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2018 ANNUAL MEETING HOT TOPICS AND WHAT IT MEANS FOR 2019

Amy I. Pandit
Mims Maynard Zabriskie

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Overview

- I. 2018 Annual Meeting Hot Topics
- II. 2018 Director-Related Developments
- III. 2018 Stockholder Proposals

2018 ANNUAL MEETING HOT TOPICS

2018 Proxy Season Developments

- CEO Pay Ratio
 - As of July 2018, Semler Brossy reported a 71:1 ratio for Russell 3000 companies (median compensation is \$63,804)
 - Ratio was generally greatest with Consumer Discretionary or Retail companies
- Say-on-Pay ("SOP") vote
 - Approximately 2.6% of SOP proposals have failed to date for Russell 3000 companies
 - 2018 SOP support fell behind 2017, with failure rate doubling with upswing in failures at S&P 500 companies
 - Reasons for failure are primarily (i) mismatch between executive pay and company performance (such as lack of rigor in goals) and (ii) lack of responsiveness to stockholder concerns

2018 Proxy Season Developments (cont.)

- SEC renewed focus on perk disclosure
 - Dow Chemical fined \$1.75M (\$3M of perk omissions over four years)
 - The company relied on an improper standard of business purpose to exclude perks
 - SEC order also requires Dow Chemical to retain an independent consultant for a one-year period to review perk policies, controls and training and then report to the company and SEC regarding its recommendations (i.e., to comply with Item 402 and adopt appropriate internal controls)
 - Recent Energy XXI enforcement action for failure to disclose at least \$1M of CEO perks over a five-year period

2018 Proxy Season Developments (cont.)

- Metric selection and goal setting
 - Executive compensation has become a way for stockholders to understand the connection between what management and the Board view as long-term value drivers and company actions to achieve such goals
 - Rigor of goal setting is a key element of executive compensation analysis
 - ISS has identified as a red flag setting targets below prior year achievement
- Emerging issues with stock repurchase programs and incentive compensation metrics
 - Many companies have announced stock repurchase programs
 - Investor criticism and even stockholder proposals highlight concerns about stock repurchase programs positively affecting calculation of incentive metric pay-outs with goals such as EPS

Section 162(m) Developments

- 2017 Tax Cuts and Jobs Act made significant changes to Section 162(m) \$1M deduction limitation
 - Includes CFO as a covered employee
 - Eliminates exceptions for commissions and “qualified performance based compensation”
 - Once a covered employee, always a covered employee
- Compensation payable under a written binding contract that was in existence on November 2, 2017 is grandfathered as long as not materially modified
 - Significant issues with determining what is grandfathered
 - When does negative discretion prevent grandfathering?
 - Be careful not to materially modify grandfathered agreements

2018 Investor/Advisor Activism-ESG

- Stockholder engagement on environmental, social and governance (ESG) issues and related litigation concerns
 - Developing formalized policies around stockholder engagement
 - Historically passive investors, such as BlackRock, Vanguard and State Street, are actively looking for ESG engagement—diversity, sustainability and proxy access

2018 Investor/Advisor Activism-ESG (cont.)

- Assessing corporate culture (sexual harassment and sexist behavior)
 - Part of BlackRock's human capital management engagement initiative (creating a healthy culture and preventing unwanted behaviors)
 - CalPERS is also considering looking into corporate cultures and sexual harassment
 - At least semi-annually, reports to the Board regarding these types of complaints
 - Consider unstructured Board tours so that Board can get a better feel for corporate culture

2018 Investor/Advisor Activism-ESG (cont.)

- State Street is evaluating S&P 500 companies for non-compliance with the Investor Stewardship Group (ISG) governance principles
 - Letters sent to board chairs and lead directors requesting they evaluate and disclose their compliance with principles outlined by ISG
 - State Street will use a screening methodology that identifies voting guidelines encompassed in the six ISG corporate governance principles, and companies that do not meet at least three of 13 voting guidelines will be targeted for further engagement
 - If not adequately explaining governance approach, it may hold the board accountable at election time

