2019 Annual Meeting And Reporting Considerations: Part 3

By **Brian Breheny, Joseph Yaffe, Caroline Kim, Hagen Ganem and Andrew Brady** (January 16, 2019, 2:37 PM EST)

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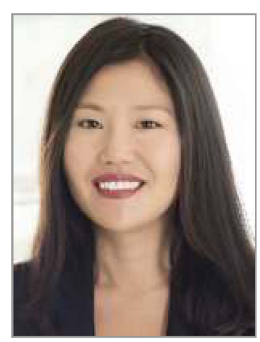

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Each company faces important decisions in preparing for its 2019 annual meeting and reporting season. This four-part series covers essential areas on which companies should focus as they plan for 2019, including corporate governance, executive compensation and disclosure matters.

Part 3 of this series, below, focuses on corporate governance best practices, including updates to D&O questionnaires; Institutional Shareholder Services and Glass Lewis proxy advisory voting guidelines; environmental, social and governance reporting; board diversity and related disclosures; and shareholder proposals. See part 1 **here** and part 2 **here**.

Review and Consider Updates to D&O Questionnaires

Although there have been no significant regulatory changes in 2018 that should impact director and officer, or D&O, questionnaires, companies may want to consider the following recent developments as they finalize their questionnaires.

"Outside Director" Status Under Section 162(m)

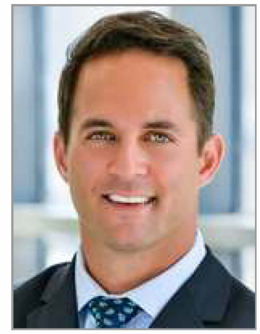
Companies that do not have any grandfathered compensation arrangements under the Tax Cuts and Jobs Act amendments to Section 162(m) may want to update their D&O questionnaires to omit any questions concerning "outside director" eligibility for membership on the compensation committee. For additional information, see the section in **part 2** titled "Plan for Grandfathering and Other Potential Changes in Pay Practices Due to the Tax Cuts and Jobs Act."

Board Diversity and Skills Matrix

Companies that plan to provide more robust disclosures in their annual proxy statements regarding board composition (see the section below titled "Consider Recommendations to Increase Board Diversity and Enhance Related Disclosures") should consider any necessary updates to their D&O questionnaires. For example, if companies intend to disclose a form of the diversity and skills matrix, the company may need certain additional information from directors, such as specific types of skills and experiences, sexual orientation, gender, age, race or ethnicity.

Perks Disclosures

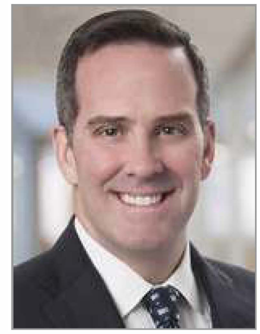
The D&O questionnaire can supplement a company's internal processes and procedures to identify perks disclosable as executive compensation. The SEC enforcement action relating to improper disclosures of executive perks serves as a reminder for companies to ensure that the D&O questionnaire adequately solicits information and the questionnaires are completed on a timely basis by all directors and officers.



Hagen Ganem

For example, in July 2018, the U.S. Securities and Exchange Commission charged the former CEO of an energy company[1] with hiding personal loans that should be reported as related person transactions, and submitting personal expenses for reimbursement that should be reported as perks. The SEC noted in its complaint that the former CEO had not completed his D&O questionnaires.

Assess Impact of Proxy Advisory Voting Guidelines by ISS and Glass Lewis



Andrew Brady

Proxy advisory firms Institutional Shareholder Services[2] and Glass Lewis[3] have updated certain of their voting guidelines for the 2019 annual meeting season. Companies should assess the potential impact of such updates, summarized below, when considering changes to corporate governance practices, including shareholder engagement, as well as proxy statement disclosures, which could serve as a basis for recommendations by ISS.

Board Gender Diversity

ISS announced that, effective for meetings on or after Feb. 1, 2020, it will generally recommend that shareholders vote against or withhold from the nominating committee chair (or other directors on a case-by-case basis) at companies in the Russell 3000 or S&P 1500 indices if no women serve on the company's board.

Glass Lewis will begin implementing its updated board gender diversity policy for meetings held after Jan. 1, 2019. As previously announced, under the new policy Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female directors and may also vote against other members of the nominating committee in certain circumstances.

