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## Glass Lewis Releases 2015 Proxy Paper Guidelines

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

John J. Cannon III  
+1.212.848.8159  
[jcannon@shearman.com](mailto:jcannon@shearman.com)

David P. Connolly  
+1.212.848.4274  
[david.connolly@shearman.com](mailto:david.connolly@shearman.com)

Stephen T. Giove  
+1.212.848.7325  
[sgiove@shearman.com](mailto:sgiove@shearman.com)

Kenneth J. Laverriere  
+1.212.848.8172  
[klaverriere@shearman.com](mailto:klaverriere@shearman.com)

Doreen E. Lilienfeld  
+1.212.848.7171  
[dlilienfeld@shearman.com](mailto:dlilienfeld@shearman.com)

Clare O'Brien  
+1.212.848.8966  
[cobrien@shearman.com](mailto:cobrien@shearman.com)

Linda E. Rappaport  
+1.212.848.7004  
[lrappaport@shearman.com](mailto:lrappaport@shearman.com)

Amy Gitlitz Bennett  
+1.212.848.8974  
[agitlitz@shearman.com](mailto:agitlitz@shearman.com)

George T. Spera, Jr.  
+1.212.848.7636  
[gspera@shearman.com](mailto:gspera@shearman.com)

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**On November 6, 2014, Glass Lewis & Co. (“Glass Lewis”) released its 2015 Proxy Paper Guidelines for the United States showing the key draft policy changes for the 2015 proxy season. There are updates in the following areas:**

- **Governance Committee Performance;**
- **Board Responsiveness to Majority-Approved Shareholder Proposals;**
- **Vote Recommendations Following an IPO;**
- **“Material” Transactions with Directors;**
- **Management Say-on-Pay Proposals; and**
- **Proposals to Adopt or Amend Employee Stock Purchase Plans.**

**The 2015 policies generally will be effective for shareholder meetings of publicly traded companies held during the 2015 proxy season.<sup>1</sup>**

<sup>1</sup> The 2015 Proxy Paper Guidelines for the United States can be found at: [http://www.glasslewis.com/assets/uploads/2013/12/2015\\_GUIDELINES\\_United\\_States.pdf](http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf). Institutional Shareholder Services (“ISS”) also released its 2015 proxy guidelines on November 6, 2014. Our client publication summarizing ISS’s 2015 policies can be found at: <http://www.shearman.com/en/newsinsights/publications/2014/11/iss-publishes-2015-proxy-voting-guideline-updates>.

## Governance Committee Performance

Glass Lewis adopted a new policy regarding instances where the board of directors, without seeking shareholder approval, has amended the company's governing documents to reduce, remove or otherwise impede the ability of shareholders to exercise shareholder rights that Glass Lewis deems important. In these instances, Glass Lewis may recommend "Against" the chairman of the governance committee or the entire committee. Glass Lewis listed the following examples of board actions that may lead to such a recommendation:

- The elimination of the ability of shareholders to call a special meeting or to act by written consent;
- An increase to the ownership threshold required for shareholders to call a special meeting;
- An increase to vote requirements for charter or bylaw amendments;
- The adoption of provisions that limit the ability of shareholders to pursue full legal recourse (e.g., exclusive forum or fee shifting bylaws);
- The adoption of a classified board structure; and
- The elimination of the ability of shareholders to remove a director without cause.

## Board Responsiveness to Majority-Approved Shareholder Proposals

Under its prior policies, Glass Lewis would recommend "Against" all members of the governance committee during whose tenure a shareholder proposal relating to shareholder rights that Glass Lewis deems important received support from a majority of the votes cast if the board has not begun to implement or enact the proposal's subject matter. Glass Lewis lists examples of such shareholder proposals, including those seeking a declassified board structure, a majority vote standard for director elections or a right to call a special meeting.

