

## ADVISORY | Securities and Capital Markets

November 10, 2014

### REMINDERS FOR THE 2015 PROXY SEASON

This is the time of year when many calendar year-end companies are busy preparing for annual meetings and related proxy soliciting activities. As part of that preparation, companies are focusing on proxy advisory firms, which are publishing new policy updates and providing other information relevant to the 2015 proxy season, as well as deadlines for shareholder proposals, which are quickly approaching. This advisory provides some reminders and other notes for companies to keep in mind as they prepare for the 2015 proxy season.

#### PROXY ADVISORY FIRM UPDATES

- **ISS to Launch QuickScore 3.0.** On November 24, 2014, Institutional Shareholder Services (ISS) will launch the latest version of its corporate governance ratings system, QuickScore 3.0. QuickScore is a scoring system designed by ISS to help investors identify corporate governance risks. It is one of many tools that institutional investors rely upon in making their voting decisions. The latest version of QuickScore will include updated factors used by ISS to determine a company's rating, including new thresholds relating to the election of directors and say-on-pay votes. Previously, QuickScore gave lower scores to companies with directors who received less than 95 percent shareholder approval. QuickScore 3.0 will lower the threshold to 80 percent. For say-on-pay votes, ISS will now apply a 70 percent shareholder approval threshold rather than an approval threshold tied to an index/industry average. Other new factors to be considered by ISS will include (i) disclosure regarding annual board evaluations, (ii) the gender diversity of the board, (iii) whether there is a sunset provision for any unequal voting rights, (iv) the number of financial experts on the audit committee, and (v) whether a company's poison pill has a Three-Year Independent Director Evaluation, or TIDE, provision which requires that a committee of the board comprised of independent directors meet at least once every three years to review the company's poison pill.
- **November 14 Deadline for Verifying the Data Used by ISS.** Companies should review and verify the information about themselves that ISS will use in calculating QuickScores. The verification period opened on November 3, 2014 and any updates or corrections must be submitted by 8:00 P.M. (EST) on November 14, 2014. The data verification site is accessible through ISS' Governance Analytics website at: <https://ga.isscorporateservices.com>.
- **ISS Releases its 2015 Updates to its Benchmark Proxy Voting Guidelines.** Released on November 6, 2014 and effective for shareholder meetings on or after February 1, 2015, ISS's updated proxy voting guidelines include a number of policies applicable to US companies.<sup>1</sup>
  - **ISS will change its approach to independent board chair shareholder proposals.** ISS has historically recommended a "For" vote for shareholder proposals calling for an independent board chair, unless the company meets six specified criteria. ISS has made changes to this policy under which it will now consider, among other factors, (i) the absence or presence of an executive chair, (ii) recent board or executive

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<sup>1</sup> ISS' complete proxy voting guidelines are available at <http://www.issgovernance.com/file/policy/2015USPolicyUpdates.pdf>

leadership transitions, and (iii) director/CEO tenure. In addition, ISS proposes to change its approach for review from one where there is a presumption that it will recommend a vote against directors where certain factors are present to a “holistic” approach that will take all factors into consideration.

- **ISS Announces New Scorecard Approach to Equity Plans.** ISS has announced its new Equity Plan Scorecard (“EPSC”) policy, a “scorecard” approach to evaluating equity plan proposals for the 2015 proxy season. Historically, ISS recommended votes “For” or “Against” a company’s equity plan based on a series of specific pass/fail tests (e.g., ISS will recommend a vote “Against” a company’s equity plan if the total cost of the company’s plans is unreasonable, or if the plan includes certain undesirable features). Under the EPSC policy, ISS will take a more “flexible” approach and instead consider a range of criteria in three categories: plan cost, plan features and grant practices. Each company will be given a weighted, positive or negative score for each of these factors, and the total EPSC score received by a company will generally determine whether ISS will recommend a vote “For” or “Against” the plan. Companies will have an opportunity to verify the company-specific information that will be used by the EPSC by logging in to <http://www.issgovernance.com/equity-plan-data-verification-webform>. This website can be accessed during the verification window that typically opens within two weeks of the filing of definitive proxy materials.
- **Glass Lewis Releases its 2015 Policy Guidelines.** Glass Lewis has released its policy guidelines for 2015.<sup>2</sup> Among these guidelines, Glass Lewis has adopted a new policy for the upcoming proxy season in which it may recommend that shareholders vote “Against” the chairman of the governance committee, or the entire committee, in certain instances where a board has amended the company’s governing documents to reduce or remove important shareholder rights and has done so without shareholder approval. This will likely influence companies that are considering exclusive forum or fee shifting bylaw provisions, or similar governance changes. The updated guidelines also include new provisions pursuant to which Glass Lewis will more closely scrutinize companies’ charter and bylaws prior to an IPO. Specifically, Glass Lewis will consider recommending a vote “Against” the governance committee chair, the entire governance committee, or all members of the board who served at the time of the adoption of an anti-takeover provision, exclusive forum provision or fee-shifting provision in the company’s bylaws, if such provisions are not put up for shareholder vote following the company’s IPO. The updates also contain other noteworthy changes, including changes relating to how Glass Lewis will approach company responses to majority supported shareholder proposals, related party transactions, off-cycle compensation awards, and employee stock purchase plans.