2018 Investor/Advisor Activism-ESG (cont.)

- BlackRock – A connection between company management of ESG risk factors and long-term value creation
- ISS E&S Quality Score – new system of governance rating evaluating the quality of companies E&S disclosures relative to industry peers
 - Evaluation based on 380 factors used by standard setters such as Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB) and Financial Stability Board’s Task Force on Climate-Related Financial Disclosure (TCFD)
 - About 1,500 companies graded in first-year in energy, materials and capital goods with expanded 2018 coverage to 5,000 companies
 - Not supposed to impact voting recommendations on management proposals

2018 Investor/Advisor Activism-ESG (cont.)

- Activist hedge funds are focusing on ESG issues
 - Jana Partners announced launch of social responsibility fund
 - Value Act Capital Partners has its own ESG themed fund
 - Trian Partners and Blue Harbor Capital have incorporated ESG principles into their investment strategies
- World Federation of Exchanges (WFE) recently issued updated metrics for exchanges that opt to issue ESG reporting guidance
 - 30 baseline metrics including climate risk mitigation, emissions intensity, gender, pay ratio, human rights, ethics and anti-corruption and disclosure
 - More than 35 exchanges have issued or committed to issue ESG reporting guidance to listed companies, including Nasdaq, but not NYSE yet

2018 Investor/Advisor Activism-ESG (Diversity)

- Approximately 90% of S&P 500 companies and 58% of Russell 3000 companies have at least two female directors
- States, such as CA and PA, are moving to mandate female directors on boards headquartered or incorporated in their jurisdictions
- BlackRock expects to see at least two women on every public company board
- CalSTERS and CalPERS are holding boards accountable for a lack of progress on board diversity following engagement
- Starting in 2019, Glass Lewis will recommend against governance committee chairs of Russell 3000 companies with all male boards unless there is sufficient rationale or disclosure of a plan to address the lack of female directors
- ISS will flag companies that have no women on their Boards in its proxy analysis
- Risk of stockholders, such as the NYC Comptroller, using proxy access as a tool to compel change at companies

2018 Delaware Developments

- In June 2018, Delaware legislation signed enacting the Delaware Certification of Adoption of Transparency and Sustainability Standards Act (effective October 2018)
 - First of its kind
 - Represents Delaware's initiative to support sustainability practices with a platform for companies to demonstrate commitment to corporate and society responsibilities
 - Participation is voluntary for entities that wish to become certified as reporting entities. It enables entities to craft a sustainability regime that is flexible with a few mandatory features requiring that the Board approve its standards and assessment measures and that standards and assessment measures be made publicly available

2018 Delaware Developments (cont.)

- To seek certification as a “reporting entity,” a company’s board must adopt resolutions creating “standards” (assess and report the impact of activities on society and the environment” and “assessment measures” (to measure performance in meeting the standards)
- Entities that participate can obtain certification of adoption of transparency and sustainability standards from the Secretary of State

Virtual-Only Annual Meetings

- Rise in virtual-only meetings – Broadridge expects to facilitate over 300 virtual meetings in 2018, up from 236 in 2017 (about 20% expected to be hybrid)
- Continued backlash against virtual-only meetings:
 - NYC pension funds amended voting guidelines to oppose governance committee members at companies that hold virtual-only meetings
 - Glass Lewis, for 2019, will recommend a vote against governance committee members unless stockholders are afforded the same rights and opportunities to participate in a virtual-only meeting

Virtual-Only Annual Meetings (cont.)

- Other Considerations
 - Are there controversial items on the ballot?
 - Whether the company is facing significant stockholder dissent?
 - Whether annual meetings have been widely or lightly attended?

