

2015 Proxy Season Preview

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Overview of the 2015 Proxy Season – Agenda

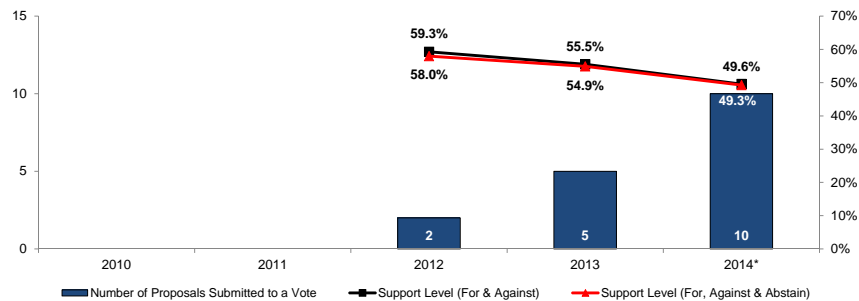
- Shareholder proposal trends
- Impact of increasing shareholder activism
- Say-on-pay and compensation disclosure trends
- Voting policy changes from proxy advisory firms
- Trends in actions to enhance corporate governance and say-on-pay votes

Shareholder Proposals Trends

Shareholder Proposal: Proxy Access

- A total of 22 proxy access proposals were submitted in 2014
- Companies receiving majority support for proxy access proposals:
 2014 - Nabors Industries Ltd., Abercrombie & Fitch Co., SLM Corporation, Big Lots, Inc., International Game Technology and Boston Properties, Inc.
 2013 - Verizon, CenturyLink and Darden Restaurants
 2012 - Nabors Industries and Chesapeake Energy
- SEC-style proposal (3% for 3 years, 20/25% cap on seats) continues to garner greatest support
- NYC Pension Funds launched a national campaign in November 2014 submitting 75 separate proxy access proposals with 3 years / 3% terms as part of its "Boardroom Accountability Project"

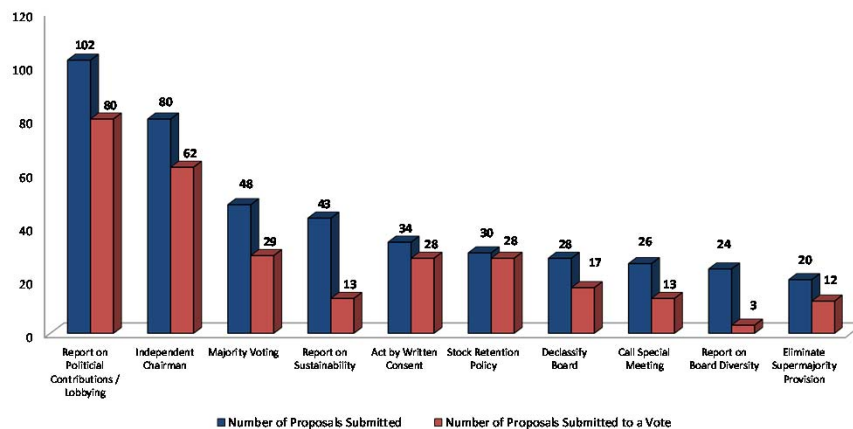
Proxy Access Proposals (3 Years at 3%)



*Data from January 1, 2014-October 31, 2014
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Shareholder Proposals Trends (Cont'd)

2014 - Top 10 Proposals Submitted



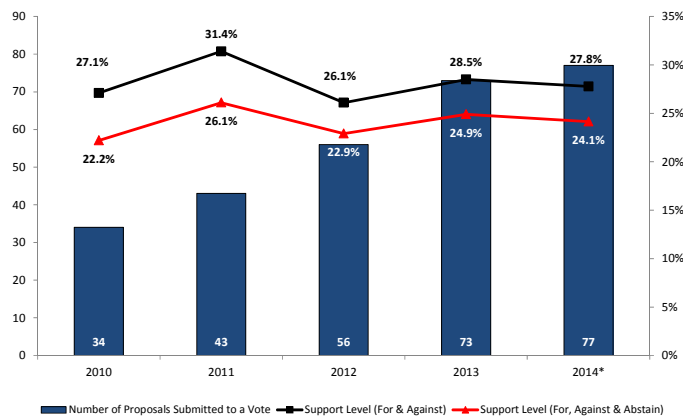
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #1: Report on Political Contributions/Lobbying Payments

