

2016 Proxy Season Preview

December 16, 2015

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-2-

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Today's Presenters



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-3-

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Overview of the 2016 Proxy Season Preview – Agenda

- D&O questionnaires
- SEC rulemaking updates
- Voting policy changes from proxy advisory firms
- Shareholder proposals, including proxy access
- Say-on-pay and compensation governance trends
- Shareholder engagement

-4-

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D&O Questionnaires

- No updates for SEC, NYSE or Nasdaq rule changes
- However, need to consider additional questions due to PCAOB Auditing Standard No. 18 regarding related party transactions
 - » Should be discussed with the company's auditors
 - » Some companies asking D&Os to identify immediate family members and entities they control

-5-

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SEC Rulemaking Update

- CEO Pay Ratio – Final
- Mandatory Clawback – Proposed
- Pay for Performance Disclosure – Proposed
- Hedging Disclosure – Proposed

No rule changes expected to be effective for 2016 proxy season

-6-

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SEC Rules - CEO Pay Ratio Status and Timing

- Final rules issued on August 5, 2015
- Disclosure required for compensation for full fiscal years beginning on and after January 1, 2017
- For calendar year issuers, pay ratio disclosure will first be required in proxy or information statement for the 2018 annual meeting, based on 2017 compensation

-7-

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SEC Rules - CEO Pay Ratio Required Disclosure and Scope

- Required disclosure:
 - » The median of the annual total compensation of all employees of the company and its consolidated subsidiaries (Median Pay) other than the principal executive officer (CEO);
 - » The annual total compensation of the CEO (CEO Pay); and
 - » The ratio of the Median Pay to the CEO Pay, expressed either as a ratio in which the Median Pay is one (e.g., 1 to 100) or in narrative as a multiple (e.g., “our CEO’s pay for 2015 was 100 times the median of the total compensation of all of our employees (other than our CEO) for 2015”)

-8-

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SEC Rules – CEO Pay Ratio

Key Issue: Identifying the Median Employee

- Pool of employees will include all full-time, part-time, seasonal, or temporary workers employed on the day selected by the company, whether located in the U.S. or outside the U.S. (subject to limited exceptions for certain non-U.S. employees)
- May use either the entire employee population or statistical sampling or other reasonable methods
- May use either (1) actual annual total compensation, calculated using the Summary Compensation Table rules, or (2) any other annual compensation measure that is consistently applied to all employees included in the calculation
- Identify every three years

-9-

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SEC Rules – CEO Pay Ratio

Action Steps

- **Step 1:** Assemble working group
- **Step 2:** Evaluate compensation measures available to use in identifying the median employee and consider whether statistical sampling may be necessary
- **Step 3:** Prepare “mock-up” disclosures using 2014 or 2015 compensation information

-10-

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SEC Rules – Clawbacks

Status and Scope

- Proposed rules issued July 1, 2015
- Comment period ended September 14, 2015
- Stock exchanges would adopt rules requiring listed companies to adopt compensation recovery policies

-11-

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SEC Rules – Clawbacks

Scope of Clawbacks

- Policy would be triggered by an accounting restatement required to correct an error that is material to previously issued financial statements
- Policy would apply to incentive-based compensation received by current or former executive officers during the three fiscal years preceding the date on which the issuer is required to prepare the accounting restatement
- Incentive-based compensation subject to the clawback would include compensation received due to achievement of a goal based on accounting principles or on stock price or total stockholder return (TSR)
 - » Stock options that are granted, earned and vested based solely on continued employment would not be subject to the policy

-12-

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SEC Rules – Clawbacks

Scope of Clawbacks

- Amount of the recovery would be the excess of the amount of incentive-based compensation the executive officer actually received over the amount the executive officer would have received based on the restated numbers
 - » Determined on a pre-tax basis
 - » Where the incentive compensation is based on stock price or TSR, reasonable estimates could be used to calculate the excess amount
- No-fault basis for recovery
- Policy and information on enforcement will need to be filed
- **Action step:** ensure that current incentive awards and plans and any applicable agreement permit recovery in the event the clawback policy is triggered

