Client Alert

November 2019

Institutional Shareholder Services Releases Updated Voting Guidelines Relating to Problematic Capital Structures at Newly Public Companies, Independent Board Chair Proposals and Board Diversity

Institutional Shareholder Services ("ISS"), the leading proxy voting advisory firm, recently released its 2020 proxy voting guidelines updates for the U.S. and other jurisdictions (effective for meetings on or after February 1, 2020) following its annual global benchmark policy survey and comment period that ran from July 22, 2019 to October 18, 2019. ISS addressed various topics in its updated guidelines, which included three guideline revisions that are relevant to shareholder activism in the U.S. and are the focus of this client alert.

U.S. Guideline Relating to Problematic Governance Structures at Newly Public Companies ***(See Redlined Guideline in Annex A)***

ISS' existing guideline in this area provided that for newly public companies, ISS would generally recommend a vote against or withhold from one or more directors (except new nominees, who would be considered on a case-by-case basis) if, prior to or in connection with the company's public offering, the company adopted charter or bylaw provisions that are materially adverse to shareholder rights or implemented a multi-class capital structure with classes having disparate voting rights. In making its determination, ISS would consider various factors enumerated in the guideline, including the level of impairment of the shareholder rights, the ability of shareholders to reverse the impairment of such rights (*e.g.*, by way of a charter or bylaw amendment), the ability of shareholders to hold directors accountable through annual director elections and any sunset provisions applicable to the offending governance structure.

Recognizing the growing prevalence of newly public companies with multi-class capital structures with disparate voting rights and that a significant proportion of such companies provided for a sunset of these "discriminatory provisions" in their governing documents (most with time-based sunsets ranging from three to 10 years), ISS sought to "provide

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clarity" on the application of its policies for newly public companies by reformulating the existing guideline into two separate policies. The first policy specifically addresses problematic governance provisions. The second policy specifically addresses multi-class capital structures with disparate voting rights and provides a framework for assessing whether a sunset provision is reasonable and acceptable (no sunset period in excess of seven years from the IPO date will be considered reasonable). The revised guideline also "clarifies and narrows the focus" of the policy to specified "highly problematic" governance provisions.

U.S. Guideline Relating to Shareholder Proposals Requiring Independent Board Chairs ***(See Redlined Guideline in Annex B)***

ISS' existing guideline in this area provided that ISS will generally recommend a vote in favor of shareholder proposals requiring that the board chair position be filled by an independent director after taking into consideration various enumerated factors, including the scope of the proposal, the company's current board leadership and governance structures, the company's performance and other relevant factors. The guideline also provided an overview of how ISS would analyze and apply the foregoing factors.

Recognizing that shareholder proposals requiring independent board chairs are "one of the most prevalent types of shareholder proposals" in the U.S., the guideline was updated to codify ISS' existing policy application with respect to these proposals. As revised, the guideline now explicitly sets forth various factors that will increase the likelihood of ISS recommending in favor of proposals requiring an independent board chair. Consistent with input from investors, support for such a proposal "will be likely at companies where boards rely on a weak lead independent director role or there is evidence that directors failed to oversee material risks facing the company or did not adequately respond to shareholders' concerns." Components of the overview in the existing guideline of how ISS will analyze the scope of the proposal, the company's current board leadership and governance structures, the company's performance and other relevant factors will be updated and moved to the relevant Policy FAQ separately published by ISS.

U.S. Guideline Relating to Board Diversity in Uncontested Elections ***(See Redlined Guideline in Annex C)***

Given the heightened relevance of board gender diversity to shareholder activism, last year ISS issued a guideline stating that during a one-year transition period, it would highlight boards with no gender diversity, but no adverse vote recommendation would be made due to a lack of gender diversity until after the conclusion of the 2019 proxy season. Effective for uncontested meetings held on or after February 1, 2020, the guideline

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provided that ISS would generally recommend a vote against or withhold from the nominating committee chair (or other directors on a case-by-case basis) at Russell 3000 or S&P 1500 companies where there are no women on the board, subject to certain mitigating factors. These mitigating factors included a firm commitment by the company to appoint at least one female to the board *in the near term* or the presence of a female on the board at the preceding annual meeting.