- Corporate political contributions and lobbying payments were again at the center of considerable shareholder focus, yet received relatively low support
- Several large institutional investors have shifted from voting Against to voting Abstain
- Proposal garnered majority support (For + Against) at six companies in 2014¹



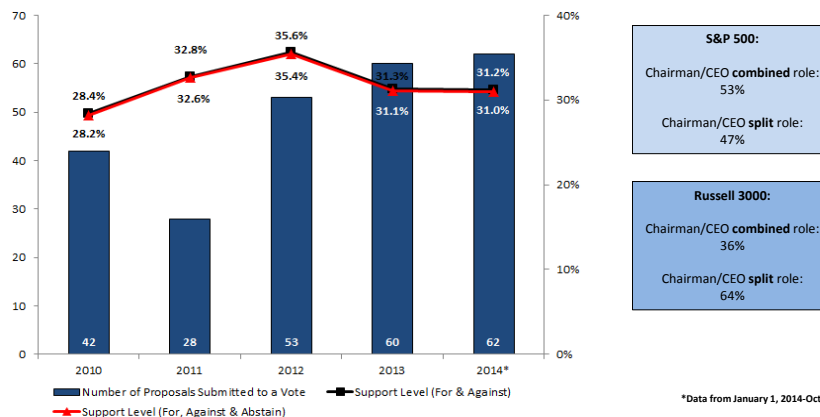
¹ Majority support reflects For votes as a percentage of For and Against votes, excluding Abstentions

*Data from January 1, 2014-October 31, 2014
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #2: Independent Chairman

- The combined Chairman/CEO role continues to be at the center of investor attention
- 48% of companies received a For recommendation from ISS in 2014 and received average support of 40%
- 52% of companies received an Against recommendation from ISS in 2014 and received average support of 23%
- Four proposals received majority support in 2014 and received average support of 55.3%



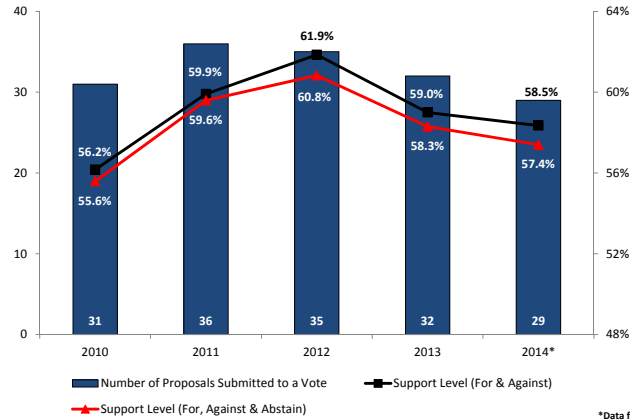
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #3: Majority Voting Standard for Director Elections

- Average support for majority voting proposals has dipped but remains above a majority of votes cast



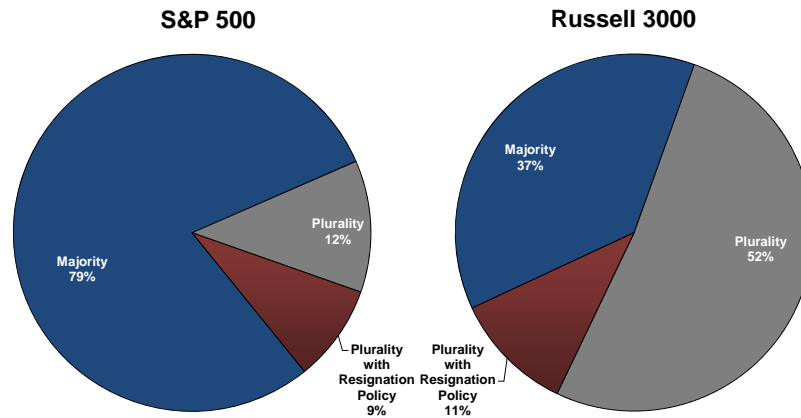
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Shareholder Proposals Trends (Cont'd)

