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GLOBAL PUBLIC COMPANY ACADEMY

2020 PROXY SEASON
A RECAP OF 2019 AND TRENDS TO WATCH

Gina Lauriero
Mims Maynard Zabriskie
Jeffrey Letalien

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Overview

I. Annual Meeting Hot Topics

II. Shareholder Proposals – Proposed Rule Changes and Recent Trends

III. Litigation-Related Developments

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ANNUAL MEETING HOT TOPICS

Overview of Hot Topics

- Pay Ratio Disclosure
- Say on Pay and Equity Plan Approval
- Glass Lewis and ISS Compensation Updates for 2020
- Glass Lewis and ISS Governance Updates for 2020
- Hedging and Pledging Disclosure
- Environmental, Social and Governance (ESG) disclosure

Pay Ratio

- CEO Pay Ratio
  - Continue to see median pay ratio levels be highly dependent on industry
    - Consumer services and retailers generally have highest ratios
    - Energy and banking tend to have the lowest
  - No need to re-run median employee calculation for the 2019 fiscal year
    - *Unless* there have been significant changes to compensation structure or employee population
  - Among S&P 500 companies, none appear to have changed CEO compensation program and policies as a result of pay ratio (or concerns relating to the same)
  - Very few companies address CEO pay ratio within CD&A
  - While shareholders and the proxy advisors continue to be agnostic toward pay ratio results, note:
    - Overlap with human capital management and gender pay gaps
    - Requests from unions and pension funds requesting more detail

Say-on-Pay

- Say-on-Pay ("SOP") vote
  - The vast majority of companies "passed" SOP
    - 99% of S&P 500 companies received majority support for SOP
    - 97% of Russell 3000 companies received majority support for SOP
  - Reasons for failure include:
    - Performance standards that are not sufficiently rigorous
    - Problematic pay practices
    - Lack of responsiveness to shareholder concerns
  - Despite continued overall passage rates, ICR Inc. recently noted that 2019 saw a "marked rise in the percentage of SOP with support rates below 80%"
    - 80% is significant, as this is the level at which shareholders and proxy advisors will scrutinize compensation committee members for their oversight of the compensation program and responsiveness to investor concern
    - ICR attributes this to:
      - Passive investors' lack of willingness to support one-time retention or discretionary awards
      - Investors increasingly willing to vote against SOP to register concerns over problematic pay practices

Equity Plans

- The vast majority of companies that put up equity plans for shareholder approval saw success in 2019
  - Average level of support approximated 90% among both Russell 3000 and S&P 500 companies
  - Few companies in the Russell 3000 had equity plan proposals that failed to achieve majority support
- Strategies when faced with a negative ISS recommendation:
  - Shareholder engagement, focusing on largest institutional holders
  - Well-drafted supplemental proxy material can be effective to rebut ISS's position (particularly if Glass Lewis has expressed support for the plan)

2019 Proxy Disclosure and ISS Issues

- Performance metrics
  - In 2020 ISS is reviewing company performance in part through an Economic Value Added (EVA) framework. The framework applies certain rules-based adjustments to financial statement accounting data in an effort to offer a "uniform" non-GAAP basis for evaluating performance across companies.
  - In 2020 ISS will incorporate EVA metrics in the secondary financial performance assessment component of the quantitative Pay-for-Performance model
  - The GAAP metrics used by ISS in past years will continued to be displayed in ISS research reports for informational purposes only
  - It is not expected that ISS' use of EVA will result in more companies using EVA for performance metrics in incentive plans

ISS 2020 Compensation Policy Updates

- Starting in 2020, ISS will begin recommending against board members responsible for non-employee director pay if there is a pattern of excessive pay over two or more years without a compelling rationale
  - Pay outliers will generally be those directors whose pay exceeds the top 2% of all comparable directors (based on index and industry median)
  - If director pay is determined to be an outlier, ISS will perform a qualitative test to analyze factors that may mitigate concerns and disclosure
  - Benchmarking and fulsome director compensation disclosure is important
  - The following circumstances, if adequately explained, will typically mitigate ISS concern:
    - One-time onboarding grants for new dirctors
    - Payments related to corporate transactions or special circumstances (such as special committee service)
    - Payments in consideration of specialized scientific expertise

ISS 2020 Compensation Policy Updates

- ISS has clarified its expectation of fulsome disclosure of payments made to terminating executives, stating that severance pay is not appropriate for executives who voluntarily resign or retire
  - Clear and direct disclosure about the nature of an executive's termination
  - Disclosure as to how the board of directors determined to pay severance to the executive, including whether there were any discretionary enhancements.
  - Identify the type of termination (termination of employment without cause/resignation for good reason) and the applicable agreement provision under which severance payments were made

ISS Equity Scorecard

- ISS considers the following three main categories in assessing omnibus equity plans:
  - Plan cost (*i.e.*, dilution and overhang)
  - Plan features (*i.e.*, minimum vesting periods, extent to which vesting can be accelerated on a discretionary basis, liberal share recycling, change in control provisions, dividends paid on unvested awards)
  - Grant practices (*i.e.*, burn rate relative to peer companies)
- ISS confirmed that the addition of an evergreen (automatic share replenishment) feature will be an automatic "overriding" factor, resulting in an ISS recommendation against the equity plan

Glass Lewis 2020 Compensation Policy Updates

- Responsiveness to Low Support for Say-on-Pay
  - Low support equates to an opposition of 20% or more
  - Expects "robust disclosure of engagement activities and specific changes made in response to shareholder feedback"
  - Absent such disclosure, "may consider recommending against the upcoming say-on-pay proposal"
  - Appropriate responses to such low shareholder support include:
    - Engaging with large shareholders to identify concerns
    - Where reasonable, implementing changes that directly address those concerns within the company's compensation program

