other committee members depending on factors such as the company's size, industry, state of headquarters, and governance profile.

Glass Lewis will "carefully review a company's disclosure of its diversity considerations" and may not recommend votes "against" directors when the board has provided a "sufficient rationale" for the absence of any female board members. Such rationale may include any notable restrictions on the board's composition (e.g., the existence of director nomination agreements with significant investors) or disclosure of a timetable for addressing the board's lack of diversity.

In light of California's recently enacted legislation requiring a minimum number of women on public company boards (discussed here), which includes having at least one woman by the end of 2019, Glass Lewis will recommend votes "against" the nominating/governance committee chair at companies headquartered in California that do not have at least one woman on the board and do not disclose a "clear plan" for addressing this issue before the end of 2019.

Conflicting Shareholder Proposals

Glass Lewis updated its policy on conflicting shareholder proposals to address special meeting proposals specifically. These updates respond to developments during the 2018 proxy season, when the Securities and Exchange Commission (the "SEC") staff permitted companies to exclude "conflicting" special meeting shareholder proposals when seeking shareholder ratification of an existing special meeting right with a higher ownership threshold.

The updated policy states that Glass Lewis generally favors a 10%-15% special meeting right and will generally recommend votes "for" shareholder and company proposals within this range. When companies exclude a special meeting shareholder proposal by seeking ratification of an existing special meeting right, Glass Lewis will recommend votes "against" both the company's ratification proposal and the members of the nominating/governance committee.

When the proxy statement includes both shareholder and company proposals on special meetings:

- Where the proposals have different thresholds for requesting a special meeting, Glass Lewis will generally recommend voting "for" the lower threshold (typically the shareholder proposal); and

- Where the company does not currently have a special meeting right, Glass Lewis may recommend that shareholders vote "for" the shareholder proposal and abstain from the company proposal seeking to establish a special meeting right. Glass Lewis views the practice of abstaining as a means for shareholders to signal their preference for an appropriate special meeting threshold while not directly opposing establishment of a special meeting right.

While it appears that the special meeting threshold will be the primary focus of Glass Lewis's analysis, Glass Lewis also will consider the company's overall governance profile, including its responsiveness to and engagement with shareholders.

Director Voting Recommendations Based on Excluded Shareholder Proposals

With respect to the exclusion of shareholder proposals more generally, Glass Lewis states in the updated policy that "it generally believe[s] that companies should not limit investors' ability to vote on shareholder proposals that advance certain rights or promote beneficial disclosure." In light of this, Glass Lewis will make note of instances where a company has successfully petitioned the SEC to exclude shareholder proposals and, "in certain very limited circumstances," may recommend votes "against" the members of the nominating/governance committee if it believes exclusion of a shareholder proposal was "detrimental to shareholders."

Environmental and Social Risk Oversight

Glass Lewis believes that companies should have "appropriate board-level oversight of material risks" to their operations, including those that are environmental and social in nature. For large cap companies or companies where Glass Lewis identifies "material oversight issues," Glass Lewis will seek to identify the directors or committees charged with oversight of environmental and social issues, and will note instances where companies have not clearly defined this oversight in their governance documents.

Where Glass Lewis believes that a company has not properly managed or mitigated environmental or social risks "to the detriment of shareholder value," Glass Lewis may recommend votes "against" directors who are responsible for oversight of environmental and social risks. If there is no explicit board oversight of environmental and social issues, Glass Lewis may recommend votes "against" members of the audit committee.

Ratification of Auditor: Additional Considerations

Glass Lewis's policies list situations in which it may recommend votes "against" ratification of the outside auditor. Under the 2019 policy updates, Glass Lewis will consider factors that may call into question an auditor's effectiveness, including auditor tenure, any pattern of inaccurate audits, and any ongoing litigation or controversies. In "limited cases," these factors may lead to a recommendation "against" auditor ratification.

Virtual-Only Shareholder Meetings

As previously announced, Glass Lewis's new policy on virtual-only shareholder meetings will take effect January 1, 2019. Under this policy, for a company that chooses to hold a virtual-only meeting, Glass Lewis will analyze the company's disclosure of its virtual meeting procedures and may recommend votes "against" the members of the nominating/governance committee if the company does not provide "effective" disclosure assuring that shareholders will have the same opportunities to participate at the virtual meeting as they would at in-person meetings.