SEC Rules - Pay for Performance Disclosure Status and Required Disclosure

- Proposed rules issued April 29, 2015
- Comment period ended July 6, 2015
- Rules would require disclosure of:
 - » The relationship between executive compensation actually paid to the registrant's executive officers and the cumulative TSR of the registrant; and
 - » The relationship between the registrant's TSR and the TSR of a peer group chosen by the registrant

SEC Rules - Pay for Performance Disclosure Disclosure Components

- The required disclosure consists of two components:

- » The following table covering the preceding 5 years (3 years for smaller reporting companies), using XBRL:

Year (a)	Summary Compensation Table Total For PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for non-PEO Named Executive Officers (d)	Average Compensation Actually Paid to non- PEO Named Executive Officers (e)	Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)

- » A graph or narrative (or both) providing a “clear description” of (1) the relationship between executive compensation actually paid and registrant TSR, and (2) the relationship between registrant TSR and peer group TSR

-15-

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SEC Rules - Pay for Performance Disclosure Compensation “Actually Paid”

- Differences from Summary Compensation Table
 - » Value of equity awards included at time of vesting rather than grant
 - » Pension plan value would be limited to changes attributable to the applicable year of service
- **Action Step:** Consider preparing “mock up” of disclosure based on 2015 pay and performance

-16-

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SEC Rules - Hedging Disclosure

- Proposed rules issued February 9, 2015
- Comment period ended April 20, 2015
- SEC has signaled it is considering changes to make clear that regular diversification transactions are not covered
- Required disclosure: whether the company permits any employee, officer or director of the company (or his or her designee) to purchase any financial instruments or otherwise engage in transactions that are designed to or have the effect of hedging or offsetting any decrease in the market value of equity securities that the employees, officers or directors receive from the company as compensation or that they otherwise hold, directly or indirectly
- Most companies already have anti-hedging policies, but will need to re-evaluate to determine how the policies match up with the specific disclosure requirements
- Because disclosure would apply to all employees (and not just officers and directors), companies must determine whether to apply anti-hedging to all employees

-17-

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ISS Policy Updates - Overboarding

- **Non-CEO directors** – new policy is to recommend against directors who sit on more than 5 (down from 6) public company boards
 - » Serving on more than 5 boards will be noted as a concern in 2016 but will not trigger negative vote recommendations until 2017
- **CEO directors** – no change to current policy of recommending against CEOs who sit on more than two public company boards besides their own

-18-

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ISS Policy Updates - Unilateral Bylaw/Charter Amendments

- For established companies – generally recommend against individual directors, committee members or entire board if the board unilaterally amends the bylaws or charter in a manner adversely impacting shareholders, considering specified factors
 - » Case-by-case recommendations on directors at subsequent annual meetings following the amendment until the adverse provision is reversed or ratified by shareholders
 - » Generally recommend against directors in subsequent years if the unilateral amendment classified the board, established supermajority vote standards to amend the bylaws or charter or eliminated shareholder right to amend bylaws
- Newly public companies – generally recommend against individual directors, committee members or entire board if the company or board adopts bylaw or charter provisions adverse to shareholders’ rights prior to or in connection with the IPO, considering specified factors
 - » Mitigating factors include a low level of impairment, the rationale, ability of shareholders to change the governance structure in the future, presence of declassified board and whether the company publicly commits to having shareholders vote on the provision within 3 years of the IPO
 - » Case-by-case recommendations on directors post-IPO until provision is reversed or ratified by shareholders

-19-

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ISS Policy Updates - Proxy Access Nominees

- Continue to evaluate proxy access nominees on a case-by-case basis using same criteria applied to nominees in contested elections
- New for 2016: ISS may consider additional relevant factors with respect to proxy access nominees, including “those that are specific to the company, to the nominee(s) and/or to the nature of the election (such as whether or not there are more candidates than board seats)”