Glass Lewis 2020 Compensation Policy Updates

- Contractual Payments
  - In evaluating say-on-pay proposals, generally disfavors contractual agreements that excessively favor an executive, including:
    - Excessive severance payments
    - New or renewed single trigger change-in-control arrangements
    - Excise tax gross ups
    - Multi-year guaranteed awards
  - Also disfavors the extension of such entitlements through renewed or revised employment agreements
- Other Compensation Matters – Clarifications in Policy
  - Will review any significant changes or modifications, including post-fiscal year end changes and one-time awards, particularly where the changes touch upon issues that are material to Glass Lewis recommendations
  - If a company has lowered short-term incentive plan performance targets mid-year, Glass Lewis expects the company to provide a robust discussion of why such decision was necessary
  - Excessively broad definitions of "change in control" in employment agreements are potentially problematic as they may lead to situations where executives receive additional compensation where no meaningful change in status or duties has occurred

ISS Updates for 2020 – Independent Board Chair

- As previewed in October, ISS has identified the following factors that will increase the likelihood of ISS recommending that shareholders vote "for" proposals requiring an independent board chair:
  - Weak or poorly defined lead independent director role
  - The presence of an executive or non-independent chair in addition to the CEO, a recent recombination of the role of CEO and chair, and/or departure from an independent chair structure
  - Evidence that the board has failed to oversee/address material risks facing the company
  - A material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board has materially diminished shareholder rights
  - Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests

ISS Updates for 2020 – Buybacks and Pay Data Proposals

- Management Proposals on Buybacks:
  - ISS will recommend approval of management-sponsored proposals to conduct open-market repurchases, as long as the buybacks
    - Do not facilitate greenmail; and
    - Are not used to inappropriately manipulate incentive compensation metrics, threaten the company's long-term viability or raise any other company-specific concerns
  - ISS will also recommend, on a case-by-case basis, proposals to repurchase shares from specified shareholders, with the goal of balancing the company's stated rationale for such repurchases against the possibility of misuse (i.e., repurchasing shares from insiders at a premium to market price)
- Shareholder Proposals on Pay Data:
  - ISS will vote on a case-by-case basis on proposals requesting reports on a company's pay data by gender, race, or ethnicity
  - Will take into account:
    - The company's current policies and disclosure regarding diversity and inclusion, and compensation philosophy (*this is unchanged from 2019*)
    - If gender, race or ethnicity pay gap issues have been the subject of recent controversy, litigation or regulatory action
    - Whether the company is lagging behind its peers on reporting such factors

ISS Updates for 2020 –Shareholder Rights & Problematic Governance Practices

- Restrictions on Shareholders' Rights:
  - ISS will oppose management proposals seeking to approve or ratify requirements that are in excess of Rule 14a-8 requirements
  - ISS will recommend vote against or withhold from members of the governance committee if the company's bylaws impose what ISS considers "undue restrictions" on shareholders' ability to amend the bylaws, even if such restrictions have been approved by the company's shareholders
- Newly-Public Companies and Problematic Governance Structure:
  - ISS generally will recommend a vote against or withhold from directors and boards of newly listed companies that have imposed, without sunsets:
    - Supermajority vote requirements to amend the organizational documents of the company
    - A classified board structure
    - Other "egregious" provisions
  - ISS will generally recommend a vote against or withhold from directors and boards of newly public companies with a multi-class capital structure in which the classes have unequal voting rights that are not subject to a reasonable time-based sunset
    - When determining the reasonableness of a sunset period, ISS will assess a company's lifespan, its post-IPO ownership structure and the board's disclosed rationale
    - Sunsets expiring more than seven years from the date of the IPO are *de facto* considered unreasonable

ISS Governance Updates for 2020

- Gender Diversity:
  - As ISS' grace period has now lapsed, ISS will recommend voting against the chair of the nominating committee at companies with no women on the board
  - Mitigating factors include:
    - Until February 1, 2021, a firm commitment to appoint at least one woman to the board within a year
    - The presence of a woman on the board at the prior year's annual meeting, together with the above "firm commitment"
    - Other relevant factors (*unchanged from 2019*)
- Newly-Nominated Directors:
  - In making recommendations for director nominees who have served on the board for less than one year, ISS will consider factors such as whether the director should be held responsible for an action taken by the board before the director joined the board
  - ISS will also exclude director nominees who have served only part of the fiscal year from its attendance policy

Glass Lewis Governance Updates for 2020

- Board Committee Performance:
  - Will generally recommend voting against the **governance committee chair** when (i) directors' records for board/committee meetings are not disclosed; or (ii) when a director attended less than 75% of board and committee meetings, but disclosure is unclear as to which director had lacking attendance
  - Will generally recommend voting against the **audit committee chair** when fees paid to external auditor are not disclosed
  - Will generally recommend voting against **all members of the compensation committee** when the board adopts a "say on frequency" other than the frequency approved by a plurality of shareholders

Hedging and Pledging Disclosure

- The SEC rules that were finalized in December 2018 regarding disclosure of hedging policies (or the lack thereof) will be effective for the 2020 proxy season
  - Emerging growth companies and smaller reporting companies (SRCs) do not have to comply until 2021, although we likely will see early adoption among some SRCs
- As a reminder, new Item 407(i) of Regulation S-K requires companies to disclose whether employees (including officers) or directors or their designees are permitted to purchase financial instruments or otherwise engage in transactions that hedge or offset, or that are designed to hedge or offset, any decrease in the market value of a company's equity securities granted to the employee or director as compensation or held directly or indirectly by the employee or director

Hedging and Pledging Disclosure (cont.)

- Companies should consider updating their insider trading policies or corporate governance guidelines, as appropriate, prior to filing their 2020 proxy statement to be sure that existing policies capture these concepts
  - According to a Corporate Counsel survey, approximately 53% of companies have not revisited their existing policies
  - About 25% of respondents have revised policies; about 22% have reviewed, but not revised, policies
- Hedging disclosure may either describe hedging policies or practices in full, or consist of a fair and accurate summary that describes the categories of covered persons and any categories of hedging transactions that are specifically permitted or prohibited
  - May be easiest just to reiterate the full "no-hedging" policy, as these policies tend not to be lengthy
  - However, according to an ongoing Corporate Counsel survey, over 90% of companies are planning to include only a "fair and accurate summary" in lieu of entire policy

Hedging and Pledging Disclosure (cont.)