When making voting recommendations, Glass Lewis will review a company's disclosure of diversity considerations and may not recommend votes against directors in cases where the board has provided a "sufficient rationale" for not having any female directors. Such rationale may include a disclosed timetable for addressing the lack of diversity on the board and any notable restrictions in place regarding the board's composition (for example, director nomination agreements with significant investors).

Environmental and Social Risk Oversight

As part of its review of how boards are overseeing environmental and social issues, Glass Lewis clarified that it may consider recommending that shareholders vote against directors who are responsible for oversight of environmental and social risks in cases where it determines that companies have not properly managed or mitigated such risks to the detriment of shareholder value, or where such mismanagement has threatened shareholder value.

Auditor Ratification

Glass Lewis updated its guidelines for situations in which it may recommend votes against ratification of a company's outside auditor. Glass Lewis will consider factors including auditor tenure, any pattern of inaccurate audits and any ongoing litigation or significant controversies that call into question the auditor's independence. Glass Lewis indicated that these factors may lead to a recommendation against auditor ratification in limited cases.

Virtual-Only Shareholder Meetings

Glass Lewis will begin implementing its new policy on virtual-only shareholder meetings for meetings held after Jan. 1, 2019. As previously announced, for companies that hold virtual-only shareholder meetings, Glass Lewis will examine the company's disclosure of its virtual meeting procedures and may recommend votes against directors on the nominating committee if the company does not provide disclosure assuring that shareholders will have the same opportunities to participate at the virtual meeting as they would at an in-person meeting.

Director Qualifications

ISS codified its approach to evaluating director attendance, indicating that when a director exhibits chronic poor attendance without reasonable justification, ISS will generally vote against the director with poor attendance and may also recommend a vote against or withhold from appropriate members of the nominating committee or the full board. ISS defines "chronic poor attendance" as three or more consecutive years of poor attendance without reasonable explanation.

As part of its assessment of directors' conflicts of interest, Glass Lewis recommends that shareholders vote against directors who provide, or whose immediate family members provide, material professional services to the company (such as legal, consulting or financial services). For meetings held after Jan. 1, 2019, Glass Lewis will "generally refrain" from recommending against a director who provides consulting services if the director does not serve on the audit, compensation or nominating committees and Glass Lewis has not identified "significant governance concerns" with the board.

Shareholder Proposals

Developments during the 2018 proxy season allowed companies to secure from the SEC staff no-action relief to exclude shareholder proposals from their proxies, by including a conflicting management-sponsored proposal to ratify an existing governance provision (particularly regarding shareholder proposals to create special meeting rights).

In response, ISS adopted a new policy on management proposals to ratify existing charter or bylaw provisions. In addition to generally recommending a vote against ratification proposals regarding governance matters that do not represent best practices, ISS may recommend a vote against or withhold from individual directors, members of the nominating committee or the full board when boards ask shareholders to ratify existing charter or bylaw provisions.

In making its recommendation, ISS will consider the following:

- The presence of a shareholder proposal addressing the same issue on the same ballot;
- The board's rationale for seeking ratification;
- Disclosure of actions to be taken by the board should the ratification proposal fail;
- Disclosure of shareholder engagement regarding the board's ratification request;
- The level of impairment to shareholders' rights caused by the existing provision;
- The history of management and shareholder proposals on the provision at the company's past meetings;
- Whether the current provision was adopted in response to the shareholder proposal;

- The company's ownership structure; and

- Previous use of ratification proposals to exclude shareholder proposals.

Glass Lewis also updated its guidelines regarding a number of specific shareholder proposal topics and regarding company responses to shareholder proposals more generally.

Special Meeting Proposals. Glass Lewis generally favors a 10 to 15 percent special meeting right, and will generally recommend that shareholders support proposals within this range. Glass Lewis also codified its approach to conflicting shareholder proposals addressing special meeting rights.

- When a company's proxy statement contains both a management and shareholder proposal requesting different thresholds for the right to call a special meeting, Glass Lewis will generally recommend voting for the lower threshold (in most instances, the shareholder proposal) and recommend voting against the higher threshold.

- When a company's proxy statement contains conflicting management and shareholder special meeting proposals, and shareholders do not currently have a special meeting right, Glass Lewis may consider recommending that shareholders vote in favor of the shareholder proposal and abstain from voting on management's proposal.

- Although Glass Lewis generally states that it will recommend voting against members of the governance committee on the basis of the company's exclusion of a shareholder proposal only in "very limited circumstances" where the exclusion is "detrimental to shareholders," in the specific context of a company exclusion of a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, Glass Lewis will typically recommend against the ratification proposal, as well as members of the nominating committee.