-20-

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ISS Policy Updates - Other Changes

- Executive Compensation Disclosure at Externally Managed Issuers
 - » List of problematic pay practices that will generally result in a negative recommendation on say on pay now includes “Insufficient Executive Compensation Disclosure by Externally Managed Issuers (EMIs)”
- Shareholder Proposals Seeking Executive Equity Retention
 - » Policy on shareholder proposals asking companies to adopt executive equity retention policies broadened to apply more generally, eliminating the necessity of the previous separate policy addressing proposals requesting 75% net share retention
 - » Clarification that ISS will strongly consider retention ratios and holding period duration (among other factors) in analyzing executive equity retention proposals on a case-by-case basis
- Shareholder Proposals on Environmental and Social Issues
 - » Updates to policies on proposals relating to animal welfare, pharmaceutical pricing, access to medicines and prescription drug re-importation and climate change/greenhouse gas emissions

-21-

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Glass Lewis Policy Updates - Overboarding

- Non-CEO directors – new policy is to recommend against directors who sit on more than 5 (down from 6) public company boards
- Executive officer directors – new policy is to recommend against directors who are executive officers of public companies and sit on more than 2 (down from 3) public company boards
- Overboarding under the revised Glass Lewis policies will be noted as a concern in 2016 but will not trigger negative vote recommendations until 2017

-22-

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Glass Lewis Policy Updates - Conflicting Management and Shareholder Proposals

- Factors to be considered in making vote recommendations with respect to conflicting management and shareholder proposals will include:
 - » Nature of the underlying issue
 - » Benefit to shareholders from implementation of the proposal
 - » Materiality of the differences between the terms of the proposals
 - » Appropriateness of the provisions given the company's shareholder base, corporate structure and other relevant circumstances
 - » Company's overall governance profile, including responsiveness to previous shareholder proposals and adoption of shareholder rights provisions

-23-

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Glass Lewis Policy Updates - Exclusive Forum Provisions

- Pre-IPO adoptions
 - » No longer triggers negative vote recommendation for the governance committee chair
 - » Provision will be weighed along with other governance practices that limit shareholder rights, including supermajority vote requirements, a classified board or a fee-shifting bylaw
- Continue policy of recommending against the governance committee chair at companies that adopt an exclusive forum provision in the past year without shareholder approval, other than in connection with an IPO, spin-off or merger

-24-

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Glass Lewis Policy Updates - Other Changes

- Nominating committee role in board composition
 - » May consider negative vote recommendation for the nominating committee chair if concludes that the board's failure to ensure that the board consists of directors with relevant experience has contributed to a company's poor performance
- Environmental and social risk oversight
 - » Negative vote recommendation for directors responsible for risk oversight if the board or management has failed to sufficiently identify and manage a material environmental or social risk that did or could negatively affect shareholder value

