INSTITUTIONAL SHAREHOLDER SERVICES AND GLASS LEWIS UPDATE PROXY VOTING GUIDELINES FOR 2023

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Institutional Shareholder Services (ISS) and **Glass, Lewis & Co.** (Glass Lewis), the two leading providers of corporate governance research and proxy voting services, have published their updated proxy voting guidelines for 2023. Both companies focused their updates on corporate governance matters, including issues relating to officer conduct, board gender diversity and board responsibilities relating to climate change and other environmental and political issues.

ISS PROXY VOTING GUIDELINES FOR 2023

The ISS proxy voting guidelines updates are effective for annual meetings on or after February 1, 2023. ISS released updates for the United States as well as Canadian and Latin American markets, but this alert will focus only on the United States updates.

The most significant updates to the ISS proxy voting guidelines relate to:

- Board gender diversity;
- Climate change;
- Unequal voting rights;
- Poison pills;
- Exculpation of officers under Delaware law;
- Political transparency; and
- Clarifications relating to "newly public" companies.

Gender Diversity on Boards

Previously, if a company in the Russell 3000 or S&P 1500 index had no women on its board, ISS would generally favor a vote against (or withhold from)[1] the chair of the nominating committee (and other directors on a case-by-case basis). This policy now applies to all companies regardless of inclusion in any particular stock market index.

If a woman does not currently serve on the board, but a woman served on the board as of the previous annual meeting, an exception will be made if the board makes a firm commitment to "return to a gender-diverse status" within a year.

Climate Change Accountability

If a company is a "significant" greenhouse gas emitter based on the current Climate Action 100+ Focus Group List, ISS already generally recommends voting against or withholding from the relevant committee chair or other director if ISS deems that the company is not taking "minimum steps" to evaluate and reduce climate change risk. Such steps include, for example, establishing "appropriate" emissions reduction targets. Previous guidelines suggested "any well-defined" reduction targets were considered to be appropriate, but ISS will now look for targets to be at least either "medium-term" focused or aimed at achieving net-zero carbon emissions by 2050.

Unequal Voting Rights

Beginning in 2023, ISS will generally recommend withholding or voting against directors individually, committee members or the entire board if a company has a common stock structure with unequal voting rights. "Unequal voting rights" include instances where classes of common stock have more votes per share than other shares, certain classes of common stock are not entitled to vote on all of the same ballot items or nominees and so-called "loyalty shares" where stockholders gain more voting rights the longer they hold their shares.

Exceptions to this new policy include newly public companies (provided that unequal voting rights sunset no more than seven years from the date of going public), cases where shares with enhanced voting power represent less than 5 percent of total voting power and scenarios where the company grants other protections for minority shareholders (such as permitting them a regular binding vote on whether the existing capital structure should stay in place).

Poison Pill

Under its existing guidelines, ISS generally recommends votes against or withholding from nominees if a company has a poison pill that was not approved by shareholders. ISS has been willing to take a case-by-case approach if boards adopt a position pill with a term of one year or less and if its evaluation of such short-term pills is based on disclosures about the reasoning for their adoption. ISS also considers other relevant factors in reviewing short-term pills, such as whether the company plans to allow shareholders to vote on renewal.

Under its new guidelines, ISS will weigh additional factors in evaluating poison pills. These include the "trigger," or threshold at which a particular shareholder's interests will be diluted, and the company's market capitalization. ISS noted that it would be less likely to find poison pills with low thresholds (thresholds of 10 percent or less) appropriate. Low thresholds suggest pills are meant to serve as general defenses against any kind of shareholder activist campaigns rather than specific defenses against hostile takeovers or opportunistic change of control approaches. ISS will also consider a company's market capitalization and any recent sharp changes as part of its assessment into whether the pill is meant to prevent "an opportunistic takeover at a price that does not reflect the company's long-term fair value." This justification for a poison pill is in contrast to what ISS views as an inappropriately low trigger, which it views as only intended to protect the board and management.

Officer Exculpation Under Delaware Law

ISS has historically taken a case-by-case voting approach to proposals on director and officer indemnification and liability protection. In light of recent changes to Delaware law, it will now take a case-by-case approach to director and officer exculpation too.

In 2022, the Delaware General Corporation Law (DGCL) was amended to allow corporations to limit or eliminate personal liability of officers for claims that they breached the fiduciary duty of care. Previously, the statute allowed exculpation of directors from duty of care breach claims but not officers. The exculpation provision must be included in the corporation's charter, and only certain officers are eligible for exculpation (e.g., president, certain specified "C-suite" officers, controller, treasurer and named executed officers in the corporation's public filings).

Under its new guidelines, ISS will evaluate the stated rationale for proposals relating to officer exculpation and assess the extent to which any such proposal would eliminate officer liability for monetary damages for violating the duty of care.

Political Transparency

In an apparent response to the increasing number of shareholder proposals demanding transparency on the relationship between companies' political activities and publicly disclosed commitments, ISS has added a new policy covering political spending and lobbying. In general, ISS will vote case-by-case on proposals asking for more disclosure about how aligned companies' political contributions, lobbying and election spending and related efforts are with their publicly stated values and disclosed policies. ISS will analyze various factors including policies and disclosures relating to political contributions, lobbying and payments to trade associations and political action committees, disclosures regarding reasons for supporting candidates for public offices, any "incongruencies" between political expenditures and publicly stated values and priorities and any "recent significant controversies" relating to lobbying or political activities.