Written Consent Proposals. Glass Lewis will generally recommend that shareholders vote against a shareholder proposal seeking the right for shareholders to act by written consent if the company has adopted a special meeting right of 15 percent or lower and has adopted reasonable proxy access provisions.

Workforce Diversity Proposals. Glass Lewis has revised its policy concerning shareholder proposals that request a report on a company's workforce diversity or efforts to promote diversity at the company. Glass Lewis will generally support such proposals and, when making its determination, will consider the company's industry and operations, the company's current disclosure on issues related to workforce diversity, the level of such disclosure at the company's peers and any lawsuits or accusations of discrimination within the company.

Environmental and Social Proposals. Glass Lewis amended its guidelines to reflect that, in evaluating environmental and social shareholder proposals, it places "significant emphasis" on the financial implications of a company adopting, or not adopting, the proposal. To assist in determining such financial materiality, Glass Lewis will consider the standards developed by the Sustainability Accounting Standards Board, or SASB.

Consider Recent Requests and Trends for Increased Environmental, Social and Governance Reporting

In response to increasing requests and demands from various environmental, social and governance, or ESG, constituents to understand the long-term performance and risk management strategies of companies, boards of directors and management should be aware of the rapidly evolving ESG landscape, in which ESG stakeholders are operating in order to effectively evaluate stakeholder preferences and ESG reporting processes, oversight and disclosures.

Although ESG generally encompasses a wide range of issues, including water management, renewable energy, labor and human rights policies, and supply chain management — and, with greater frequency, board diversity, the opioid crisis and gun control, as well as shareholder engagement initiatives under the corporate governance component — we expect climate change and sustainability, in addition to employment discrimination and equitable pay, to be key topics during the 2019 proxy season. For additional discussion of proposals on these topics, see the section below titled, "Consider Shareholder Proposal Trends and Developments."

Reporting Transparency

According to ISS, the most frequently submitted shareholder proposals during the 2017 and 2018 proxy seasons related to environmental and social, or E&S, issues, representing 45 and 44 percent, respectively, of all proposals submitted. The largest category (approximately 25 percent) of those proposals submitted during the most recent season related to climate change, and averaged 31 percent support. During the same time period, requests for sustainability reporting accounted for approximately 8 percent of all E&S proposals submitted, and averaged 37 percent support.

The data suggests that E&S matters, particularly climate change and sustainability reporting, are not only being pursued aggressively but are also receiving unprecedented levels of support. During the 2018 proxy season, a record 10 E&S proposals received majority support, including four on climate change-related issues and two on sustainability reporting.

Institutional investors are becoming increasingly more vocal in their expectations of increased transparency and disclosure regarding ESG preparedness and reporting. In 2017, 85 percent of S&P 500 companies published sustainability or corporate responsibility reports, a significant increase from only 20 percent of such companies in 2011, according to the Governance and Accountability Institute.

Notwithstanding this increase, 63 percent of respondents state that they "don't spend much time" with corporate sustainability reports; the lack of standardization and comparability across peers and industries may in part explain why respondents opine that annual report to shareholders (56 percent) and direct questions to the company (46 percent) provide more helpful ESG information than companies' sustainability or corporate responsibility reports (44 percent), according to a 2018 Clermont Partners' survey exploring how investment professionals view ESG factors when making investment decisions. As a result, the data suggests that respondents will continue to demand greater shareholder engagement activities related to ESG matters.

In the absence of a mandatory SEC disclosure framework, and due to the inability of ESG stakeholders to coalesce around a standardized comprehensive reporting and disclosure framework — such as the SASB, the Task Force on Climate-Related Financial Disclosures or the Principles for Responsible Investment — companies continue to engage with ESG constituents and consider the materiality of potential ESG issues specific to company operations and financial results to determine the level of disclosure. As a result, we expect ESG-related disclosure to continue to vary within each industry, reflecting primarily a mix of voluntary disclosures in periodic reports, annual proxy statements and corporate sustainability reports.

In addition, a number of businesses are engaged in collecting, aggregating, synthesizing and ranking ESG data. For example, ISS has integrated E&S QualityScore into its current corporate profiling solutions since February 2018. E&S QualityScore analyzes and measures the quality of a company's disclosures and transparency relating to its management of E&S issues and risks relative to its industry peers, based on more than 380 unique E&S factors. As with ISS' Governance QualityScores, E&S QualityScores have no impact on ISS' benchmark proxy voting recommendations, but do appear in ISS' published voting reports. Similarly, in September 2018, Glass Lewis announced that guidance on material ESG topics from the SASB will be integrated into its proxy research reports and vote management application in advance of the 2019 proxy season.