Director Election Standard: S&P 500 vs. Russell 3000

- A significant portion of S&P 500 companies have adopted a majority vote standard for director elections
- In the Russell 3000, meanwhile, plurality voting remains prevalent



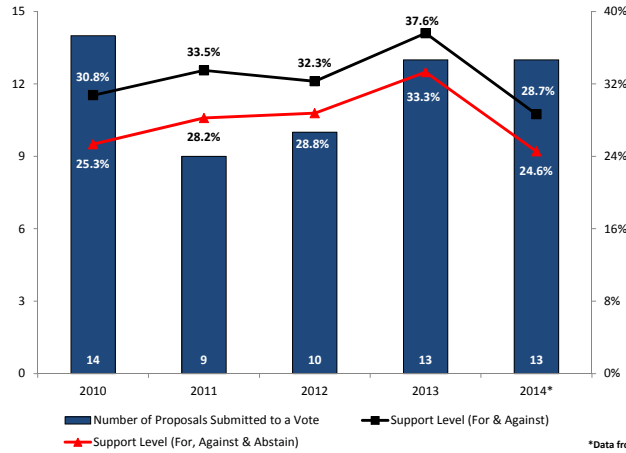
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #4: Report on Sustainability

- 92% of companies received a For recommendation from ISS in 2014



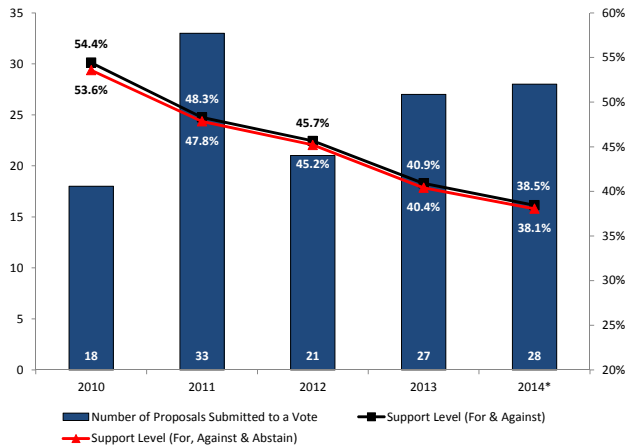
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #5: Act by Written Consent

- Support for written consent proposals continues to decline due to certain large institutional investors viewing other positive governance provisions as sufficient channels by which to address concerns, such as the right to call special meetings



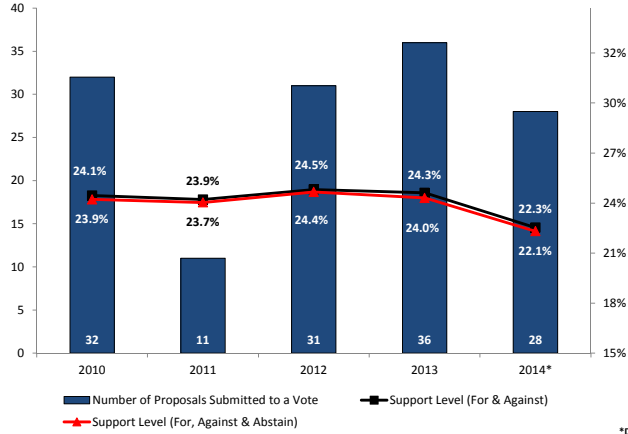
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #6: Stock Retention/Holding Period Policy