- According to a FW Cook review in October, out of the first approximately 40 companies that filed proxies after the requirement became effective for fiscal years beginning on or after July 1, 2019:
  - 100% have hedging policies in place
  - Over 60% have hedging policies that cover directors and all employees
  - Nearly 60% disclose policies that prohibit both transactions in company stock with a hedging function and derivative transactions generally
- ISS and Glass Lewis positions:
  - ISS will flag any lack of an anti-hedging policy
  - Glass Lewis supports anti-hedging policies in order to assure alignment between management and shareholders

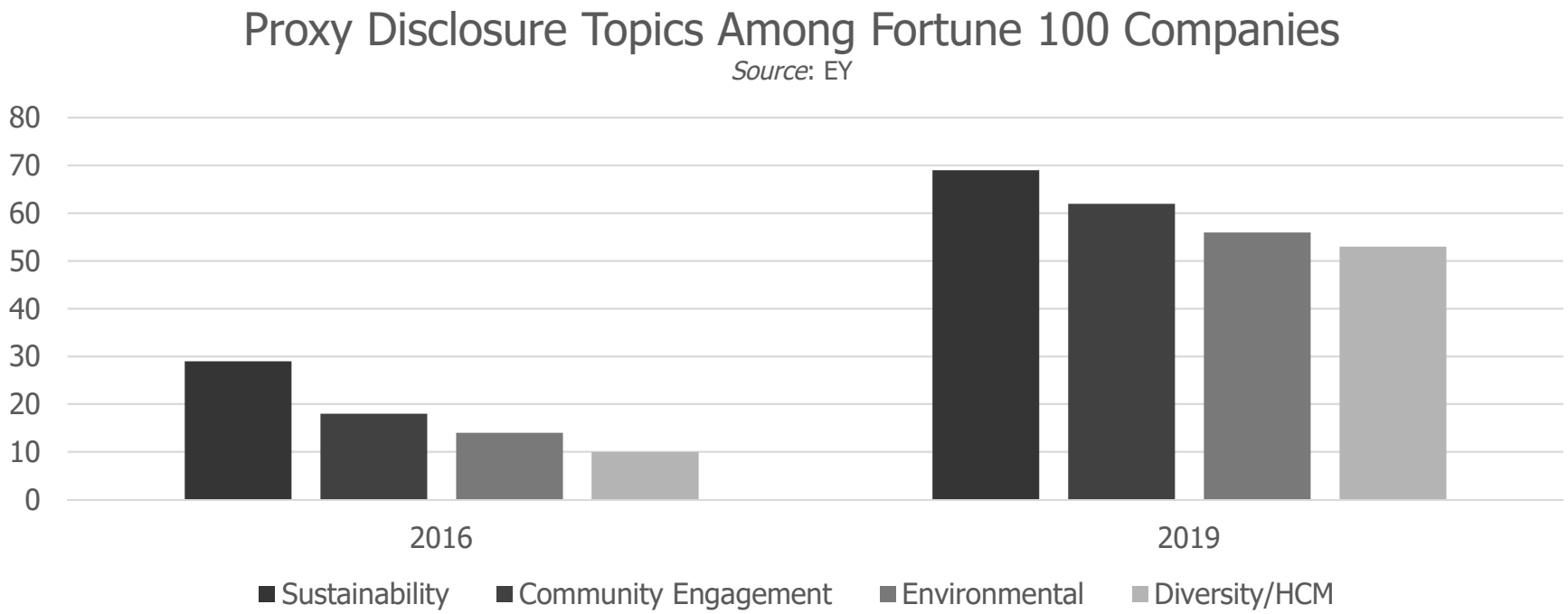
Hedging and Pledging Disclosure (cont.)

- A note on pledging:
  - Many companies also will provide "voluntary" anti-pledging policy disclosure along with anti-hedging disclosure
  - ISS' view is that any amount of pledged stock is not a responsible use of company equity; pledging by an insider will be noted in ISS report
  - ISS evaluates what is a "significant level" of pledged company stock on a case-by-case basis by measuring the aggregate pledged shares in terms of common shares outstanding or market value or trading volume

Environmental, Social and Governance (ESG)

- "Environmental, Social and Goverance" (ESG) includes disclosure about environmental, sustainability, community engagement, diversity/human capital and other corporate governance issues
- In 2019, BlackRock CEO Larry Fink issued a letter encouraging public companies to address social issues (i.e., protecting the environment and gender/racial inequality)
- In August 2019, 181 CEOs signed the Business Roundtable's Statement on Purpose of a Corporation, committing to:
  - Delivering value
  - Investing in employees
  - Dealing fairly and ethically with suppliers
  - Supporting the communities in which the company works
  - Generating long-term value for shareholders

ESG (cont.)


Proxy Disclosure Topics Among Fortune 100 Companies
Source: EY
80
70
60
50
40
30
20
10
0
2016
2019
Sustainability
Community Engagement
Environmental
Diversity/HCM

Environmental, Sustainability and Community Engagement

- More and more companies are using the proxy to message (and tout) their approach to sustainability and "good corporate citizen" initiatives over the prior year
- Proxy disclosure may include a list of environmental, sustainability and community engagement highlights
  - Ex: recycling initiatives, participation in climate change information request surveys, initiatives to reduce carbon emissions, investment in local communities through charitable giving and volunteer efforts, continuing education opportunities for rank-and-file employees

Human Capital and Diversity

- Interest in human capital management continues to be prolific due to:
  - #MeToo movement
  - Heightened interest in gender pay gap & pay equity disclosure
  - Influencers like BlackRock have called out human capital management as an investment issue and are encouraging more transparent disclosure
- Board and Committee oversight:
  - Ensure that corporate policies relating to, for example, sexual harassment and misconduct are clear, regularly reviewed, and understood by management
  - Board must be informed about policies and training procedures, as well as their efficacy and enforcement
  - Complaints about C-suite executives should be brought to the attention of the audit committee or other designated committee

Human Capital and Diversity (cont.)

- Proposed disclosure requirements:
  - Along these lines, in August 2019, as part of its disclosure modernization proposals, the SEC has proposed that companies disclose a description of their human capital management resources, including metrics or objectives that management focuses on when managing the business (only to the extent such disclosure is material to an understanding of the company's business)
- Disclosure trends:
  - A November 2019 study by EY (based on human capital and culture-related disclosures in the proxy statements of 82 companies on the 2019 Fortune 100 list) noted that many companies voluntarily highlight management's general efforts around certain human capital issues (e.g., diversity and inclusion or broader workforce compensation) and broadly disclose board oversight of human capital management or culture, including related committee oversight responsibilities

Human Capital and Diversity (cont.)