A major challenge arises from the fact that each ESG ratings provider has its own methodology, and a company may receive widely divergent ratings from different organizations. Moreover, the ESG rating agencies may use different combinations of data sources other than company disclosures, even where companies may not agree with the veracity or accuracy of those data sources — resulting in disparities in ratings due to reliance on a number of subjective factors, including company size, geography and industry-specific criteria, and a lack of standardization or controls and procedures to verify company data.[4]

Regulatory Developments

As for regulatory ESG initiatives, in October 2018, two law professors, joined by other securities law experts, government officials, non-governmental organizations and numerous investors and associated organizations representing more than $5 trillion in assets under management, submitted a petition for rulemaking to the SEC in response to the 2016 Concept Release on Business and Financial Disclosure Required by Regulation S-K, requesting that the SEC develop a standardized framework under which companies would be required to disclose identified ESG factors relating to their operations.

Specifically, the petition requests that the SEC develop a "comprehensive framework for clearer, more consistent, more complete, and more easily comparable information relevant to companies' long-term risks and frameworks" in order to better inform investors and provide clarity to companies' ESG reporting processes and disclosures. However, given the political climate and current SEC leadership, we do not expect the SEC to initiate a rulemaking process addressing ESG disclosures.

Consider Recommendations to Increase Board Diversity and Enhance Related Disclosures

In recent years, directors have been subject to increasingly pointed expectations and scrutiny regarding board composition, including individual and aggregate skills and diversity, with similar pressure regarding the executive ranks. Investors and advocates have voiced these expectations to enhance board and executive effectiveness, along with workplace talent recruitment and retention, hoping to maintain or increase competitiveness in a complex and changing marketplace and, according to some diversity stakeholders, optimize financial results.

While the gender of board members has traditionally been the primary focus of these diversity efforts, various stakeholders are increasingly demanding that companies address other important director characteristics and considerations including, age, race, ethnicity, education and experience, as well as composition, refreshment, oversight and the board evaluation process.

We expect board diversity and these other concerns to continue to be a key corporate governance focus for the upcoming 2019 proxy season. Accordingly, we continue to recommend that companies consider requests to increase the diversity in the boardroom and to adopt more prominent annual proxy statement disclosure regarding director and board characteristics.

Institutional Investor Activism

The push to enhance board diversity remains a point of emphasis for a number of historically ESG-focused institutional investors. Additionally, shareholder proposals, including the discussions and negotiations incidental to such submissions, remain an important engagement tool with many companies.

During the 2018 proxy season, shareholders submitted 27 proposals requesting the adoption of a board diversity policy or a report on board diversity, compared to 32 in 2017, according to ISS. Consistent with prior years, a significant number of these proposals (81 percent) were withdrawn, often as a result of engagement between proponents and companies. These engagement activities have resulted in a number of commitments by companies, including an increasing frequency in which companies have adopted a variant of the "Rooney Rule" — originated as a National Football League policy, named for Dan Rooney, former owner of the Pittsburgh Steelers and former chair of the NFL's diversity committee, requiring teams to interview ethnic minority candidates for senior executive positions — for director recruitment, and a commitment to include women and ethnically diverse candidates to increase the diversity in the pool from which board nominees are selected.

While shareholder proposals continue to provide a useful forum for engagement, some traditional investors have taken a different approach. In September 2017, the Office of the New York City

Comptroller and the New York City Pension Fund launched a campaign to push for greater board diversity and transparency reforms through its Board Accountability Project 2.0, or BAP 2.0 — an iteration of the Boardroom Accountability Project from 2014 targeting enhanced proxy access. Specifically, BAP 2.0 targeted 151 companies — 80 percent of which are in the S&P 500 — asking them to adopt a prominent matrix table in the annual proxy statement describing the skills, gender, race and ethnicity of individual directors, and to use refreshment opportunities to bring new viewpoints into the boardroom.[5]

In June 2018, the New York City Comptroller announced the results, which revealed more than 85 of the 151 targeted companies had adopted "improved processes and increased transparency regarding board quality, diversity and refreshment," and over 35 companies adopted disclosure beyond board member qualifications to include details on gender, racial and ethnic diversity. In addition, since the launch of BAP 2.0, 49 targeted companies have elected 59 new diverse directors — including 44 women — 24 companies have publicly committed to include women and people of color in the candidate pool for every board search going forward, and over 25 companies provided meaningful disclosure about their annual evaluation processes, according to the New York City Comptroller.