Governance of Newly Public Companies

For "newly public companies," ISS has typically recommended a vote against directors individually, committee members or an entire board (with new nominees evaluated case-by-case) if, before or in connection with the company's recent public offering, the company or board adopted bylaws or charter provisions that are "problematic" or materially adverse to shareholder rights. These provisions include, among others, supermajority vote requirements for charter or bylaw amendments and classified boards. A reasonable provision allowing these items to sunset after a period of time has previously been deemed a mitigating factor that ISS will consider.

In its policy update, ISS has added more specificity about what qualifies as a "newly public company" and what constitutes an acceptable period of time for these "problematic" governance structures to sunset. The new guidance states that ISS will apply the newly public company recommendations to all companies that hold or held their first annual meeting of public shareholders after February 1, 2015. ISS also specified that these "problematic" governance structures must sunset within seven years of the date of going public in order for the sunset to be considered an extenuating factor.

GLASS LEWIS POLICY GUIDELINES FOR 2023

The Glass Lewis updates, which are generally effective for annual meetings on or after January 1, 2023, related to the following key areas:

- Board gender diversity;
- Cybersecurity;

- Environmental and social disclosures;
- Overboarding;
- Climate change;
- Exculpation of officers under Delaware law; and
- Long-term incentives.

Board Gender Diversity

While Glass Lewis has historically required a minimum of one gender diverse director, under its new guidelines it will generally recommend voting against (i) the chair of the nominating committee of a board that is not at least 30 percent gender diverse or (ii) all members of the nominating committee of a board with no gender diverse directors for companies in the Russell 3000 index. The previous Glass Lewis policy requiring one gender diverse director will remain in place for companies not in the Russell 3000.

Cybersecurity

Glass Lewis will generally not make voting recommendations based on disclosure or oversight relating to cybersecurity, but it clarified in its new guidelines that it will closely evaluate a company's disclosure in cases where cyberattacks have caused significant harm to shareholders. Glass Lewis also reserves the right to recommend voting against relevant directors if it deems disclosure or oversight relating to cybersecurity "insufficient."

Environmental and Social Disclosures

Under its new guidelines Glass Lewis will generally recommend voting against the governance committee chair of a company in the Russell 1000 index that fails to provide "explicit disclosure" about the board's oversight of environmental and social issues. Glass Lewis will review the company's proxy statement and the board's committee charters to determine if directors maintain a meaningful level of oversight and accountability for a company's material environmental and social risks.

Glass Lewis also indicated that it plans to expand its review of board oversight of environmental and social issues to include all companies in the Russell 3000 index.

Overboarding

Generally, Glass Lewis recommends voting against directors who are overcommitted to other boards or "overboarded." In its new guidelines, Glass Lewis has laid out specific thresholds defining what constitutes overcommitment. Under the new guidelines, overboarding generally means a director who serves as an executive officer of a public company while serving on more than one external public company board, a director who serves as an executive chair of any public company while serving on more than two external public company boards and any director who serves on more than five public company boards. In addition to applying these specific thresholds, Glass Lewis will also weigh factors including the size and location of the other companies where the director is on the board and the director's attendance record.

In general, Glass Lewis will not recommend voting against directors at the companies where they are also an executive officer (but may vote against such persons at companies where they are not so employed should they qualify as overcommitted).

Climate Change

The new Glass Lewis guidelines provide that companies with "material exposure to climate risk" arising from their own operations should provide climate-related disclosures consistent with the recommendations from the Task Force on Climate-related Financial Disclosures (TCFD). If Glass Lewis finds either these disclosures or the manner in which board oversight responsibilities are defined to be insufficient, it may recommend voting against the chair of the governance committee or other relevant committee chair.

Officer Exculpation Under Delaware Law

As mentioned above, the DGCL was amended in 2022 to allow corporations to limit or eliminate personal liability of certain officers for claims that they breached the fiduciary duty of care. Despite this change in the DGCL, Glass Lewis states that it will closely evaluate officer exculpation provisions on a "case-by-case basis." Generally, Glass Lewis will recommend voting against proposals eliminating monetary liability for breaches of the duty of care for officers in the absence of reasonableness and a compelling rationale for adoption.

Long-Term Incentives

In its new guidelines, Glass Lewis revised its threshold for the minimum percentage of long-term equity-based incentive grants to executives that should be tied to company performance. Glass Lewis now indicates that generally at least half of the grant should consist of performance-based awards up from a prior threshold of 30 percent. Glass Lewis will not necessarily provide a negative recommendation if this threshold is not met, provided that no other significant issues with the equity-based incentive grants are identified. However, any decreases in the allocation percentage will be viewed unfavorably.

CONCLUSION

In conclusion, both Glass Lewis and ISS emphasize governance, director diversity, officer exculpation and climate change as key areas of focus in 2023. Both proxy advisory firms indicate that they will continue to closely scrutinize environmental, social and governance (ESG) issues in the upcoming year.

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[1] **Note:** "Vote against" will be used throughout to include situations where ISS or Glass Lewis may recommend either withholding or voting against.

PROFESSIONALS

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PRACTICE AREAS

Corporate & Transactional

Corporate Governance

Public Companies