- Support for stock retention policies has remained typically low



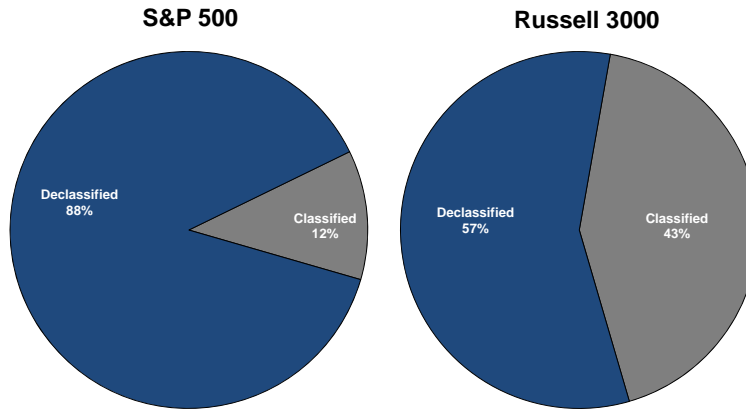
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Shareholder Proposals Trends (Cont'd)

Classified Board: S&P 500 vs. Russell 3000

- The declassified board has emerged as the norm among S&P 500 companies, whereas the classified board remains in place at a significant number of Russell 3000 companies



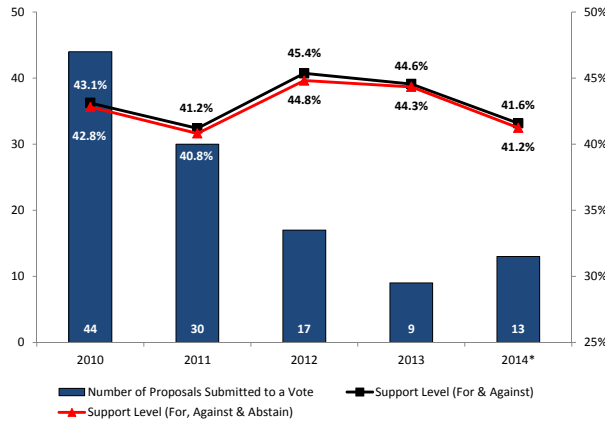
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #8: Call Special Meeting

- Many shareholder proposals were omitted due to management submitting its own special meeting proposal (predominately at the 25% threshold)
- 42% of proponents sought a 10% ownership threshold, which received average support of 35%
- 58% of proponents sought a 15% ownership threshold, which received average support of 45%



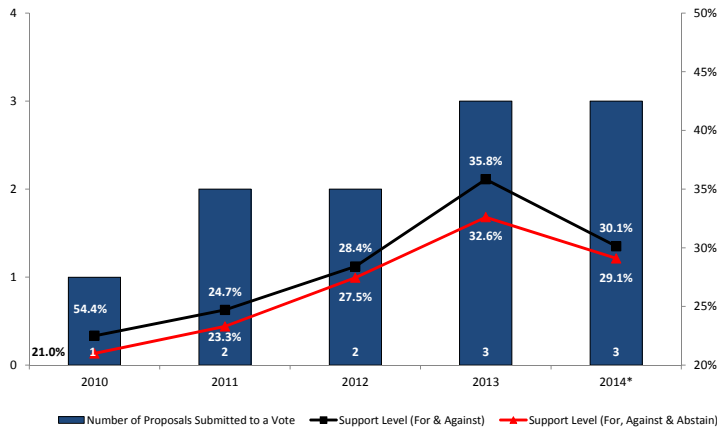
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #9: Report on Board Diversity

- New to the top 10, the board diversity proposal was submitted at 24 companies this year; however, only 3 went to a vote