In addition to continued engagement from the New York City Comptroller and other historically ESG-focused institutional investors such as CalPERS and CalSTRS, several nontraditional ESG-focused institutional investors have increasingly taken steps to support enhanced gender diversity. In February 2018, BlackRock updated its proxy voting guidelines to include an expectation that at least two women serve on each board, and indicated that it will continue engagement efforts, including potentially voting against nominating/governance committee members if it believes a company has "not adequately accounted for diversity in its board composition."[6]

Similarly, State Street Global Advisors stated in its 2018 gender diversity guidelines that it expects boards to include at least some independent female directors and, if not, indicated that it may vote against the chair of a board's nominating/governance committee or the board leader in the absence of a nominating/governance committee.[7] And, in terms of engagement, Vanguard reported in its 2018 Investment Stewardship Annual Report that more than half of its engagements over the past year included discussions about a variety of board composition matters, including director independence, tenure, skills and diversity.[8]

Proxy Advisory Firm Updates

Prior to the 2018 proxy season, ISS revised its "fundamental principles" regarding board composition to include a statement that boards should be sufficiently diverse to ensure consideration of a wide range of perspectives, and noted that ISS would highlight in its proxy research reports those boards that lacked gender diversity, although no adverse voting recommendations were issued on directors' elections for this reason during the 2018 proxy season.

In November 2018, ISS adopted a new voting policy on board gender diversity applicable for companies in either the Russell 3000 or S&P 1500 indices, effective for meetings on or after Feb. 1, 2020.[9] This policy provides that beginning in 2020, ISS may recommend voting against the chair of the nominating committee (or on a case-by-case basis, the elections of other directors responsible for the board nomination process) where the board has no gender diversity.

In addition, the policy provides for ISS to take into consideration mitigating factors that may temporarily excuse the absence of a female director, including: a firm commitment, as stated in the proxy statement and/or other SEC filings, to appoint at least one female director to the board in the near term (before the next annual meeting); the presence of at least one female director on the board at the immediately preceding annual meeting; and/or any other compelling factors considered relevant on a case-by-case basis.

ISS also recently updated its ISS Governance QualityScore, particularly in the areas of board composition and controversies. Notably, ISS created a new board diversity subcategory to further distinguish companies with significant diversity among their directors and named executive officers. The new diversity subcategory considers new factors — the number of women in board and committee leadership positions, director diversity by age and tenure, and the number of female named executive officers — as well as existing factors covering gender diversity, director refreshment and tenure.

Pursuant to its 2019 proxy voting guidelines, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members, and depending upon other factors — including the size of the company, the industry in which the company operates and the overall governance profile of the company — Glass Lewis may extend a vote against recommendation to other nominating committee members.[10] However, Glass Lewis notes that it may refrain from extending an adverse recommendation upon close examination of disclosure of the company's board diversity considerations and other relevant contextual factors, including, for example, a disclosed timetable for addressing the lack of diversity on the board, and any notable restrictions in place regarding board composition, such as director nomination agreements with significant investors.

Recent Legislative Action

In September 2018, California became the first state in the nation to require that publicly held corporations headquartered within the state include female directors on their boards.[11] Any corporation subject to the law must have at least one female director by the end of 2019. By the end of 2021, subject corporations with five board members must have at least two female directors, while those with six or more board members must have at least three female directors. A corporation may increase the size of its board in order to comply with the new requirements.

Trends and Outlook

As a result of the push for greater diversity, female representation on boards has increased in recent years, particularly at larger companies. For the second consecutive year, women and minorities represent half of the class of new S&P 500 directors, and women represent an unprecedented 40 percent of the incoming class, an increase from 36 percent in 2017, according to the 2018 Spencer Stuart Board Index.[12] In addition, on average, boards now have 2.6 female directors, compared with 1.7 a decade ago. However, smaller companies do not report a similar progression — approximately 90 percent of S&P 500 companies have two or more female directors, compared to 58 percent of Russell 3000 companies, according to ISS.[13]

In light of the sustained efforts on the part of traditional ESG-focused institutional investors, coupled with the recent updates from nontraditional ESG-focused institutional investors, we expect that diversity stakeholders will continue to seek dialogue, engagement and robust disclosure on diversity and related board composition matters.