The board diversity guideline was updated to reflect the expiration of the one-year transition period and to refer consistently to "women" rather than "females." In addition, the guideline was revised to provide that a firm commitment by the company to appoint at least one woman to the board would only be a mitigating factor until February 1, 2021 and that such commitment must be to appoint a woman to the board within a year (as opposed to in the near term). Finally, the presence of a woman on the board at the prior annual meeting will no longer be a mitigating factor on its own – the company will also need to make a firm commitment to appoint at least one woman to the board within a year.

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Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you would like to discuss further or have questions.

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ANNEX A

Board Accountability – Problematic Governance Structure – Newly Public Companies

Current ISS Policy, incorporating changes:	New ISS Policy:
Problematic Governance Structure - Newly public companies: For newly public companies[2], generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board adopted the following bylaw or charter provisions that are considered to be materially adverse to shareholder rights~~, or implemented a multi-class capital structure in which the classes have unequal voting rights considering the following factors~~: ▪ ~~The level of impairment of shareholders' rights;~~ ▪ ~~The disclosed rationale;~~ ▪ ~~The ability to change the governance structure (e.g., limitations on shareholders' right to amend the bylaws or charter, or s~~Supermajority vote requirements to amend the bylaws or charter~~)~~; ▪ ~~The ability of shareholders to hold directors accountable through annual director elections, or whether the board has a~~ A classified board structure; or ▪ Other egregious provisions. ▪ ~~Any reasonable sunset provision. and~~ ▪ ~~Other relevant factors~~ A reasonable sunset provision will be considered a mitigating factor. Unless the adverse provision ~~and/or problematic capital structure~~ is reversed or removed, vote case-by-case on director nominees in subsequent years. **Problematic Capital Structure - Newly public companies:** For newly public companies, generally vote against or withhold from the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board implemented a multi-class capital structure in which the classes have unequal voting rights without subjecting the multi-class capital structure to a reasonable time-based sunset. In assessing the reasonableness of a time-based sunset provision, consideration will be given to the company's lifespan, its post-IPO ownership structure and the board's disclosed rationale for the sunset period selected. No sunset period of more than seven years from the date of the IPO will be considered to be reasonable. Continue to vote against or withhold from incumbent directors in subsequent years, unless the problematic capital structure is reversed or removed.	**Problematic Governance Structure - Newly public companies:** For newly public companies[2], generally vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board adopted the following bylaw or charter provisions that are considered to be materially adverse to shareholder rights: ▪ Supermajority vote requirements to amend the bylaws or charter; ▪ A classified board structure; or ▪ Other egregious provisions. A reasonable sunset provision will be considered a mitigating factor. Unless the adverse provision is reversed or removed, vote case-by-case on director nominees in subsequent years. **Problematic Capital Structure - Newly public companies:** For newly public companies, generally vote against or withhold from the entire board (except new nominees, who should be considered case-by-case) if, prior to or in connection with the company's public offering, the company or its board implemented a multi-class capital structure in which the classes have unequal voting rights without subjecting the multi-class capital structure to a reasonable time-based sunset. In assessing the reasonableness of a time-based sunset provision, consideration will be given to the company's lifespan, its post-IPO ownership structure and the board's disclosed rationale for the sunset period selected. No sunset period of more than seven years from the date of the IPO will be considered to be reasonable. Continue to vote against or withhold from incumbent directors in subsequent years, unless the problematic capital structure is reversed or removed.

[2] Newly-public companies generally include companies that emerge from bankruptcy, spin-offs, direct listings, and those who complete a traditional initial public offering.