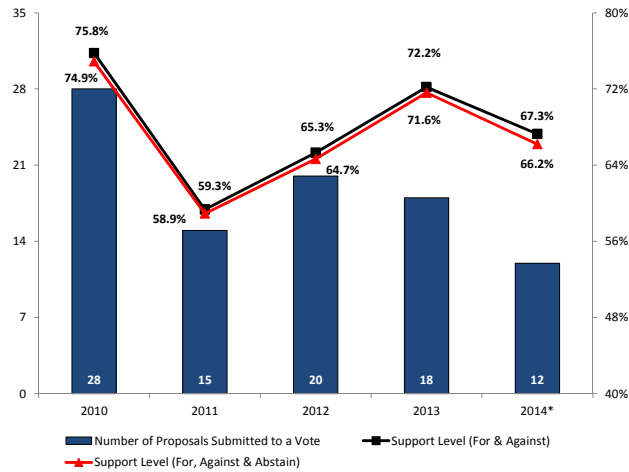
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Shareholder Proposals Trends (Cont'd)

Shareholder Proposal #10: Eliminate Supermajority Provision

- Eliminate supermajority provision proposals have consistently received strong support



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Shareholder Proposals Trends (Cont'd)

Other Compensation-Related Proposals

- Prohibit Accelerated Vesting of Equity Awards
 - 29 proposals of this type submitted in 2014
 - 20 were voted on and received average support of 35.8%, with 4 receiving majority support
- Limit Severance Pay
 - 4 proposals of this type submitted in 2014
 - 2 were voted on, with 1 receiving majority support
- Prohibit Tax Gross-Ups
 - 1 proposal of this type submitted in 2014, down from 4 in 2013
 - Proposal received 34.7% support

Based on data from Alliance Advisors

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Impact of Increasing Shareholder Activism

- Activist funds continue to proliferate – over \$100 billion in assets under management
- Shareholder activism continues to grow – over 350 campaigns in 2014
- Activists targets include large cap brand name companies
- Activists obtaining support from institutional investors
- Activists have partnered with strategic bidders (e.g., Pershing Square partnering with Valeant in hostile bid for Allergan)
- Settlements granting dissidents board seats have become common (e.g., Bank of New York Mellon, Dow Chemical, Walgreen)
- Activist wins either by shareholder vote or settlement in 72% of proxy fights in 2014 (Source: FactSet SharkWatch)

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Say-on-Pay and Compensation Disclosure Trends

- Overall “say on pay” results in 2014 have been similar to 2013, although results for individual companies have varied
 - Average support was 92% across all companies
 - Shareholder engagement appeared to work for companies with failed votes in 2013; a majority of these companies received greater than 70% support in 2014
- There continues to be a correlation between failed “say on pay” votes and negative vote recommendations from proxy advisory services, but correlation in 2014 was less strong than in prior years
 - In 2014, a negative ISS recommendation correlated to a decline in median voting support by 25.9% at S&P companies compared to 32.5% over the prior three years*

*Statistics courtesy of Wescott, 2014 Proxy Season Wrap-up (The Advisor July 2014)

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Say-on-Pay and Compensation Disclosure Trends (Cont'd)

- Most common reasons for failed say on pay votes
 - Pay and performance “disconnect”
 - Poor stock performance
 - Insufficiently rigorous performance goals
 - Special awards, mega-grants or non-performance-based equity
 - “Problematic” pay practices

Say on Pay Forecast for 2015

- No significant changes in ISS policies relating to say on pay
- Glass Lewis
 - Enhanced scrutiny for one-time awards
 - Recoupment/clawback policies
 - Triggering events should include restatements of financial results or similar revisions of performance indicators
 - Limited board discretion
- Will companies hold “say-when-on-pay” frequency vote early?

Compensation Disclosure Trends and Considerations

- Say on pay disclosure considerations
 - Pay for performance disclosure trends
 - “Realizable” or “realized” pay
 - Use of charts or other graphics
 - Location in proxy statement
 - Establishing workable precedent
 - SEC requirements:
 - GAAP presentation or reconciliation
 - Not materially misleading (balance)
 - Executive summaries and lists of best practices
 - Sometimes-overlooked required disclosures
 - Discuss consideration of prior say on pay vote in CD&A
 - Disclose frequency and when next vote will occur in say on pay proposal
 - Voluntary pay ratio disclosures?