-25-

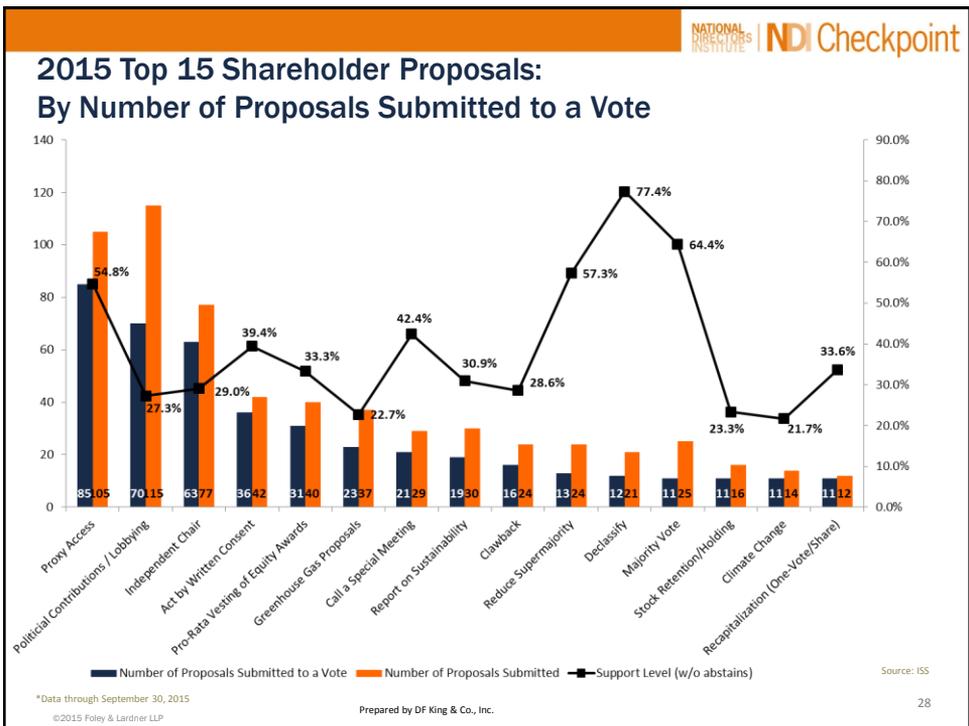
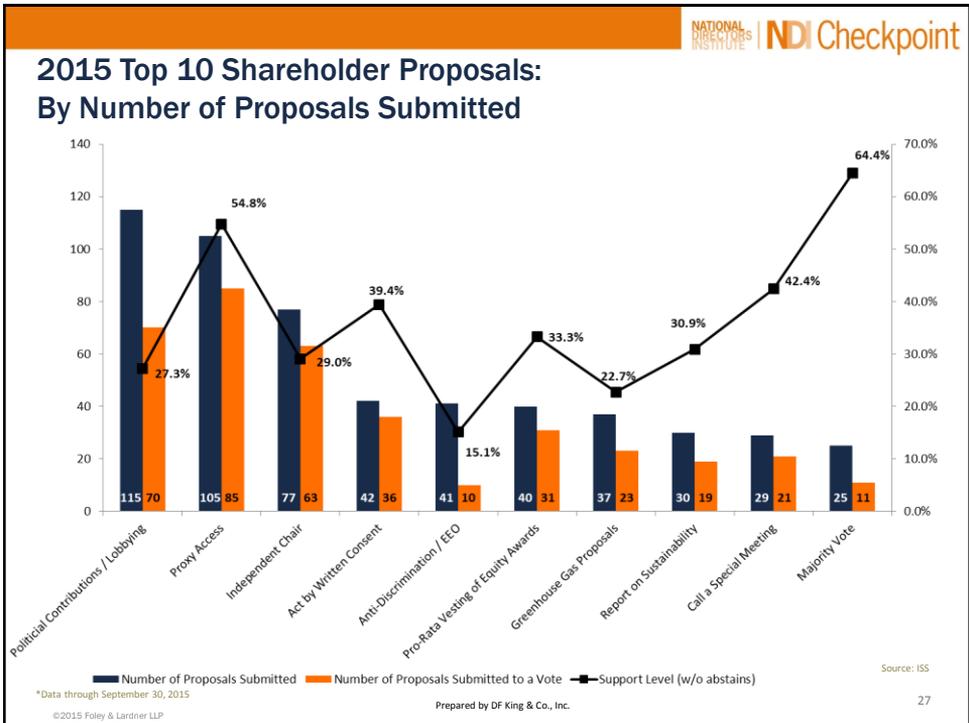
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Glass Lewis Policy Updates - Other Changes

- Compensation updates
 - » Highlighted factors to be considered when analyzing one-time and transitional awards and advised that sign-on arrangements and make-whole payments should be clearly disclosed
 - » Minor clarifications to factors considered when analyzing the qualitative aspects of equity compensation plans and note that significant changes in plan terms should be clearly disclosed