Consider Shareholder Proposal Trends and Developments

Another wave of shareholder proposals submitted to companies for inclusion in their annual meeting proxy statements are expected this upcoming proxy season. The landscape is not anticipated to change significantly from past years. This means most governance proposals are expected to relate to special meeting and written consent rights, independent board chairs, majority voting in uncontested director elections, the removal of supermajority voting provisions, proxy access and board declassification.

Proposals focused on environmental and social topics are expected to cover a wide range of issues again this season, most likely led by proposals focused on climate change risks, sustainability reporting, board diversity and gender pay equity issues. In addition, a number of companies can again expect proposals relating to their involvement in the political process and concerning their executive compensation pay practices.

Below is a brief summary of observations from the 2018 proxy season on some of the more notable proposal topics that might shed more light on what to expect this upcoming season, as well as an overview of the SEC staff's recent guidance on the application of Exchange Act Rule 14a-8.

Special Meeting Proposals

Special meeting proposals were the most frequent governance proposal topic submitted to companies during the 2018 proxy season. Indeed, almost triple the amount of special meeting proposals were submitted to companies last year versus the prior year. As with proposals seeking the ability of shareholders to act by written consent, average support for proposals that seek a new right to call special meetings remained slightly over 40 percent (two such proposals passed) during the 2018 proxy season.

Proposals seeking to amend an existing special meeting right to reduce the ownership threshold for calling a meeting similarly averaged almost 40 percent (five such proposals passed) during the 2018 proxy season. Given the potential for shareholder approval of these proposals, seven companies during the 2018 proxy season submitted a management-sponsored proposal asking for ratification of their existing special meeting bylaw provisions and obtained relief from the SEC staff to exclude a related shareholder proposal on the basis that it competed with management's proposal.

Responding to concerns expressed by institutional investors, the SEC staff only allowed these companies to exclude the proposals on the condition that the companies provide additional disclosures in their proxy statements such as, among other things, a statement that the company omitted a shareholder proposal to lower the ownership threshold and an explanation of the company's expected course of action, if ratification of the management-sponsored proposal was not received. All of the management-sponsored ratification proposals submitted under those circumstances passed, although only one received greater than 60 percent support.

Given statements by ISS and Glass Lewis that they will recommend a vote against these ratification proposals and nominating and governance committee members of companies that put forth such proposals, it is unclear whether companies will attempt a similar approach this season.

Proxy Access Proposals

With at least 70 percent of S&P 500 companies currently having some form of proxy access, calls for a company to offer shareholders the ability to include their director nominees in the company's proxy statements dropped dramatically year-over-year, from 115 in 2017 to 55 in 2018. Companies without proxy access that receive such proposals typically decide to adopt their own form of proxy access, and have been able to exclude a related shareholder proposal on the basis of substantial implementation.

In the rare instance that a shareholder proposal seeking proxy access for the first time at a company went to a vote during the 2018 proxy season, it received on average 40 percent support (three passed; nine failed). During the 2018 proxy season, 30 companies received shareholder proposals to amend one or more provisions of their existing proxy access bylaws. Such proposals are more difficult to exclude on substantial implementation and other bases without a company revising to some extent its existing bylaws, so such proposals typically make it onto the ballot. Nevertheless, these so-called "fix it" proposals only averaged 28 percent support, with no such proposal passing, during 2018.

Environmental and Social Proposals

Despite the continued prevalence of governance-related shareholder proposals, the 2018 proxy season marked the second year in a row that E&S proposals outnumbered governance proposals. About 25 percent of the E&S proposals that made it on the ballot concerned climate change, such as requests for an assessment of the long-term impacts of public climate change policies aimed at reaching a 2 degree Celsius target and calls for companies to adopt goals to reduce their greenhouse gas emissions.

While such proposals generally averaged 31 percent support during 2018, shareholders passed resolutions related to climate change at three companies in the oil and gas industry. Institutional investors, like BlackRock, Vanguard and State Street Global Advisors, as well as certain members of Congress, continue to call for additional disclosures related to climate change risks. Absent a congressional mandate, however, the SEC is unlikely to adopt an explicit disclosure requirement. As a result, and given ISS' consideration of E&S disclosures as part of its QualityScore rankings, climate change-related proposals are expected to increase in number over the coming years.

