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PREPARING FOR THE 2019 PROXY SEASON

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Companies gearing up for their annual meetings of shareholders need to be prepared to face the upcoming proxy season's hot-button issues. These issues arise from many actors, including the Securities and Exchange Commission ("SEC"), Institutional Shareholder Services Inc. ("ISS"), Glass, Lewis & Co. ("Glass Lewis"), and activist investors. In this LEGALcurrents®, we discuss what these regulatory and advisory developments mean for companies entering the 2019 proxy season.

SEC Disclosure Update and Simplification

In August 2018, the SEC published Release No. 33-10532, titled "Disclosure Update and Simplification." These final rules, which became effective on November 5, 2018, changed some of the disclosure requirements applicable to a company's annual report on Form 10-K. The following is a non-exhaustive list of select key disclosure requirement changes that companies should be cognizant of while drafting their annual reports.

- **Description of Business.** The requirements to disclose segment financial information, amounts spent on research and development, and information by geographic area have been eliminated from Item 1 of Form 10-K. Note, however, that some of these eliminated disclosures are still required in other areas of the Form 10-K.
- **Market for Registrant's Common Equity.** Due to the amount of freely available market information, the requirements to disclose certain historical equity pricing data have been eliminated from Item 5 on Form 10-K. Companies must, however, disclose the principal U.S. market(s) and the corresponding trading symbol(s) for each class of their common equity. The requirement to disclose the frequency and amount of cash dividends has also been removed from Item 5, but it is still required in interim period financial statements.
- **Amendments to Conform to Financial Accounting Standards Board Requirements**. The final rules changed the terminology of "income statement" to "statement of comprehensive income" and eliminated accounting disclosures related to "extraordinary items" and "cumulative effect of a change in accounting principle" to conform with the Financial Accounting Standards Board's practices.
- **Elimination of the SEC's Public Reference Room Disclosure**. Lastly, the final rules also eliminate the requirement to disclose the physical address of the SEC's Public Reference Room. Companies still must disclose the SEC's website and the company's own website, if they have one.

ISS Voting Policies Updates

ISS, a proxy advisory firm, released updates to its Global Proxy Voting Guidelines. These updates, with some exceptions, take effect for annual meetings on or after February 1, 2019. Several notable updates follow.

- **Director Accountability.** ISS may recommend voting against ratifying existing shareholder rights when the ratification is used as a means to exclude shareholder proposals seeking more favorable shareholder rights.
- **Chronic Poor Attendance.** ISS will recommend voting against any director with three or more consecutive years of less than 75% attendance at board and committee meetings without a reasonable explanation.
- **Environmental and Social Shareholder Proposals.** ISS will consider whether there are significant controversies associated with a company's environmental or social practices when analyzing environmental and social shareholder proposals.
- **Board Gender Diversity.** For companies in the Russell 3000 or S&P 1500 indices, ISS may recommend voting against nominating committee chairs and other directors who are responsible for the board nomination process at companies with no gender diversity. However, this new policy is effective for meetings on or after February 1, 2020.

Other issues addressed by ISS this year include equity plans, reverse stock splits, and executive compensation.

Glass Lewis Approach to Proxy Voting Updates

Glass Lewis, also a proxy advisory firm, released updates to its Approach to Proxy Advice. These updates recently took effect with the beginning of the new year. Several notable updates follow.

- **Board Gender Diversity.** For companies in the Russell 3000 index, Glass Lewis may recommend voting against nominating committee members at companies with no female members on its board.
- **Conflicting and Excluded Proposals.** If there are conflicting proposals relating to the required ownership percentage to call a special meeting, Glass Lewis will generally recommend voting for the lower threshold and against the higher threshold. If there are conflicting proposals relating to establishing a new special meeting right, Glass Lewis will generally recommend voting for the shareholder proposal and abstaining from voting for the company's proposal. If the company has excluded a special meeting shareholder right proposal in favor of the company's proposal to ratify an existing special meeting right, Glass Lewis will generally recommend voting against ratifying the company's proposal and members of the nominating and governance committee.
- **Environmental and Social Risk Oversight**. Glass Lewis may recommend voting against members of the board who are responsible for oversight of environmental and social risks when companies have not properly managed or mitigated environmental or social risks to the detriment of shareholder value.

Additionally, if there is not explicit board oversight of environmental and social issues, Glass Lewis may recommend voting against members of the audit committee.

- **Virtual Only Shareholder Meetings.** Glass Lewis may recommend voting against governance committee members if companies opt to hold their annual meeting by virtual means, without the option of attending in person, and without providing disclosures assuring shareholders that they will be afforded the same rights as they would at an in-person meeting.

Other issues addressed by Glass Lewis this year include ratification of auditors, executive compensation, and minor clarifying amendments and housekeeping changes.

Companies should carefully consider their position on the issues that ISS and Glass Lewis deem to be important for the coming year when preparing for the proxy season. ISS and Glass Lewis each released their updates on these issues in November 2018.

SEC Guidance

On October 23, 2018, the SEC issued guidance on two of the Rule 14a-8 exceptions to a company's obligation to include shareholder proposals in its proxy materials. Specifically, the SEC set forth factors that a board should discuss in concluding that the shareholder proposal may be excluded from the proxy materials under the "economic relevance" or "ordinary business" exceptions. These factors are:

- 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 illustrate whether or not a matter is significant to the company;
- the differences between the proposal's specific request and the actions the company has already taken, if any, and an analysis of whether those differences present a significant policy issue for the company;
- the extent of shareholder engagement on the issue and the level of shareholder interest expressed through 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 have previously voted on the matter and the board's views as to the related voting results.

Companies seeking to exclude shareholder proposals in reliance on the "economic relevance" or "ordinary business" exceptions should include the board's analysis of the factors outlined above in their no-action requests to best ensure that the proposal may be properly excluded.

Activist Shareholder Trends

Following trends from the 2018 proxy season, companies should expect environmental issues (like climate change and carbon emissions) and social issues (like board gender diversity and workplace culture as it relates to the #MeToo movement) to continue to be a hotbed of shareholder activism for 2019.

What to Do Now

Companies should prepare for the 2019 proxy season by educating board members about the updated SEC disclosure requirements and the various proxy advisory firms' updates. Companies may want to engage significant shareholders and activist investors to determine the proper process for resolving any concerns.

If you would like more information on how to prepare for the 2019 proxy season, please contact a member of Harter Secrest & Emery LLP's Securities and Capital Markets Group at 585.232.6500 or visit www.hselaw.com.

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