Compensation Disclosure Trends and Considerations (Cont'd)

- Dodd-Frank requires the SEC to issue rules requiring issuers to disclose in their proxy statements a “pay ratio,” described as the following:
 - The median of the annual total compensation of all employees of the issuer, except the CEO; the annual total compensation of the CEO; and the ratio of those two amounts, with total compensation determined in accordance with Item 402 of Regulation S-K.
- The SEC proposed rules in September 2013
- Final rules target date delayed until October 2015

Compensation Disclosure Trends and Considerations (Cont'd)

- Under the proposed SEC pay ratio rules, for purposes of identifying the median employee:
 - Employee pool would include:
 - All employees of the registrant and its subsidiaries on the last day of the most recently completed fiscal year
 - All domestic and foreign full-time, part-time, seasonal or temporary workers employed on that day
 - Companies would be permitted to use their entire employee population or statistical sampling

Voting Policy Changes from Proxy Advisory Firms - ISS

- Shareholder proposals requiring an independent chairman of the board
 - ISS is replacing current "safe harbor" policy for a more holistic evaluation
 - Under current policy, ISS will generally recommend against independent chair proposals if the company meets the following elements:
 - Strong lead director role
 - Satisfactory performance, based on 1- and 3-year TSR
 - Two-thirds (2/3) independent board
 - Formal governance guidelines
 - Fully independent board committees
 - No other significant governance issues
 - Under new "holistic" approach, the following would also be considered:
 - Whether the company has an executive chair
 - Recent leadership transitions at the company
 - Director/CEO tenure
 - A longer (5-year) TSR performance period

Voting Policy Changes from Proxy Advisory Firms – ISS (Cont'd)

- Unilateral bylaw/charter amendments
 - Policy on responding to amendments to bylaws or charter without shareholder approval in a manner that:
 - Materially diminishes shareholders' rights or
 - Could adversely impact shareholders without shareholder approval
 - Generally will trigger negative vote recommendation on individual directors, committee members or entire board
 - Factors considered include:
 - Board's rationale for acting without shareholder approval
 - Shareholder engagement regarding the amendment
 - Level of impairment to shareholders' rights
 - Board's track record
 - Leadership structure
 - Governance provisions
 - Whether change was made in connection with IPO
 - Timing relative to significant business developments

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Voting Policy Changes from Proxy Advisory Firms – ISS (Cont'd)

- Shareholders' Litigation Rights
 - For bylaw provisions impacting shareholders' ability to bring suit against the company, ISS will recommend on a case by case basis, taking into account:
 - Company's stated rationale
 - Disclosure of past harm from shareholder lawsuits
 - Scope of the bylaw, including lawsuits to which it would apply
 - Governance features, such as shareholders' ability to repeal, annual director elections, majority vote standard
 - ISS will generally vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits

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Voting Policy Changes from Proxy Advisory Firms – ISS (Cont'd)

- Proposals requiring disclosure of political contributions
 - ISS will continue its approach of generally recommending “for” such proposals
 - Update policy slightly modifies ISS’s evaluation of proposals, most notably reviewing and considering management and board oversight mechanisms in applying its policy
- Proposals calling for adoption of greenhouse gas (GHG) emission reduction goals
 - ISS has clarified factors it will consider in the analysis:
 - Whether the company provides disclosure of year-over-year GHG emissions performance data
 - Whether the company’s disclosure lags behind peers
 - The company’s actual GHG emissions performance
 - The company’s current GHG emission policies, oversight mechanisms, and related initiatives
 - Whether the company has been the subject of recent, significant violations, fines, litigation, or controversy related to GHG emissions

Voting Policy Changes from Proxy Advisory Firms – ISS (Cont'd)