The remaining E&S proposals during the 2018 proxy season covered a wide range of topics such as drug pricing, opioids, cybersecurity risks, student loans and gun violence. Gender and ethnic pay equity and board diversity were among the most frequent topics. As discussed in the section above titled "Consider Recommendations to Increase Board Diversity and Enhance Related Disclosures," given the positions taken by proxy advisory firms and some institutional investors and initiatives like California's new mandate, shareholder proposals calling for increased board diversity, perhaps not surprisingly, increased in number and in terms of shareholder support during recent years.

Nevertheless, such proposals still average only about 18 percent shareholder support. Unlikely to see these proposals pass, proponents often are willing to negotiate a withdrawal upon a company's agreement to revise its processes and/or provide additional disclosures.

Lobbying and Political Contributions and Activities Proposals

For the first time in many years, the number of lobbying and political contributions and activities proposals fell below 100 (just over 90 proposals submitted in 2018). The steady decrease since 2015, when close to 125 were submitted, has been attributed to increased public disclosures made by companies, often on their websites, about their direct and indirect lobbying activities and political contributions. Still, many companies decline to expand their public disclosures in this regard, choosing instead to let these shareholder proposals go to a vote, with the knowledge that such proposals tend to receive only about 30 percent shareholder support, as they did again during the 2018 proxy season.

Executive Compensation Proposals

Just fewer than 40 executive compensation-related proposals, roughly the same number as last year, were voted on by companies during the 2018 proxy season. Consistent with the prior season, none of these proposals received majority support, and the proposal that received the highest level of support — requests for the adoption of, or an amendment to, a clawback policy — averaged roughly 42 percent support.

Notably, there were 11 proposals voted on by companies that sought to tie social and other non-financial performance issues, such as drug pricing, cybersecurity risks, social responsibility and environmental sustainability, to executive compensation decisions. As examples, one proposal asked the compensation committee to report annually on the extent to which risks related to public concern over drug pricing strategies are integrated into executive incentive compensation decisions, and another proposal asked the board to publish a report assessing the feasibility of integrating cybersecurity and data privacy metrics into executive compensation performance targets.

While these types of proposals were difficult to exclude from company proxy statements under Rule 14a-8, given the SEC staff's general deference toward executive compensation proposals at the time, none of these socially-oriented proposals received majority support in 2018.

New SEC Staff Guidance

"Relevance" and "Ordinary Business" Exclusions. Last year, the SEC staff published Staff Legal Bulletin No. 14I,[14] which invited companies to assist the staff by including in Rule 14a-8 no-action requests a discussion of the board's analysis of whether a proposal (a) is "otherwise significantly related" to a company's business, in the case of a "relevance" no-action request under Rule 14a-8(i)(5), or (b) focuses on sufficiently significant policy issues with a nexus to the company's business operations, in the case of an "ordinary business" no-action request under Rule 14a-8(i)(7). Although a number of companies attempted to utilize this guidance by including some discussion of the board's analysis in their no-action requests, virtually all of these attempts were unsuccessful.

In October 2018, the SEC staff published Staff Legal Bulletin No. 14J,[15] which reiterated that a well-developed discussion of the board's analysis can assist the SEC staff in evaluating certain no-action requests. In particular, the SEC staff stated that a well-developed discussion "will describe in sufficient detail the specific substantive factors the board considered in arriving at its conclusion that an issue is not otherwise significantly related to its business … or is not sufficiently significant in relation to the company." The SEC staff then suggested a nonexclusive list of potential factors a board may consider:

- The extent to which the proposal relates to the company's core business activities;

- Quantitative data, including financial statement impact, related to the matter that illustrates its lack of significance;

- Whether the company already has addressed the issue in some manner, such that the difference between the proposal's specific request and the actions already taken does not present a significant policy issue for the company;

- The extent of shareholder engagement on the matter and level of shareholder interest expressed in that engagement;

- Whether anyone other than the proponent has requested the type of action or information sought by the proposal; and

- Whether the company's shareholders previously have voted on the matter and the board's views of the voting results, including whether any subsequent actions taken by the company or intervening events since the vote impact the significance of the issue to the company.

The SEC staff confirmed that the inclusion of a board analysis is not required in a no-action request, and that the inclusion or absence of a board analysis does not create any presumption for or against exclusion of a proposal.

Micromanagement. The ordinary business basis for excluding a shareholder proposal has two distinct prongs. One prong looks to the substance of the proposal; the second prong relates to the degree to which a proposal "micromanages" the company "by probing too deeply into matters of a complex nature," which may occur if the proposal "involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies." The SEC staff explains in SLB 14J that a proposal can relate to subject matter that is appropriate for shareholder consideration, but can be excludable because it does so in a manner that micromanages the company.