In its 2015 policies, Glass Lewis applies a more nuanced approach to evaluating the adequacy of a board's response to these types of proposals. Glass Lewis will not only consider whether the board has enacted the proposal's subject matter, but it will now examine the quality of the right enacted or proffered for any conditions that may unreasonably interfere with a shareholder's ability to actually exercise the right (e.g., overly restrictive procedural requirements).

## Vote Recommendations Following an IPO

While Glass Lewis generally refrains from issuing voting recommendations on the basis of most corporate governance best practices during the one-year period following an initial public offering ("IPO"), its 2015 policies provide for increased scrutiny of certain provisions. These include anti-takeover provisions adopted in a company's charter or bylaws prior to an IPO that are not later put up for a shareholder vote following the IPO. The 2015 policies specifically provide that the following cases warrant strong shareholder-action against the board of a company that completed an IPO within the past year:

- **Adoption of an anti-takeover provision.** In cases where a board adopts an anti-takeover provision preceding an IPO, Glass Lewis will consider recommending "Against" the members of the board serving at the time that the provision was adopted if the board (1) did not also commit to submit the anti-takeover provision to a shareholder vote within 12 months of the IPO or (2) did not provide a sound rationale for adopting the anti-takeover provision.

- **Adoption of an exclusive forum provision or fee shifting bylaw.** Glass Lewis has adopted a bright-line rule with respect to exclusive forum provisions and fee-shifting bylaws adopted by the board prior to an IPO. Glass Lewis will recommend “Against” the governance committee chair in the case of an exclusive forum provision, and “Against” the entire governance committee in the case of a fee shifting bylaw, if such provisions are not put up for a shareholder vote following the IPO. In each instance, if the company does not have a governance committee, Glass Lewis will recommend “Against” the chairman of the board who served during the period of time when the provision was adopted.

### “Material” Transactions with Directors

In the context of determining director independence, Glass Lewis deems a “material” relationship to exist between the company and a director where such director is employed by a professional services firm (such as a law firm, investment bank or consulting firm) and the company has paid such firm \$120,000 or more during the past three or five years, depending on the specific circumstances. For this category of “material” relationships, Glass Lewis has clarified in its 2015 policies that it may deem such a transaction to be immaterial where (1) the amount represents less than 1% of the firm’s annual revenues and (2) the board provides a compelling rationale as to why the director’s independence is not affected by the relationship.

### Advisory Vote on Executive Compensation (“Say-on-Pay”)

Glass Lewis applies a highly nuanced approach when evaluating Say-on-Pay proposals. This approach is less formulaic than the methodology adopted by Institutional Shareholder Services, allowing for more flexibility (and potentially, unpredictability).

Glass Lewis reviews executive compensation on a case-by-case basis based on the company’s industry, size, maturity, performance, financial condition, historic pay-for-performance practices and any other relevant internal or external factors. Under its 2014 policies, Glass Lewis reviewed Say-on-Pay proposals on both a qualitative and quantitative basis focusing on four primary areas:

- Overall design and structure of the company’s executive compensation program, including the selection and challenging nature of performance metrics;
- The quality and content of the company’s disclosure;
- The quantum paid to executives; and
- The link between compensation and performance as indicated by the company’s current and past pay-for-performance grades.

The 2015 policies add a fifth factor:

- *The implementation and effectiveness of the company’s executive compensation programs, including pay mix and use of performance metrics in determining pay levels.*

Glass Lewis will recommend “Against” a Say-on-Pay proposal if it finds deficiencies in the design, implementation or management of a company’s compensation program, including: (1) a pattern of poor pay-for-performance practices, (2) unclear disclosures regarding the overall compensation structure, (3) questionable adjustments to certain aspects of the overall compensation structure or (4) other egregious compensation practices. The 2015 policies include a

non-exhaustive list of eleven factors Glass Lewis considers in making its voting recommendations with no changes from the 2014 policies.<sup>2</sup>

While the 2015 policies do not significantly modify Glass Lewis's approach to evaluating management Say-on-Pay proposals, Glass Lewis has refined its views in a few areas.