-26-

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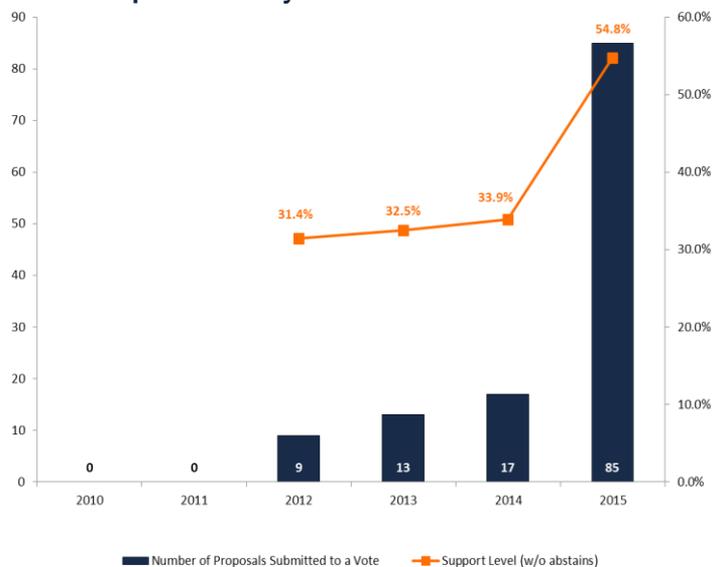
New SEC Staff Guidance on Shareholder Proposal Exclusions

- October 22, 2015 SEC Staff Legal Bulletin No. 14H
- Provides interpretive guidance on two provisions of Rule 14a-8 under the Securities Exchange Act:
 - » 14a-8(i)(9) – Exclusion relating to conflicting proposals
 - Whether a proposal may be excluded focuses on whether “direct conflict between the management and shareholder proposals”
 - Direct conflict exists “if a reasonable shareholder could not logically vote in favor of both proposals, *i.e.*, a vote for one proposal is tantamount to a vote against the other proposal.”
 - » 14a-8(i)(7) – Exclusion relating to ordinary business operations
 - SEC Staff will follow traditional approach, not Third Circuit Test in *Trinity Wall Street v. Wal-Mart Stores, Inc.*

-29-

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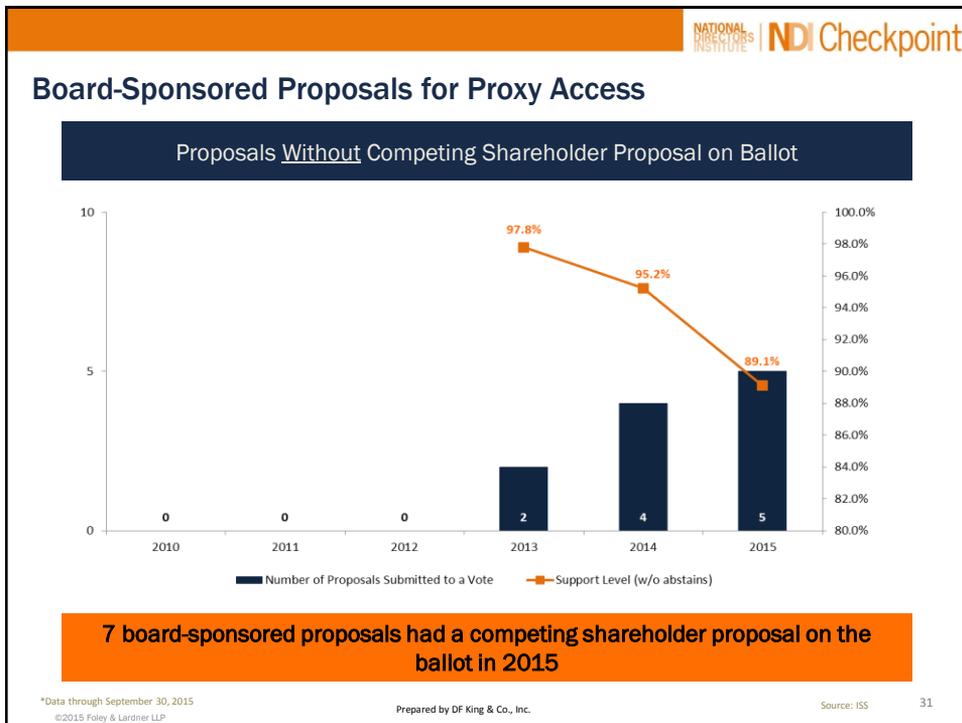
Shareholder Proposal: Proxy Access