Examples of effective disclosure include descriptions of how shareholders can ask questions during the meeting, the company's guidelines on how questions and comments will be recognized and disclosed to meeting participants, procedures for posting questions and answers on the company's website as soon as practical after the meeting, and how the company will deal with any potential technical issues regarding accessing the virtual meeting including providing technical support.

Director Recommendations Based on Company Performance

Glass Lewis typically recommends that shareholders vote against directors who have served on boards or as executives at companies with "indicators of mismanagement or actions against the interests of shareholders." One instance where Glass Lewis may issue an "against" recommendation is where a company's performance for the past three years has been in the bottom quartile of the sector and the board has not taken reasonable steps to address the poor performance. For 2019, Glass Lewis has clarified that rather than looking solely at stock price performance, it will also consider the company's overall corporate governance, pay-for-performance alignment, and board responsiveness to shareholders, in order to assess whether "the company performed significantly worse than its peers."

Directors Who Provide Consulting Services

Under its voting policies on conflicts of interest, Glass Lewis recommends that shareholders vote "against" directors who provide, or whose immediate family members provide, material professional services to the company, including legal, consulting or financial services. Beginning in 2019, Glass Lewis will generally refrain from voting against directors who provide consulting services if they do not serve on the audit, compensation or nominating/governance committees and Glass Lewis has not identified "significant governance concerns" at the company.

Executive Compensation

Glass Lewis clarified or amended several executive compensation policies:

- *Say-on-pay voting recommendations*. Glass Lewis has provided additional guidance on how it evaluates executive compensation programs in making recommendations on say-on-pay proposals. In particular, Glass Lewis evaluates both the structure of a company's program and the company's disclosures, in each case using a rating scale of "Good," "Fair" and "Poor." According to Glass Lewis, most companies receive a "Fair" rating for both structure and disclosure, and the other two ratings primarily highlight companies that are outliers.

- *Peer group and other practices*. Glass Lewis's say-on-pay policy identifies practices that may lead to an "against" recommendation for say-on-pay proposals. The 2019 updates clarify that these practices may also influence Glass Lewis's evaluation of the structure of a company's compensation program. The updates also provide more detail on the peer group practices that Glass Lewis views as problematic. These practices now will include the use of outsized peer groups and compensation targets set well above peers.

- *Pay-for-performance assessment*. Glass Lewis uses a grading system of "A" through "F" to benchmark executive pay and company performance against a peer group. The updated voting policies clarify that the grades represent the relationship between a company's percentile rank for pay and its percentile rank for performance. In other words, a grade of "A" reflects that a company's percentile rank for pay is significantly less than its percentile rank for performance, while a grade of "F" reflects that the pay ranking is significantly higher than the performance ranking. Separately, the analysis in Glass Lewis's proxy papers reflects a comparison between a company and its peer group, with respect to both pay levels and performance.

- *Added excise tax gross-ups*. Glass Lewis may recommend votes "against" all members of the compensation committee if executive employment agreements contain new excise tax gross-up provisions, particularly if the company had previously committed not to provide gross-ups. New gross-up provisions related to excise taxes on excess parachute payments also may lead to votes "against" a company's say-on-pay proposal.

- *Sign-on and severance arrangements*. Glass Lewis has clarified the terms of sign-on and severance arrangements that may contribute to negative voting recommendations on say-on-pay proposals. Glass Lewis will consider the size and design of any contractual payments, as well as U.S. market practice. Excessive sign-on awards may support or drive a negative voting recommendation, and multi-year guaranteed bonuses may drive "against" recommendations on their own. In addition to the size of contractual payments, Glass Lewis will consider their terms. Key man clauses, board continuity conditions, or excessively broad change in control triggers may help drive a negative voting recommendation. In general, Glass Lewis will be wary of terms that are "excessively restrictive" in favor of an executive or could incentive behaviors that are not in a company's best interests. Glass Lewis believes companies should abide by pre-determined severance amounts in most circumstances, and will consider severance amounts actually paid and in "special cases," their appropriateness given the circumstances of the executive's departure.