- In early 2019, the SEC's Division of Corporation Finance issued new guidance regarding diversity characteristics of directors and Board diversity policy disclosures
- The guidance specifies that:
  - If a board or nominating committee considered diversity characteristics of a candidate and the candidate consents to the disclosure of such self-identified diversity characteristics in the proxy statement, the SEC expects to see disclosure addressing such diversity characteristics and how they were considered; and
  - The SEC staff expects that any description of diversity policies include a discussion of how the company considers the diversity attributes of nominees and what qualifications the diversity policy takes into consideration

Human Capital and Diversity (cont.)

- Female presence on boards of directors continues to accelerate –
  - 23% of directorships in 2019 are held by women
  - Most (56%) of S&P 500 boards have at least three female directors (Source: EY)
- On October 11, NYC Comptroller Scott Stringer launched the third stage of the Boardroom Accountability Project
  - Calls for 56 S&P 500 companies to adopt "Rooney rule" in recruiting for directors and CEOs
  - Announcement also indicated that the Comptroller's Office will "file shareholder proposals at companies with lack of apparent racial diversity at the highest levels"
- California law requires female directors of CA-based public companies
- In January 2020, Goldman Sachs announced that it will not underwrite IPOs of companies with all white male boards

Board Evaluation Disclosure

- Fulsome disclosure of how the board and committees conduct evaluations, as well as action items resulting from such evaluations, likely will continue to be a disclosure trend in 2020
- In 2019, the Council of Institutional Investors published a report noting that –
  - Shareholders wish to understand how the board approaches the task of continual improvement
  - Proxy statements do not always fully convey the rigor or results of the evaluation processes
- Vast majority of large companies provide at least some substantive disclosure about their board evaluation processes; many organizations, including CII, feel that there remains room for improvement

Board Evaluation Disclosure (cont.)

- EY recently published a survey of Fortune 100 companies, which concluded:
  - The vast majority (93%) of companies provided some disclosure about their board evaluation process.
  - Most (73%) disclosed that the Nom/Gov Committee did this process either alone or with the independent lead director or chair
  - Slightly more companies used an independent facilitator at least periodically (i.e., every two or three years) in 2019 vs. 2018
  - Approximately 40% of companies (up from 25% last year) disclosed that they included individual director self-evaluations along with board and committee evaluations
  - Approximately 50% of companies (up from 40% last year) disclosed the general topics covered by the evaluation
  - About 25% of companies (up from 20% in 2018) disclosed actions taken as a result of their board evaluation

Board Evaluation – Best Practices

- Best practices for improving the evaluation process include:
  - Adding a peer review process where directors have the opportunity to review each other anonymously
  - Implementing a periodic "check in" to supplement the formal, annual evaluation (i.e., where lead independent director speaks with each director on a quarterly basis)
  - Strong proxy disclosure would highlight how the board has enhanced its process on a year-over-year basis; i.e., enhanced ongoing education opportunities for directors based on the feedback received through the evaluation process

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SHAREHOLDER PROPOSALS: RULE CHANGES AND TRENDS

Modernization of Shareholder Proposal Rules

- On November 5, the SEC proposed amendments to Rule 14a-8 that would revise:
  - The eligibility requirements under Rule 14a-8(b)
  - The one-proposal limit under Rule 14a-8(c)
  - The resubmission threshold under Rule 14a-8(i)(12)
- Other proposed procedural requirements –
  - Codification of requirements set out in Staff Legal Bulletin No. 14I (Nov. 1, 2017) regarding a shareholder's delegation of authority to a representative (i.e., formalizes the documentation required when a shareholder is using a representative to submit a proposal)
  - Would require a proponent to provide the company with a written statement that the proponent is able to meet with the company in person or by teleconference no less than 10 days nor more than 30 days after submission of the shareholder proposal
    - Proponent would need to provide the company with contact information and business days and specific times that the proponent is available to discuss the proposal
    - Contact information and availability for engagement would be that of the shareholder and not the representative, although the representative could participate in the discussion

Proposed Amendments to Rule 14a-8(b)

- The proposed amendments to 14a-8(b) would update the current requirement that a shareholder-proponent hold at least $2,000 or 1% of a company's securities for at least one year to be eligible to submit a proposal
- Proposed amendments would:
  - Eliminate the 1% threshold
  - Provide three alternative thresholds, any one of which a shareholder could satisfy to be eligible to submit a proposal:
    - Continuous ownership of at least $2,000 of the company's securities for at least three years;
    - Continuous ownership of at least $15,000 of the company's securities for at least two years; or
    - Continuous ownership of at least $25,000 of the company's securities for at least one year.
- The proposed amendments also would no longer allow two or more shareholders to aggregate their securities to meet the applicable minimum ownership thresholds to submit a Rule 14a-8 proposal
  - However, would continue to be permitted to co-file or co-sponsor shareholder proposal as a group if each shareholder-proponent in the group meets an eligibility requirement.

Proposed Amendments to Rule 14a-8(c)

- Currently provides that "each shareholder may submit no more than one proposal to a company for a particular shareholders' meeting"
- As amended, would apply the "one proposal" rule to "each person" rather than "each shareholder" who submits a proposal
  - That is, a shareholder-proponent would not be permitted to submit one proposal in his or her own name and simultaneously serve as a representative to submit a different proposal on another shareholder's behalf for consideration at the same meeting
  - Similarly, a representative would not be permitted to submit more than one proposal to be considered at the same meeting, even if the representative were to submit each proposal on behalf of different shareholders

Proposed Amendments to Rule 14a-8(i)(12)

- Rule 14a-8(i)(12) provides companies with an exclusion mechanism to the extent a proposal deals with substantially the same subject matter as another proposal(s) that has or have been previously included in the company's proxy materials within the preceding five years