*Data through September 30, 2015
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Source: ISS

30



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Proxy Access - Trends

- Over 100 companies have adopted proxy access bylaws
- At least 30 more companies that have not yet adopted proxy access where either (i) shareholders approved a shareholder proposal or a management proposal or (ii) the company has announced intention to adopt proxy access
- 3% minimum ownership and 3 year minimum holding period are becoming standard except in unique cases
 - » Cap on number of nominees varies, e.g., 20%, 25% or at least 2
 - » Maximum number of shareholders in a group that may aggregate holdings varies, e.g., unrestricted or 20

-32-

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Proxy Access – 2016 Shareholder Proposals

- **McRitchie/Chevedden proposals for 2016 annual meetings:**
 - » Ownership requirement of 3% (including recallable loaned stock) for 3 years
 - » Unrestricted number of shareholders may form group to aggregate holdings for minimum ownership
 - » Maximum number of nominees of greater of 25% or two directors
 - » Bylaws must not contain restrictions on nominations or re-nominations that do not apply to other directors
- **Shareholder proposals also being submitted to companies that adopted proxy access in 2015**

-33-

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Proxy Access – Alternatives if Receive Shareholder Proposal

- **Potential alternatives:**
 - » Negotiate withdrawal in exchange for commitment to adopt proxy access bylaw
 - » Include shareholder proposal in proxy statement and recommend against it
 - » Adopt proxy access bylaw and seek to exclude shareholder proposal under Rule 14a-8(i)(10) as substantially implemented
 - » Adopt proxy access bylaw and recommend against shareholder proposal as unnecessary
 - » Submit both the shareholder proposal and a competing management proposal for a vote
- **Shareholder engagement is key**

-34-

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Proxy Access – Other Terms

- In addition to key terms, there are a number of other proxy access terms subject to variation that are important to investors:
 - » Treatment of loaned shares - whether count as owned and must be recalled
 - » Treatment of funds under common control for purposes of counting against group maximum
 - » Nominating shareholder intent to hold shares after annual meeting
 - » Treatment of incumbent access directors as counting against proxy access nominee cap
 - » Bar on re-nomination based on failure to receive specified level of support
 - » Prohibition on third party compensation of nominee

-35-

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Say on Pay – 2015 Proxy Season Results

- Overall results similar to 2014, although the results for individual companies varied
 - » Average support was 91% across all companies (2% failure rate)
 - » The proportion of pay programs receiving less than 70% - the threshold that draws additional ISS scrutiny - fell slightly from 2014.
- Shareholder engagement appeared to work for some companies with failed votes in 2014; 38% of these companies received greater than 80% support in 2015
- On the other hand, of the 49 companies that lost pay votes this year, 31% received over 80% approval in 2014

*Statistics courtesy of Westcott, 2015 Proxy Season Wrap-up (The Advisor August 2015)

-36-

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Say on Pay – 2015 Proxy Season Results

- **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
- **Disclosure trends**
 - » Shareholder engagement and committee processes
 - » Pay and performance relationship

-37-

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Say on Pay Forecast for 2016

- Flat to declining stock prices may cause performance awards to fall short of target
 - » Waiving performance goals likely to be seen a problematic
- Presidential election cycle and media focus on executive pay?
- No significant changes in proxy advisor policies relating to say on pay
- Will companies hold “say-when-on-pay” frequency vote early?