- **One-Off Awards.** Glass Lewis has added a summary of its approach to analyzing one-off awards granted outside of a company's standard incentive schemes. While Glass Lewis generally believes that one-off awards undermine the integrity of a company's regular incentive plans and the link between pay and performance, it recognizes that in certain circumstances, additional incentives may be appropriate. Glass Lewis will assess 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. Glass Lewis believes that if such awards are made, (1) the company should provide a thorough description of the awards, including a "cogent and convincing explanation of their necessity and why existing awards do not provide sufficient motivation," (2) the award should be tied to future service and performance and (3) the company should describe how these awards will affect its regular compensation arrangements.
- **Clawbacks.** Glass Lewis notes that it is prudent for boards to adopt a "detailed and stringent" bonus recoupment policy that is triggered in the event of a restatement of financial results or similar revision of performance indicators upon which the bonuses were based. The clawback policy should be subject to limited discretion. This addition encourages companies to adopt voluntary clawbacks in the absence of SEC rulemaking implementing the clawback provisions under Section 954 of the Dodd-Frank Act.
- **Compensation Consultant Independence.** Companies should provide clear disclosure of the compensation consultant relationships that is not limited to the six factors specified by the SEC. Glass Lewis will note a potential for a conflict of interest when the fees paid to the advisor or its affiliates for other services to the company exceed the fees paid for compensation consulting.

### Employee Stock Purchase Plans

The 2015 policies add a description of Glass Lewis's approach to evaluating proposals to adopt or amend employee stock purchase plans ("ESPPs"). Previously, Glass Lewis did not disclose its approach to ESPPs. For 2015, Glass Lewis maintains a quantitative model that estimates the cost of an ESPP by measuring the expected discount, purchase period, expected purchase activity and whether the ESPP has a "lookback" feature (e.g., the plan bases the purchase price on the stock price at either the beginning or end of the purchase period, whichever is lower). The model compares this data to ESPPs at similar companies. Glass Lewis will also analyze the potential shareholder dilution and whether shareholders will not have a chance to approve the program for an excessive period of time. Except for the most extreme cases, Glass Lewis will generally recommend a vote in favor of ESPP proposals; however, ESPPs that contain evergreen provisions

<sup>2</sup> The factors include: (1) inappropriate peer group and/or benchmarking, (2) inadequate or no rationale for changes to peer groups, (3) egregious or excessive bonuses, equity awards or severance payments, (4) targeting compensation at higher than median without adequate justification, (5) problematic contractual payments, such as guaranteed bonuses, (6) performance targets not sufficiently challenging and/or providing for high potential payouts, (7) performance targets are lowered, without justification, (8) discretionary bonuses paid when incentive plan targets were not met, (9) insufficient disclosure of policies, (10) executive pay high relative to peers and not justified by outstanding company performance and (11) the terms of long-term incentive plans are inappropriate.

(that automatically increase the number of shares available under the ESPP each year) will generally receive a negative recommendation.

## Conclusion

As was the case in 2014, Glass Lewis has not proposed sweeping changes to its existing policies.

The 2015 policies demonstrate that Glass Lewis is increasingly critical of any actions taken by a board to limit important shareholder rights that are not subject to a shareholder vote. Therefore, companies that intend to adopt anti-takeover or other corporate governance policies that limit shareholder rights should consider seeking shareholder support before implementing such policies. Glass Lewis has taken a similar approach in the IPO context, and companies with pre-IPO amendments to their governing documents that limit important shareholder rights should consider submitting such amendments to a shareholder vote within the first year following the IPO.

With respect to proposals relating to important shareholder rights that receive majority shareholder support, companies should now focus on the quality of the rights implemented and ensure that they have not imposed unreasonable impediments to shareholders' ability to exercise such rights.

The effects of the ESPP policies remain unclear as Glass Lewis has not previously disclosed its approach to these types of plans. Finally, while the modifications to Say-on-Pay provide greater clarification on Glass Lewis's policies, it is not likely that they will significantly affect the outcome of its recommendations.

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599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

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