Current Threshold for Exclusion	Proposed Threshold for Exclusion
Proposal received less than 3% of votes and was proposed once within the preceding five calendar years	Proposal received less than 5% of votes and was proposed once within the preceding five calendar years
Proposal received less than 6% of votes and was proposed twice within the preceding five calendar years	Proposal received less than 15% of votes and was proposed twice within the preceding five calendar years
Proposal received less than 10% of votes and was proposed three or more times within the preceding five calendar years	Proposal received less than 25% of votes and was proposed three or more times within the preceding five calendar years

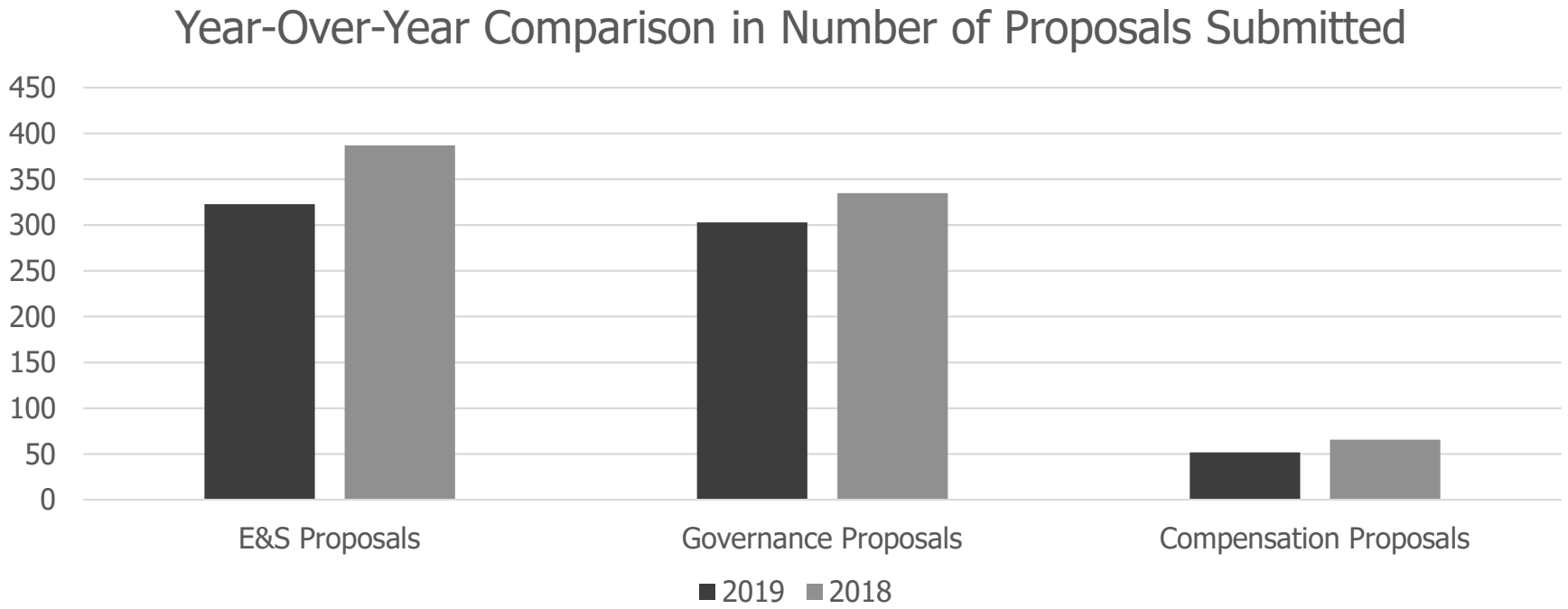
Proposed Amendments to Rule 14a-8(i)(12) (cont.)

- Amendments also would add a new "momentum" requirement
  - Companies could exclude shareholder proposals concerning substantially the same subject matter as proposals previously voted on three or more times in the last five calendar years if:
    - The most recently voted on proposal received less than 50% of the votes cast; and
    - Support declined by 10% or more compared to the immediately preceding shareholder vote on the matter
- For example, take a proposal dealing with substantially the same subject matter that had previously been voted on three times in the prior five years and received 26% of votes cast on the third submission compared to 30% on the second submission
  - The 26% of votes cast represents a decline of more than 10% from the previous 30% of votes cast
  - The proposal would be excludable