-38-

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Shareholder Litigation Over Director Pay

- Director pay, as well as executive pay, has been the subject of shareholder litigation
- *Calma v. Templeton* (the “Citrix” case)
 - » In April 2015, the Delaware Court of Chancery Court refused to dismiss a breach of fiduciary duty claim brought by shareholders against the Board of Directors arising from equity compensation awards that Citrix Systems, Inc. had granted to its non-employee directors
 - » The fact that Citrix’s shareholders had approved individual award limits in the equity plan under which the directors’ awards were granted did not secure business-judgment-rule deference with respect to the amount of the director pay because the limits in the plan were not “meaningful”
 - » Instead, director defendants would have to show that their compensation was “entirely fair”

-39-

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Shareholder Litigation Over Director Pay

- Other recent cases similar to *Citrix*
 - » An excessive compensation lawsuit was filed in 2014 against the officers and directors of Facebook
 - Alleges directors received excessive compensation
 - Argues that the “demand” requirement is excused “Because . . . all the non-employee Director Defendants . . . received the challenged compensation pursuant to an incentive plan that contains no limits on their compensation, let alone meaningful ones, the Director Defendants stand on both sides of the compensation awards.”
 - » The Facebook complaint follows the 2012 Delaware case, *Seinfeld v. Slager*, which likewise alleged that directors had paid themselves excessive compensation
 - The court allowed plaintiffs to proceed without making a demand because the directors were not considered disinterested
- **Recommendation:** Consider establishing separate, “meaningful” award limits for non-employee directors in shareholder-approved omnibus plans or using a separate shareholder-approved plan for awards to non-employee directors

-40-

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Shareholder Engagement

- Company engagement with shareholders key, particularly on proxy access, say on pay, equity plan and other governance and compensation issues
 - » Timing: prior to proxy season
 - » Methods:
 - Surveys
 - Group meetings
 - One-on-one meetings
 - Conference calls
 - E-Forums
 - Additional soliciting material
 - » Designation of shareholder engagement “spokesperson(s)”
 - Board and Board committee involvement

Questions & Answers

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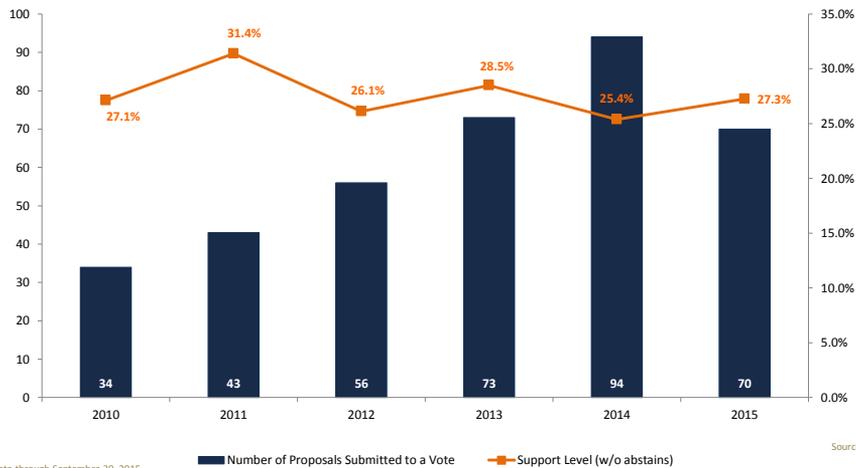
Appendix - 2015 Shareholder Proposal Information

-45-

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Shareholder Proposal: Report on Political Contributions/Lobbying Payments

- Although fewer proposals went to a vote this year, the issue of political contributions and lobbying payments remains an important focus of certain constituencies
- Average support for these proposals has been grounded in the mid to high 20's as a percent of the votes cast and no proposal garnered majority support in 2015



*Data through September 30, 2015

■ Number of Proposals Submitted to a Vote — Support Level (w/o abstains)

Source: ISS

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46