## SHAREHOLDER PROPOSAL REMINDERS

Below are a few important things for companies to keep in mind as shareholder proposals start to arrive in connection with the 2015 proxy season.

- **Only 15 Days to Review and Respond to Proposals.** The proxy rules give a company only 15 days from the date of receipt of a shareholder proposal to notify the shareholder of deficiencies in its proposal. Consequently, it is important for companies to be on alert for shareholder proposals in order to ensure sufficient time to evaluate them for possible deficiencies. In our experience, every year some shareholder proposals are not given attention and sit for days before they are routed to a company’s corporate secretary or general counsel.

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<sup>2</sup> Glass-Lewis’ complete policy guidelines are available at:  
[http://www.glasslewis.com/assets/uploads/2013/12/2015\\_GUIDELINES\\_United\\_States.pdf](http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf)

- **Allow Time For Revisions.** Under a policy that was articulated by the U.S. Securities and Exchange Commission (“SEC”) in 2011<sup>3</sup>, a shareholder may not make revisions to his or her proposal after the deadline for submitting proposals to the company. Consequently, once a company receives a shareholder proposal, it should wait until after that deadline before submitting a request to the SEC staff for a no-action letter. Thereafter, such request should be made as soon as practicable, and certainly before the no-action request submission deadline in Rule 14a-8.<sup>4</sup>
- **Deficiency Notices.** Generally, a company may only omit a shareholder proposal based on a defect in eligibility or procedure when (i) it has provided written notice to the shareholder of the defect in the shareholder’s submission within 14 calendar days of receiving the proposal, and (ii) the shareholder has failed to respond to the notice or cure the defect within 14 calendar days of receiving the deficiency notice.<sup>5</sup> When drafting a deficiency notice, a company should:
  - provide adequate detail about what the shareholder must do to remedy all eligibility or procedural defects;
  - explicitly state that the shareholder must respond to the company’s notice within 14 calendar days of receiving the notice of defect(s); and
  - send the notification by a means that allows the company to determine when the shareholder received the notice.<sup>6</sup>

Companies should also include a copy of Rule 14a-8 in their deficiency notices.<sup>7</sup> If the shareholder fails to respond or provides an inadequate response to a notification that has been made with these considerations in mind, the staff generally will grant relief.

## SHAREHOLDER PROPOSALS: TRENDS

In 2014, the number of shareholder proposals submitted to public companies decreased slightly from 2013, continuing a decline that began in 2010 when the say-on-pay vote became mandatory under the Dodd-Frank Act. Notwithstanding this decline, Rule 14a-8 continues to be an important tool for shareholders seeking to effect changes in corporate governance. The following are key shareholder proposal topics that we observed in 2014 and expect to see in 2015:

- **Political Spending and Lobbying.** Political spending and lobbying activity topped the list for individual shareholder proposal topics in 2014. 86 proposals were submitted to a vote; five received over 40 percent of votes cast. An increasing number of companies are providing disclosures regarding their political spending and lobbying activities,<sup>8</sup> but shareholder activists remain unsatisfied with the lack of disclosure regarding contributions to trade associations and social welfare organizations.<sup>9</sup> With major players like the Center for Public Accountability expanding its index of political spending disclosures to include the top 300 companies, we expect to see more companies receive political spending and lobbying proposals from shareholders in 2015.

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<sup>3</sup> See Staff Legal Bulletin No. 14F (CF), *Shareholder Proposals* (Oct. 18, 2011).

<sup>4</sup> *Id.*

<sup>5</sup> See Rule 14a-8(f).

<sup>6</sup> See Staff Legal Bulletin No. 14 (CF), *Shareholder Proposals* (Jul. 13, 2001).