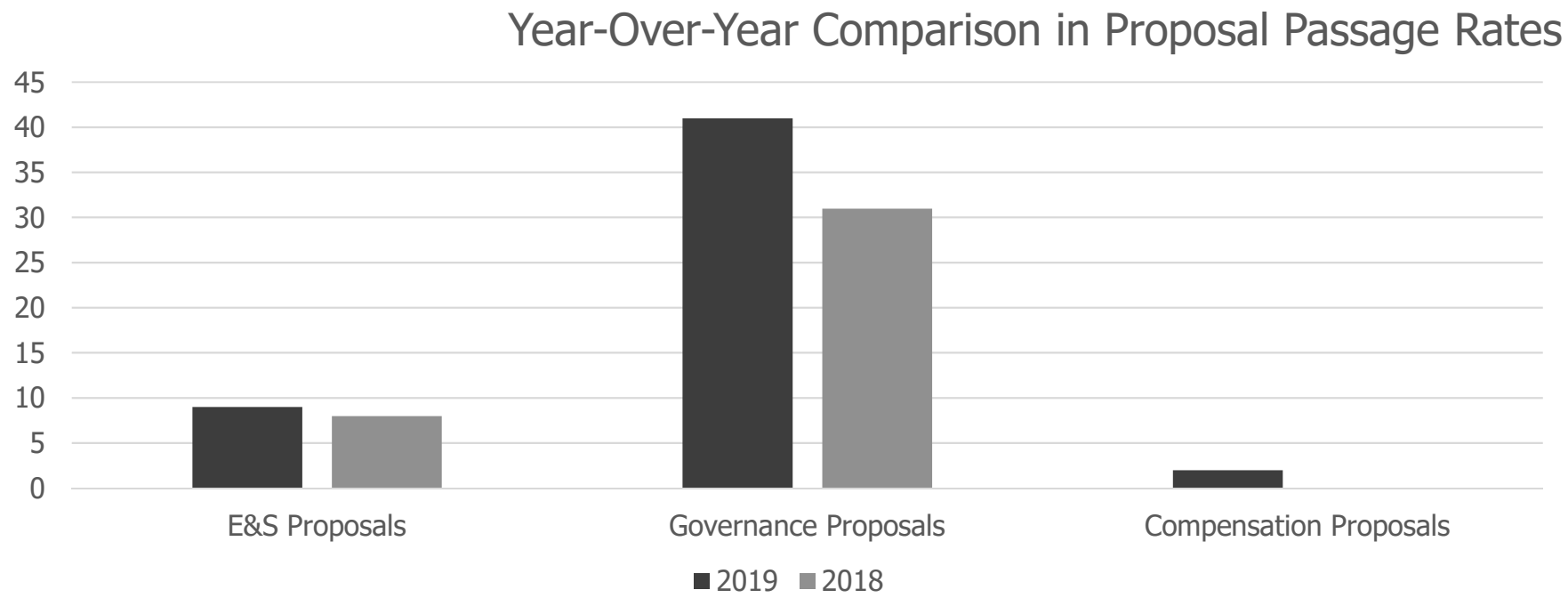
2019 Shareholder Proposal Trends

- We saw a reduction in total number of proposals submitted in 2019 as compared to 2018, as well as a general reduction in the number of proposals that went to a vote
  - E&S shareholder proposals continued to gain momentum in 2019, receiving average support of 28% and with nine proposals passing
  - A record number of E&S proposals also were withdrawn, indicating that companies are more willing to engage with proponents on these topics
- Additionally, more shareholder proposals ultimately passed (*i.e.*, received a majority of votes cast) in 2019 than 2018, which included proposals relating to:
  - Adoption of majority vote standard; and
  - Elimination of supermajority voting thresholds

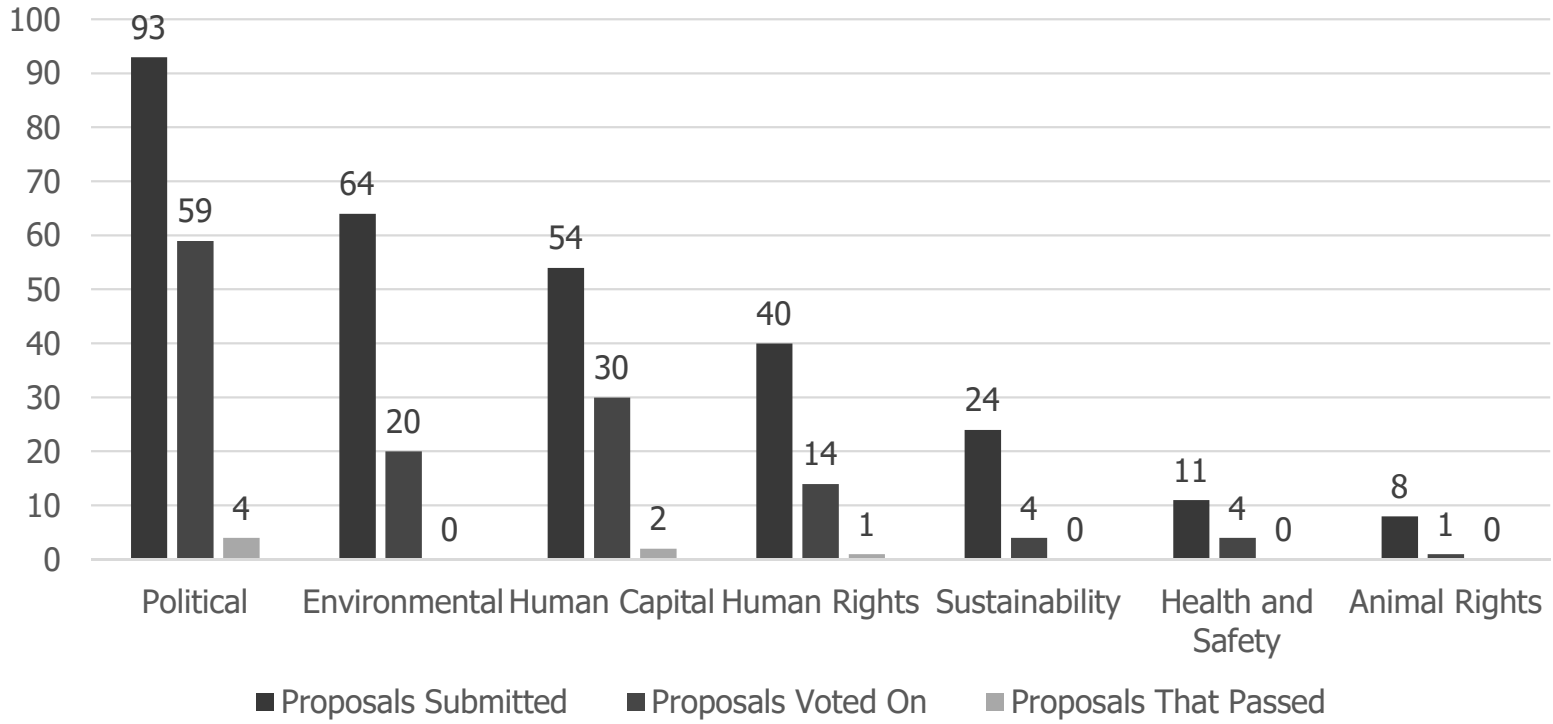
2019 Shareholder Proposal Trends (cont.)



2019 Shareholder Proposal Trends (cont.)



E&S Proposals – By the Numbers



SEC No-Action Process Changes

- On September 6th, the SEC's Division of Corporation Finance announced changes to its process for administering the Rule 14a-8 no-action process
- Although SEC staff will continue to weigh in on companies' requests to exclude a proposal, that input may consist of declining to state a view
  - Corp Fin indicated that this should not be interpreted as indicating that the proposal must be included, but only that SEC staff is not taking a position on the merits
  - Should this occur, a company may still have a valid basis to exclude the proposal, despite the staff declining to take a view
- SEC staff also may respond to some no-action requests orally
  - Will continue to issue letters where the SEC still believes such process will "provide value" - e.g., to provide "broadly applicable guidance" on Rule 14a-8 compliance
- The announcement also reinforced the SEC staff's view that companies' inclusion of a board analysis is "often useful" to its review and evaluation of a no-action request

SEC No-Action Process Changes (cont.)