- *Grants of front-loaded awards*. Glass Lewis has added a new discussion of "front-loading," or providing large grants intended to serve as compensation for multiple years. In making recommendations on say-on-pay proposals, Glass Lewis will apply particular scrutiny to front-loaded awards. It will consider a company's rationale for front-loaded awards and expects companies to include a firm commitment not to grant additional awards for a defined period. If a company breaks this commitment, Glass Lewis may recommend "against" the company's say-on-pay proposal unless the company provides a "convincing" rationale.

- *Clawbacks*. Glass Lewis will begin looking beyond the minimum legal requirements for clawbacks and considering the specific terms of companies' clawback policies. According to the updated voting policies, Glass Lewis believes that clawbacks "should be triggered, at a minimum, in the event of a restatement of financial results or similar revision of performance indicators upon which bonuses were based." Clawback policies that simply track minimum legal requirements "may inform" Glass Lewis's overall view of a company's compensation program.

- *Discretionary short-term incentives*. Glass Lewis will not recommend votes "against" a say-on-pay proposal solely based on a company's use of discretionary short-term bonuses if there is meaningful disclosure of the rationale behind the use of a discretionary mechanism and the bonus amount determinations. However, other "significant" issues, such as a disconnect between pay and performance, may help drive a negative voting recommendation.

- *Equity plans that cover directors*. Glass Lewis continues to believe that equity grants to directors should not be performance-based. Where an equity plan covers non-management directors exclusively or primarily, the updated voting policies state that the plan should not provide for any performance-based awards. Where non-management director grants are made under a broad-based equity plan, Glass Lewis will continue to use its proprietary model to guide its voting recommendations. However, beginning in 2019, if a broad-based plan allows or explicitly provides for performance-based awards to directors, Glass Lewis may recommend "against" the plan on this basis, particularly if the company has granted performance-based awards to directors in the past.

- *Reduced executive compensation disclosure for smaller reporting companies*. Glass Lewis may recommend votes "against" all compensation committee members when the board has "materially decreased" proxy disclosure about executive compensation practices in a manner that "substantially impacts" shareholders' ability to make an informed assessment of a company's executive compensation practices. In its summary of the 2019 policy updates, Glass Lewis indicates that this new policy applies to smaller reporting companies, in light of recent SEC rule changes to the definition of "smaller reporting company" that expand the number of registrants qualifying for scaled disclosure accommodations in their SEC filings, including in the area of executive compensation.

Shareholder Proposals

In addition to special meeting shareholder proposals (discussed above), Glass Lewis has also updated its policies on other shareholder proposals in several respects:

- *Environmental and social proposals*. Glass Lewis has formalized the role that financial materiality will play in its consideration of environmental and social proposals. In the discussion of its "Overall Approach" to these proposals, Glass Lewis states that it will evaluate shareholder proposals on environmental and social issues "in the context of the financial materiality of the issue to the company's operations" and will "place a significant emphasis on the financial implications of a company adopting, or not adopting" a proposal. Glass Lewis believes that all companies face risks associated with environmental and social issues, but that these risks manifest themselves differently at different companies, based on factors including a company's operations, workforce, structure and geography. Glass Lewis plans to use the standards developed by the Sustainability Accounting Standards Board ("SASB") to assist it in determining financial materiality.

- *Written consent proposals*. If a company has adopted a special meeting right of 15% or lower and reasonable proxy access provisions, Glass Lewis will generally recommend that shareholders vote "against" a shareholder proposal seeking the right for shareholders to act by written consent.

Workforce diversity. Glass Lewis has adopted a formal policy on shareholder proposals asking companies to provide disclosure about workforce diversity or efforts to promote diversity within the workforce. In making voting recommendations, Glass Lewis will consider a company's industry and the nature of its operations, the company's current disclosures on issues involving workforce diversity, the level of disclosure at peer companies, and any lawsuits or accusations of discrimination within the company.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have about these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, or any of the following lawyers in the firm's Securities Regulation and Corporate Governance and Executive Compensation and Employee Benefits practice groups:

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