2018 Takeaways

- Continue to see increased proxy disclosure on:
 - Board diversity
 - Board refreshment
 - Culture
 - Human capital management
 - Director skills/matrices
- Profound rise in investor interest in ESG matters
 - Companies should be taking a careful look at ESG messaging on key areas of interest by stakeholders
 - Implement changes prior to stockholder proposal deadlines, if possible
- If considering virtual-only annual meeting, carefully consider investor base

2018 DIRECTOR-RELATED DEVELOPMENTS

Director Compensation Litigation

- Delaware applies the entire fairness standard in reviewing challenges to discretionary director compensation (*Investors Bancorp* case – December 13, 2017)
 - Under the entire fairness standard, directors have the burden of proving that their self-interested actions were entirely fair to the company (both in amount and process)
 - Entire fairness standard imposes a heavy burden on directors (cannot support a motion to dismiss or likely even a motion for summary judgment)
 - In practice, the company is forced to settle unless it is prepared to engage in expensive, time-consuming distracting and embarrassing litigation and a trial on the merits

Director Compensation Litigation (cont.)

- Business Judgment Rule (BJR) standard is the presumption that the Board acted in good faith and in the best interests of stockholders
- Under *Investors Bancorp*, to have the BJR apply to director compensation decisions, director equity awards approved by stockholders must be “specific” as to amounts and terms
- BJR standard for stockholder ratification of director compensation is available only in two circumstances:
 - Stockholders approve specific director compensation awards
 - When the plan is self-executing (fixed amounts and fixed criteria/automatic formulaic grants)

Director Compensation Litigation (cont.)

- Some companies are asking for stockholder approval of director compensation (e.g., JP Morgan Chase incorporated director compensation program into the omnibus incentive plan submitted for approval in 2018)
- Other companies are choosing to retain discretion to set director compensation, and are establishing processes to minimize risk

Director-Related Litigation, Plans and Disclosure

- Continue to see actions brought where equity grants exceed plan limits
 - Plaintiffs' lawyers are reviewing the Grants of Plan-Based Awards table (the performance equity maximum column and time-based equity columns) and then checking against plan limits
- Continue to see actions brought for misleading/incomplete proxy disclosure if equity plan proposal disclosure does not meet technical disclosure requirements
 - For example, number of "eligible" participants in each class, not "actual"
- Continue to see whistleblower claims being made if confidentiality provisions do not have an express carve-out for whistleblowing
 - Veiled threat to report the company to SEC Enforcement

Director-Related Litigation, Plans and Disclosure (cont.)

- Starting in 2019, ISS will begin recommending against the board members responsible for non-employee director pay if there is a pattern of excessive pay over multiple years without a compelling rationale
 - ISS historically has considered director pay above the top 5% of comparable directors (based on index and industry median) to be an outlier

Director-Related Takeaways/Minimizing Risk

- Companies should have a robust process for evaluating and approving director compensation, including
 - Benchmarking against an appropriate peer group
 - Receiving advice from compensation experts
 - Separating director compensation decisions from executive compensation decisions, including having the decisions made at separate meetings
- Equity plans submitted for stockholder approval should, at a minimum, include meaningful director award limits