- Equity Plan Scorecard (EPSC)
 - Replaces previous methodology for evaluating equity plan proposals, which consisted of a series of “pass/fail” tests
 - Voting recommendations will now be based on a combination of factors relating to (1) cost, (2) plan features, and (3) grant practices
 - Total EPSC “score” will generally determine voting recommendation

Voting Policy Changes from Proxy Advisory Firms – ISS (Cont'd)

- Three Categories of Factors Under Equity Plan Scorecard (EPSC)
 - **Plan cost** – the total estimated cost relative to industry/market cap peers, measured by estimated Shareholder Value Transfer (SVT)
 - **Plan features** – single-trigger vesting, discretionary vesting authority, liberal share recycling on various award types and minimum vesting periods
 - **Grant practices** – 3-year relative burn rate, vesting requirements in last 3 years' worth of CEO awards, estimated duration of the plan, proportion of most recent CEO awards subject to performance conditions, presence of clawback policy, presence of equity holding requirements

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Voting Policy Changes from Proxy Advisory Firms – ISS (Cont'd)

- Total EPSC “score” will generally determine voting recommendation
- However, there will still be “bright line” features that will trigger a negative recommendation:
 - Award vesting based on liberal change of control definition
 - Plan permits repricing without shareholder approval
 - Plan serves as vehicle for problematic pay practices or pay for performance disconnect
 - Any other plan features that are determined to have a “significant negative impact on shareholder interests”

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Voting Policy Changes from Proxy Advisory Firms – Glass Lewis

- Governance Committee Vote Recommendations
 - Will recommend vote against chairman or full governance committee if the board unilaterally amends governance documents “to reduce or remove important shareholder rights, or to otherwise impede the ability of shareholders to exercise such right”
 - Will recommend vote against full governance committee if board fails to respond adequately to shareholder proposals relating to “important shareholder rights” that receive majority support

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Voting Policy Changes from Proxy Advisory Firms – Glass Lewis (Cont'd)

- Director Independence
 - In assessing the “materiality” of a relationship in determining director independence, a \$120,000 threshold generally applies for a director employed by a professional services firm
 - Glass Lewis clarified that a transaction exceeding \$120,000 will not be considered material if the amount represents less than 1% of the firm’s annual revenue and the board provides a “compelling rationale” as to why independence is not affected

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Voting Policy Changes from Proxy Advisory Firms – Glass Lewis (Cont'd)

- Say on pay and “one-off” awards
 - A new element in Glass Lewis’s say on pay analysis will consider any “one-off awards granted outside of existing incentive programs”
 - In the event of any “one-off” awards, Glass Lewis will look for:
 - A thorough description of the awards and their necessity
 - Tie to future service and performance, where possible
 - A description of if and how the awards will affect regular compensation arrangements
 - Glass Lewis will consider the “terms and size of the grants in the context of the company’s overall incentive strategy and granting practices, as well as the current operating environment”

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Trends in Actions to Enhance Corporate Governance and Say-on-Pay Votes

- Many companies have taken action in recent years to improve their corporate governance scores and say on pay
- Some actions may be “low-hanging fruit”
 - Relatively little downside from management’s perspective
 - Significant upside in terms of corporate governance perception and say on pay success
- Some common examples include:
 - Anti-hedging or pledging policies
 - Recoupment or “clawback” policies
 - Enhanced stock ownership guidelines
 - Eliminating tax gross-ups prospectively
 - Adding new director candidates to refresh or diversify the board
 - Allowing shareholder rights plans to expire
- Potentially more difficult changes include:
 - Equity holding policies
 - Eliminating or reducing perquisites
 - Substituting “double trigger” vesting arrangements in place of “single trigger”
 - Adopting majority vote standard for director elections
 - Eliminating classified boards

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Questions & Answers

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Thank You

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- CLE questions? Contact Ellie Kemmeter at ekemmeter@foley.com
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