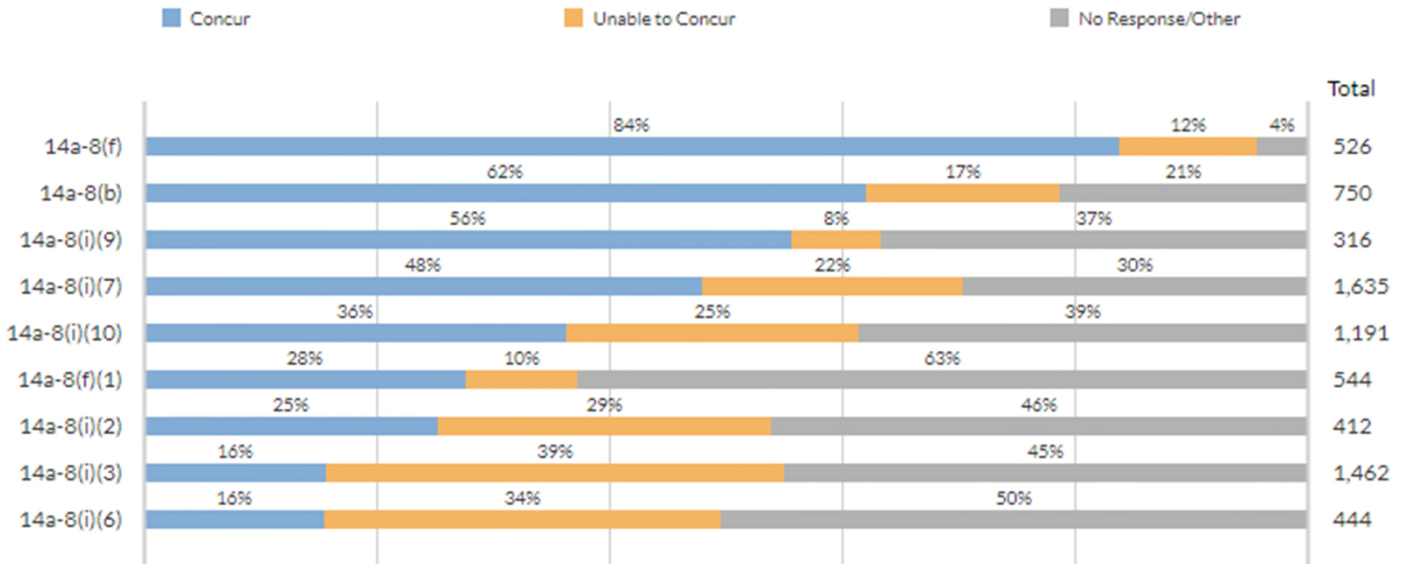
- On September 19th, the Council of Institutional Investors, US SIF, the Shareholder Rights Group, Ceres, and the Interfaith Center on Corporate Responsibility sent a letter to Corp Fin Director, Bill Hinman, requesting that the Division rescind these changes
- The letter identifies a number of adverse consequences anticipated to result from the changes, including reduced transparency, predictability, and accountability; increased burden for investor-proponents, who may need to litigate to enforce the rule; and increased conflict between companies and their investors

Glass Lewis on No-Action Process Changes

- As part of the issuance of its recent voting policy guideline updates, Glass Lewis noted that, to the extent the SEC verbally permits a company to exclude a shareholder proposal and there is no "written record" of this determination by the SEC, Glass Lewis "expect[s] the company to provide some disclosure concerning this no-action relief"
- Glass Lewis notes that "in cases where a company has failed to include a proposal on its ballot without such disclosure, [Glass Lewis] will generally recommend [that] shareholders vote against the members of the governance committee of the board"

No-Action Requests for 2019 Proxy Season

- Top Exclusionary Rules Requested and Success Rate



- *Source:* Intelligize

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2019 LITIGATION-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 may be forced to settle unless it is prepared to engage in expensive, time-consuming, and distracting 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 shareholders
  - Under *Investors Bancorp*, to have the BJR apply to director compensation decisions, director equity awards approved by shareholders must be "specific" as to amounts and terms
  - BJR standard for shareholder ratification of director compensation is available only in two circumstances:
    - shareholders approve specific director compensation awards
    - When the plan is self-executing (fixed amounts and fixed criteria/automatic formulaic grants)

Director Compensation Litigation (cont.)

- Plaintiffs lawyers are making fairly frequent claims relating to director compensation. Many cases have settled and required some or all of the following:
  - Mandatory say-on-director pay
  - Proxy disclosure of process for determining director compensation
  - Proxy disclosure of process for identifying peer group members
  - Mandatory director stock ownership guidelines
  - Pay plaintiffs' legal fees
- Starting in 2020, ISS will begin recommending against board members responsible for non-employee director pay if there is a pattern of "excessive" pay over two or more years without a compelling rationale

Director Compensation - Best Practices

- Consider having shareholders approve formulaic grants for directors with limited discretion
- Consider setting a "meaningful" limit on director compensation and denominating compensation in dollars rather than in number of shares
- Establish a robust process for evaluating and approving director compensation, including
  - Benchmarking against an appropriate and carefully constructed peer group
  - Receiving advice from a compensation expert
  - Separating director compensation decisions from executive compensation decisions, including having decisions made at separate meetings
  - Annually reviewing director compensation
  - Seeking frequent shareholder re-approval
- Include a thorough description of the process for determining director compensation, including compensation rationale, components and benchmarking in proxy

Delaware Standard of Review for Board Decisions on Controlling Shareholder Compensation

- The Board of Directors approved a 10-year incentive-based compensation plan for its CEO, allowing the CEO to earn performance-based stock options
- The CEO is c a controlling shareholder and a member of the Board
- The award was approved by an independent compensation committee of the Board and thereafter ratified by a majority of the minority shareholders.
- Plaintiff-shareholder brought several claims against the CEO and the Board, including breach of fiduciary duty claims.
- Defendants filed a motion to dismiss the breach claim under the "business judgment rule" (BJR)