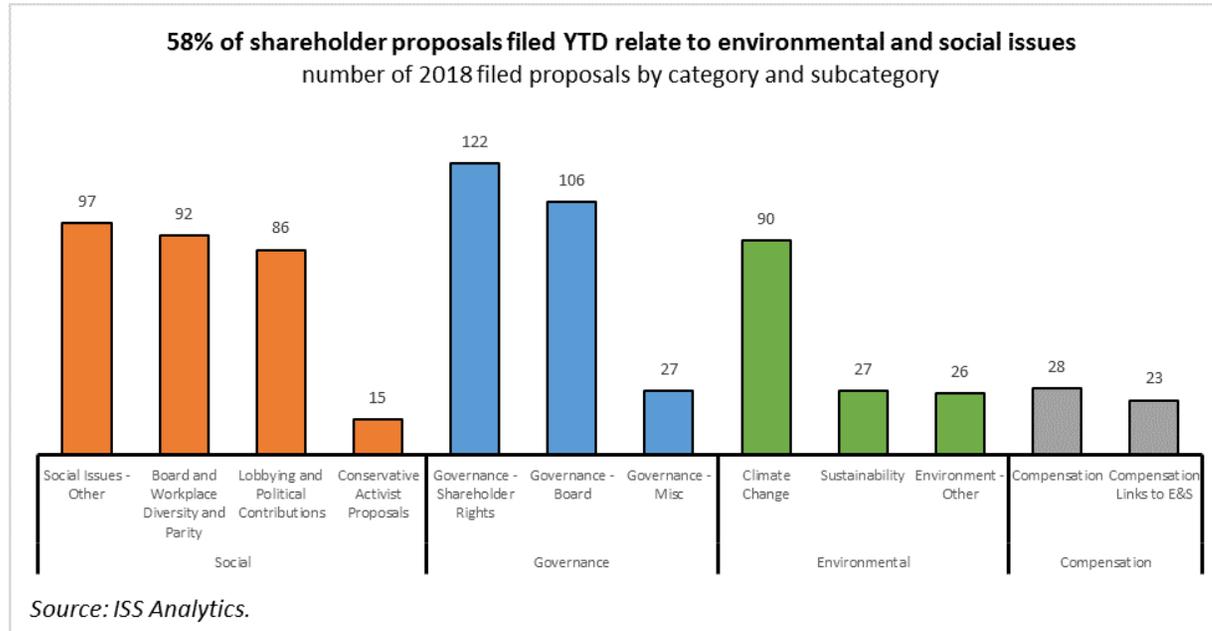
Director-Related Takeaways/Minimizing Risk (cont.)

- Follow best practices
 - Stock ownership requirements that are meaningful and consistent with market practice
 - Consider holding requirements
- Consider having stockholders approve non-discretionary formulaic grants for directors
- Include thorough proxy disclosure of director compensation process and peer benchmarking
- Confirm proxy disclosures, particularly plan proposals, include every disclosure technically required (even if seems outdated or nonsensical)
- Confirm all awards are within plan limits (assuming maximum pay-out)
- Check confidentiality provisions in contracts and confirm they have carve-outs for whistleblowing (particularly an issue now with hyperlinking of exhibits)

2018 STOCKHOLDER PROPOSALS

Stockholder Proposal Trends

- Environmental and social issues overshadowing governance and compensation-related proposals



Stockholder Proposal Trends (cont.)

- Support levels for stockholder proposals have been high (54% of voted proposals received above 30% of votes cast) (as of July 2018)
- Climate Change Stockholder Proposals
 - Over 90 proposed filings related to climate change
 - Vanguard, Fidelity and BlackRock have been voting for climate change-related proposals
 - ISS and Glass Lewis generally recommend a vote for climate change proposals
 - 2° Celsius Paris Agreement proposal received a majority vote at Kinder Morgan and Anadarko

Stockholder Proposal Trends (cont.)

- Political Spending and Lobbying
 - Often tied to climate change and stockholder proposals requesting more disclosure around corporate lobbying and election spending
 - About 50 lobbying and 30 political contributions proposals are expected in 2018
 - Rarely receive majority backing but increasing support trends
 - BlackRock, Vanguard, Fidelity and Capital Group American Funds maintain long-standing approach of voting against or abstaining on election spending proposals
- Special Meetings and Written Consents
 - Nearly tripled from 2017

Stockholder Proposal Trends (cont.)

- Proxy Access proposals less in volume and support in 2018 proxy season
 - Over two-thirds of S&P 500 firms have adopted proxy access
 - “Fix it” proxy access proposals average only 28% of favorable votes (similar to 2017)
 - Over the past year, approximately 40% of proxy access adoptions occurred at small- and mid-cap firms
- Board and Executive Management Diversity
 - Stockholder proposals to increase gender diversity on the board and senior executive team, including tying CEO pay to diversity goals

Stockholder Proposal Trends (cont.)