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ANNEX B

Independent Board Chair

Current ISS Policy, incorporating changes:	New ISS Policy:
General Recommendation: Generally vote for shareholder proposals requiring that the board chair~~man's~~ position be filled by an independent director, taking into consideration the following: ▪ The scope and rationale of the proposal; ▪ The company's current board leadership structure; ▪ The company's governance structure and practices; ▪ Company performance; and ▪ Any other relevant factors that may be applicable. The following factors will increase the likelihood of a "for" recommendation: ▪ A majority non-independent board and/or the presence of non-independent directors on key board committees; ▪ A weak or poorly-defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role; ▪ The presence of an executive or non-independent chair in addition to the CEO; a recent recombination of the role of CEO and chair; and/or departure from a structure with an independent chair. ▪ Evidence that the board has failed to oversee and address material risks facing the company; ▪ A material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board has materially diminished shareholder rights; or ▪ Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests. ~~Regarding the scope of the proposal, consider whether the proposal is precatory or binding and whether the proposal is seeking an immediate change in the chairman role or the policy can be implemented at the next CEO transition.~~ ~~Under the review of the company's board leadership structure, ISS may support the proposal under the following scenarios absent a compelling rationale: the presence of an executive or non-independent chair in addition to the CEO; a recent recombination of the role of CEO and chair; and/or departure from a structure with an independent chair. ISS will also consider any recent transitions in board leadership and the effect such transitions may have on independent board leadership as well as the designation of a lead director role.~~ ~~When considering the governance structure, ISS will consider the overall independence of the board, the independence of key committees, the establishment of governance guidelines, board tenure and its relationship to CEO tenure, and any other factors that may be relevant. Any concerns about a company's governance structure will weigh in favor of support for the proposal.~~ ~~The review of the company's governance practices may include, but is not limited to, poor compensation practices, material failures of governance and risk oversight, related-party transactions or other issues putting director independence at risk, corporate or management scandals, and actions by management or the board with potential or realized negative impact on shareholders. Any such practices may suggest a need for more independent oversight at the company thus warranting support of the proposal.~~ ~~ISS' performance assessment will generally consider one-, three-, and five-year TSR compared to the company's peers and the market as a whole. While poor performance will weigh in favor of the adoption of an independent chair policy, strong performance over the long term will be considered a mitigating factor when determining whether the proposed leadership change warrants support.~~	**General Recommendation:** Generally vote for shareholder proposals requiring that the board chair position be filled by an independent director, taking into consideration the following: ▪ The scope and rationale of the proposal; ▪ The company's current board leadership structure; ▪ The company's governance structure and practices; ▪ Company performance; and ▪ Any other relevant factors that may be applicable. The following factors will increase the likelihood of a "for" recommendation: ▪ A majority non-independent board and/or the presence of non-independent directors on key board committees; ▪ A weak or poorly-defined lead independent director role that fails toserve as an appropriate counterbalance to a combined CEO/chair role; ▪ The presence of an executive or non-independent chair in addition to the CEO, a recent recombination of the role of CEO and chair, and/or departure from a structure with an independent chair; ▪ Evidence that the board has failed to oversee and address materialrisks facing the company; ▪ A material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board hasmaterially diminished shareholder rights; or ▪ Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests.

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ANNEX C

Board Composition – Diversity

Current ISS Policy, incorporating changes:	New ISS Policy:
Diversity: ~~Highlight boards with no gender diversity. For 2019 meetings, no adverse vote recommendations will be made due to a lack of gender diversity.~~ For companies in the Russell 3000 or S&P 1500 indices, ~~effective for meetings on or after Feb. 1, 2020,~~ generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies where~~when~~ there are no women on the company's board. Mitigating factors include: ▪ Until Feb. 1, 2021, a ~~A~~ firm commitment, as stated in the proxy statement,to appoint at least one ~~female~~ woman to the board within a year ~~in the near term~~; ▪ The presence of a ~~female~~ woman on the board at the preceding annual meeting and a firm commitment to appoint at least one woman to the board within a year; or ▪ Other relevant factors as applicable.	**Diversity:** For companies in the Russell 3000 or S&P 1500 indices, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies where there are no women on the company's board. Mitigating factors include: ▪ Until Feb. 1, 2021, a firm commitment, as stated in the proxy statement, to appoint at least one woman to the board within a year; ▪ The presence of a woman on the board at the preceding annual meetingand a firm commitment to appoint at least one woman to the board within a year; or ▪ Other relevant factors as applicable.

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