Entire Fairness

- The threshold question for the court was, under which standard of review should the court adjudicate the claim?
  - Generally decisions of a board of directors, such as the approval of executive compensation, receive great judicial deference under BJR
  - However, because the CEO is a controlling shareholder and the potential beneficiary of the award, the court questioned whether the award should trigger heightened judicial scrutiny
- Historically, BJR has applied to a board's decisions on executive compensation, even where the recipient of the compensation is a controlling shareholder, if the compensation decision was made by an independent compensation committee
- *In re Ezcorp Inc. Consulting Agreement Derivative Litigation*, the court applied the entire fairness framework where shareholders challenged payments under agreements between Ezcorp and a company affiliated with Ezcorp's controlling shareholder.
  - BJR may be available if the transaction is conditioned at the outset on the following "dual protections":
    - Negotiated by an independent special committee;
    - Subsequent approval by a fully informed vote of the "majority of the minority" of disinterested shareholders

Entire Fairness (cont.)

- Here, the court determined that the "entire fairness" standard of review should apply to breach of fiduciary duty claims
  - The court determined that, for purposes of the motion to dismiss, a majority of the compensation committee that approved the award was not independent of the CEO's influence
  - There lacked a basis on which to conclude that the shareholder vote approving the award would not be subject to inherent coercion.
- Under the entire fairness standard, the plaintiff-shareholder must demonstrate from well-pled facts that it is reasonably conceivable that the award is unfair as to process and price
- The court dismissed the defendant's motion to dismiss the fiduciary breach claims largely on the size of the award

Takeaways

- In the case of board decisions regarding the compensation of a controlling shareholder, companies should consider whether to condition the compensation at the outset on the following "dual protections":
  - Negotiated by an independent special committee, and
  - Approval by a fully informed vote of the "majority of the minority" of disinterested shareholders
- BJR may not be available when controlling shareholder is heavily involved with both sides of decisions with respect to controlling shareholder compensation

Clawbacks – Advancement of Legal Fees

- Former executives in clawback litigation claiming advancement of fees in the litigation.
  - Issue is whether the company's indemnification provisions in the company charter/bylaws require it to advance legal fees for the litigation.
    - Company filed a lawsuit seeking a clawback of incentive compensation to executives
    - Executives responded by filing suit in Delaware seeking advancement of legal expenses
    - Company's bylaws provide for advancement of legal fees to former corporate officers for legal claim related to actions taken in their official corporate capacity
    - Company's compensation clawback provision was silent on the matter of advancement of fees
    - Company argued such advancement would discourage future clawback suits and be contrary to public policy
    - Court required the Company to advance legal fees to the defendants

Clawbacks – Advancement of Legal Fees (cont.)

- Takeaways
  - Companies should consider whether their charter/bylaws and other agreements creating indemnification and advancement obligations reflect their intentions, including in clawback litigation
  - Clawback policies could address advancement, although consider whether the clawback policy would override charter/bylaws or indemnification agreements

Proxy-Related Litigation – Tabulation of Votes

- Over the past year, there have been incidents of complaint letters/threatened litigation over Forms 8-K that included incorrectly tabulated shareholder votes
  - In these situations, companies had relied upon information provided by a third party
- We understand that plaintiffs' firms are paying attention to this issue
  - Importance of having numbers double-checked and paying attention to the impact of abstentions

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QUESTIONS?

Biography

Gina L. Lauriero
Partner
gina.lauriero@morganlewis.com
New York
+1.212.309.7103

Gina L. Lauriero advises clients across the spectrum of employee benefits and executive compensation matters. Her practice encompasses designing, implementing, and administering equity, incentive compensation, nonqualified deferred compensation, employment, and severance plans and agreements for public and private companies. When clients undertake mergers, acquisitions, and other corporate transactions, she offers advice on all employee benefits and compensation-related aspects. Gina's recent work has included advising a credit ratings agency on its acquisition of a leading provider of analytical tools and data.

Gina also provided counsel to a British communications and events company in its acquisition of the entire issued and outstanding capital stock of a privately held US trade show organizer.

Biography

Mims Maynard Zabriskie
Partner
mims.zabriskie@morganlewis.com
Philadelphia
+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. Mims also represents executives in the negotiation of employment agreements and equity compensation, including in connection with transactions. She advises on benefits and executive compensation issues that arise during major corporate transactions, including mergers and acquisitions, sales, IPOs, and spinoffs.

Co-leader of the firm's Executive Compensation Task Force, Mims advises corporations and compensation committees with respect to governance issues relating to executive compensation and works with corporations and executives to design and negotiate employment agreements, severance agreements, and change of control agreements for key executives. She advises companies with respect to equity compensation plans, deferred compensation and other executive plans, and change of control agreements in preparation for sales or public offerings.

Mims has experience with qualified and nonqualified plans, including retirement and other defined benefit plans, and 401(k) and other defined contribution plans. She also advises on severance plans and clawback policies; matters related to ERISA and the Internal Revenue Code, including Section 409A, Section 162(m), and Section 280G; and issues involving the Internal Revenue Service and the US Department of Labor.

Biography

Jeffrey A. Letalien
Of Counsel
jeffrey.letalien@morganlewis.com
New York
+1.212.309.6763

Jeffrey A. Letalien represents domestic and foreign issuers, underwriters, and investors in diverse transactions. These transactions include public and private offerings and business combinations, as well as with respect to corporate governance, reporting and disclosure obligations, and other matters relating to securities regulation. Jeff regularly counsels public companies on compliance with periodic reporting requirements, complex indenture covenant requirements, and the corporate governance requirements of various stock exchanges.

Jeff represents public and private companies as issuers of debt and equity securities, including initial public offerings (IPOs), private placements of high-yield, convertible, and investment-grade debt securities under Rule 144A, and public-for-private exchange offers. He represents public companies, including commodity pools and other exchange-traded funds, in connection with their periodic reporting, as well as funds and individuals investing in securities of public and private companies, and related matters, including Section 13(d) and Section 16 reporting and compliance. He also advises public companies in connection with "going dark" and going private, as well as in connection with disclosure obligations relating to business combinations, including proxy statements and tender offer materials.

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