- Closing gender pay gaps—particular focus on financial institutions in 2018
 - Success with seven of nine targets
 - Citigroup and BoA became the first banks to conduct and disclose results of pay audit of global workforces and commit to increasing pay of women and minorities as warranted
 - Social investment funds are also requesting workforce diversity reports from banks and financial institutions showing a breakdown of companies' employee population by race, gender and EEO-1 job categories
 - Retailers are another industry of focus since women are typically a large share of the workforce

Amy I. Pandit



Representing publicly traded corporations, Amy counsels clients on corporate governance; executive compensation; and in federal securities laws, stock exchange, Sarbanes–Oxley Act, and Dodd–Frank Act compliance matters. She also advises clients in diverse and complex corporate finance transactions. Amy works closely with companies’ boards of directors and executive management teams, engaging them on critical legal and compliance matters and advising on corporate governance issues most relevant to their business, stockholders, and other stakeholders.

Partner

Morgan Lewis

amy.pandit@morganlewis.com

+1.412.560.7415

Morgan Lewis

Mims Maynard Zabriskie



Partner

Morgan Lewis

mims.zabriskie@morganlewis.com

+1.215.963.5036

Mims Maynard Zabriskie advises on complex executive compensation and employee benefit plan matters, including the design, negotiation, and implementation of executive compensation, equity compensation, and tax-qualified retirement plans and shareholder approval of equity plans. She counsels large publicly and privately owned businesses, including Fortune 500 enterprises, technology companies, and universities on a range of legal issues related to executive compensation governance, and employee benefit plans. She also advises on benefits and executive compensation issues that arise during major corporate transactions, including mergers and acquisitions, sales, IPOs, and spinoffs.

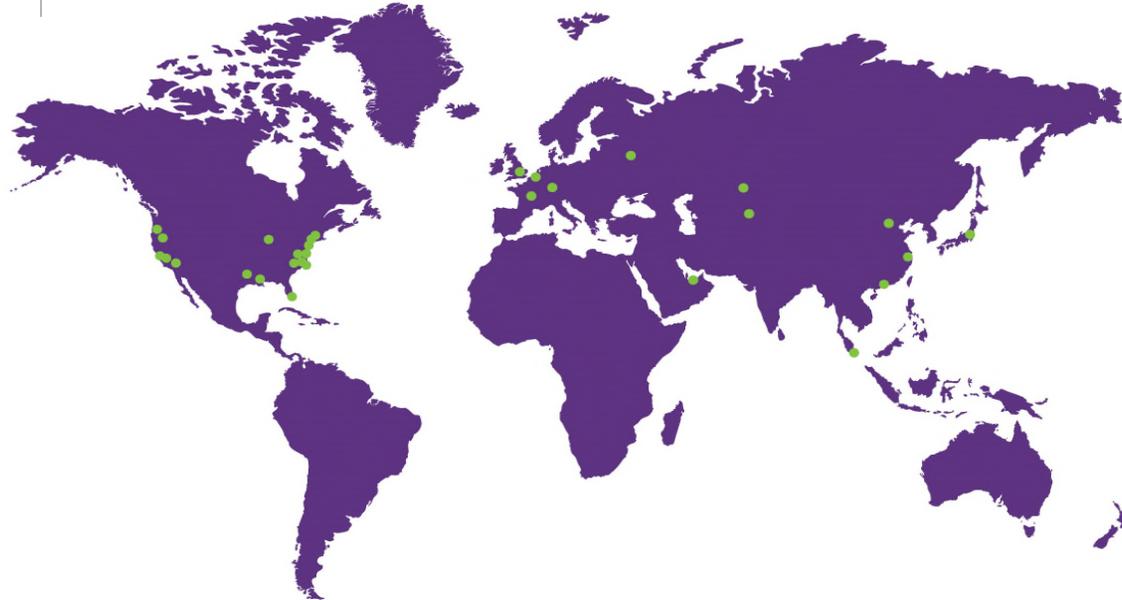
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