Micromanagement arguments found new life during the 2018 proxy season. Although SLB 14J does not change the overall substance of the micromanagement prong of the ordinary business exclusion, the discussion of micromanagement suggests that its newfound vitality is likely to continue into the upcoming shareholder proposal season.

Proposals Addressing Senior Executive or Director Compensation. For some time, proposals concerning the workforce generally have been excludable as relating to ordinary business matters, and proposals focusing on senior executive or director compensation have not been excludable as ordinary business. SLB 14J addresses three aspects of this framework.

First, SLB 14J articulates the existing framework for analyzing proposals that address both senior executive or director compensation and ordinary business matters. It explains that the SEC staff analyzes the focus of the proposal to ascertain whether the underlying concern of the proposal is an ordinary business matter or is a senior executive and/or director compensation matter. Accordingly, SLB 14J says that proponents cannot avoid exclusion by including an aspect of senior executive or director compensation in a proposal that otherwise focuses on an ordinary business matter.

Second, SLB 14J articulates a new approach regarding proposals that address aspects of senior executive or director compensation that also are available or applicable to a company's general workforce. Where a proposal focuses on aspects of compensation available only to senior executives or directors, generally the proposal may not be excluded as relating to an ordinary business matter. On the other hand, if a proposal focuses on aspects of compensation that are broadly available to a company's general workforce, in addition to its senior executives and/or directors, and the company demonstrates that the executives' or directors' eligibility to receive the compensation does not implicate significant compensation matters, the proposal may be excluded on ordinary business grounds. It remains to be seen whether this distinction will prove to be of practical use to companies in arguing for the exclusion of proposals.

Third, and perhaps most significantly, SLB 14J expresses a reversal of the SEC staff's prior position that proposals addressing senior executive or director compensation could not be excluded on the basis of micromanagement under the ordinary business exclusion. Consistent with the micromanagement discussion above, SLB 14J states that, going forward, the SEC staff may agree that proposals addressing senior executive or director compensation that seek intricate detail or seek to impose specific timeframes or methods for implementing complex policies can be excluded on the basis of micromanagement. Where, precisely, the SEC staff draws the line on micromanagement and senior executive or director compensation only will become clear over time as these arguments develop.

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[1] The SEC's press release "SEC Charges Oil Company CEO, Board Member With Hiding Personal Loans" (July 16, 2018) and related SEC complaint and order are available here.

[2] ISS' 2019 U.S. Proxy Voting Guidelines (Dec. 6, 2018) are available here, and 2019 Americas Policy Updates (Nov. 19, 2018) are available here.

[3] Glass Lewis' proxy paper "2019 Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice — United States" (2018) is available here, and Glass Lewis' proxy paper "2019 Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice — Shareholder Initiatives" (2018) is available here.

[4] For additional detail, refer to our publication in Harvard Law School Forum on Corporate Governance and Financial Regulation titled "Making Sense of the Current ESG Landscape" (Oct. 18, 2018), available here.

[5] New York City Comptroller's press release "Comptroller Stringer, NYC Funds: Unprecedented Disclosure of Corporate Boardroom Diversity Following Groundbreaking Campaign" (June 27, 2018) is available here.

[6] BlackRock's guidelines"Proxy Voting Guidelines for U.S. Securities" (Feb. 2018) are available here.

[7] State Street Global Advisors' release "Guidance on Enhancing Gender Diversity on Boards" (2018) is available here.

[8] Vanguard's report "Investment Stewardship Annual Report" (2018) is available here.

[9] ISS' 2019 Americas Policy Updates (Nov. 19, 2018) is available here.

[10] Glass Lewis' proxy paper "2019 Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice — United States" (2018) is available here.

[11] A copy of the California bill SB-826 is available here. For additional detail, please see our client alert "California to Require Inclusion of Female Directors at Public Corporations Based in the State" (Oct. 1, 2018), available here.

[12] Spencer Stuart's report "2018 United States Spencer Stuart Board Index" is available here.

Highlights of the report “2018 US Spencer Stuart Board Index Highlights” (2018) are available here.

[13] For additional detail, see “An Early Look at US 2018 Proxy Season Trends,” Harvard Law School Forum on Corporate Governance and Financial Regulation (May 2018), available here.

[14] SEC Staff Legal Bulletin No. 14I (Nov. 1, 2017) is available here.

[15] SEC Staff Legal Bulletin No. 14J (Oct. 23, 2018) is available here.