<sup>7</sup> *Id.*

<sup>8</sup> Reflecting the increased focus on these issues, in 2014 more than 130 companies voluntarily included disclosure regarding their political activity despite not having been the target of any shareholder activism on the subject. See *The 2014 CPA-Zicklin Index of Corporate Political Disclosure and Accountability*, The Center for Political Accountability (Sept. 24, 2014).

<sup>9</sup> See Melissa Aguilar and Matteo Tonello, *Proxy Voting Analytics (2010-2014)*, The Conference Board (November 2014).

- **Executive Compensation.** Executive compensation proposals continued to be a focal point for shareholders in 2014 and are expected to be so again in 2015. In 2014, the most common topics in this area included clawback provisions, the imposition of policies that executives hold shares until retirement, and limitations on the accelerated vesting of equity awards.

One new executive compensation proposal that was submitted to a number of companies in 2014 sought to take advantage of the anticipated executive compensation pay ratio disclosures mandated by the Dodd-Frank Act. Under that proposal, boards were asked to limit the individual total compensation paid to each named executive officer to 99 times the median annual total compensation paid to all employees.<sup>10</sup> The proposal was excluded on procedural grounds by many companies in 2014, but no companies were able to exclude the proposal on substantive grounds. We expect many more such proposals to be submitted in 2015 in anticipation of the SEC's adoption of its proposed pay ratio rule.<sup>11</sup>

- **Cybersecurity and Data Protection.** The SEC expressed its views regarding cybersecurity disclosure issues when it issued guidance on the topic in 2011. More recently, it held a roundtable on cybersecurity in March 2014.<sup>12</sup> In 2014, a number of companies received proposals regarding cybersecurity and data protection issues. These ranged from proposals requesting that companies publish reports on their responses to requests for customer information by US and foreign governments<sup>13</sup> to proposals regarding how boards oversee privacy and data security risks.<sup>14</sup> Some companies were able to exclude these proposals on procedural grounds, but many survived challenge. In light of the continued focus on these matters from all sides, we expect many more companies to receive proposals on cybersecurity and data protection in 2015.

- **Shareholder Access.** We expect an increase in the number of shareholder access proposals submitted in 2015. Shareholder access proposals seek the adoption of governance policies that allow shareholders to include their nominees to the board on a company's proxy card, along with the company's nominees. In 2014, there were 13 shareholder access proposals voted upon, which received average support levels of 39.1 percent. For the 2015 season, this number is likely to increase markedly, due largely to a new initiative announced by the New York City Pension Funds. This initiative, which is called the Boardroom Accountability Project, is a national campaign to get more companies to adopt shareholder access regimes. The project kicked off with a submission of proxy access proposals to 75 companies.<sup>15</sup> The proposals request that the board adopt a bylaw provision that would give shareholders who own three percent of a company's equity securities for at least three years the right to include nominees in the company's proxy materials (with the number of shareholder nominees appearing in such proxy materials not to exceed 25 percent of the number of current directors).<sup>16</sup>

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Covington has extensive expertise in these areas and would be happy to assist companies with their plans for the 2015 proxy season.

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<sup>10</sup> See, e.g., *Exelon Corporation*, SEC No-Action Letter (Jan. 2, 2014)

<sup>11</sup> See SEC Release No. 33-9452, *Pay Ratio Disclosure* (Sept. 18, 2013).

<sup>12</sup> See the transcript of the U.S. Securities and Exchange Commission Cybersecurity Roundtable (Mar. 26, 2014). (available at <http://www.sec.gov/spotlight/cybersecurity-roundtable.shtml>)

<sup>13</sup> See, e.g., *Verizon communications Inc.*, SEC No-Action Letter (Feb. 7, 2014).

<sup>14</sup> See, e.g., *AT&T, Inc.*, SEC No-Action Letter (Feb. 21, 2014)

<sup>15</sup> The targeted companies were chosen based on issues that have taken priority with shareholders: climate change, board diversity and CEO pay. 33 of the companies are carbon-intensive coal, oil and gas, or utility companies, 24 companies have little to no gender, racial or ethnic diversity on the board, and 25 companies received substantial opposition to their 2014 say-on-pay vote. See the complete list of companies at <http://comptroller.nyc.gov/boardroom-accountability/bap-companies/>

<sup>16</sup> See the full proposal at <http://comptroller.nyc.gov/wp-content/uploads/2014/11/Model-Proxy-Access.pdf>

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