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# ISS Updates Voting Policies for the 2012 Proxy Season

Institutional Shareholder Services, Inc. (ISS) has published its 2012 Corporate Governance Policy Updates. While ISS has altered a number of its policies and adopted new policies for certain types of proposals that were not previously addressed, it has maintained a formal policy of voting on many enumerated types of proposals on a "case-by-case" basis. We encourage both shareholders and ISS to make all their voting and recommendation decisions on this basis and avoid "one-size-fits-all" governance practices that do more harm than good.

Proxy Access Proposals. ISS will maintain a case-by-case approach to its recommendations on proxy access proposals made by shareholders, which will also apply to management proposals, and has specified in detail the core factors it will consider. In particular, ISS will assess both company-specific and proposal-specific factors, including the proposal's minimum share ownership threshold, the proportion of directors that shareholders could nominate under the proposal, and the proposed procedures to resolve conflicts among multiple shareholders seeking to make nominations. In a shift from its prior policy, ISS no longer cites the proponent's rationale as an enumerated core factor, although the proponent's rationale may still be considered as one of numerous, but unspecified, other factors. Neither is the binding or precatory nature of a shareholder proposal an enumerated core factor, although it may also be one of the other factors deemed relevant by ISS in a particular situation. ISS' decision to maintain a case-by-case approach, and to take into account company-specific factors, is welcome; the mandatory adoption of one-size-fits-all proxy access would be a disruptive and unwarranted step, as we have long stated. Indeed, for the reasons articulated in the D.C. Circuit decision rejecting Rule 14a-11, those supporting proxy access in any particular case should bear a high burden of demonstrating that any potential benefits outweigh the substantial costs of a proxy access regime.

Risk Oversight and Director Elections. ISS has expanded the factors it will consider in recommending "no" or "withhold" votes in uncontested director elections, now specifically adding material failures of risk oversight to the list. ISS specifies that this addition is not intended to "penalize boards for taking prudent business risks or for exhibiting reasonable risk appetite," but does not elaborate as to how it will distinguish, in hindsight, between such situations and more fundamental and systemic shortcomings.

Say on Pay. ISS will now evaluate on a case-by-case basis its recommendation regarding say on pay proposals and compensation committee member elections where a company's say on pay proposal in the previous year received the support of less than 70% of the votes cast. ISS' evaluation will be based on the company's response to the concerns expressed by shareholders in the previous year, including disclosed engagement efforts with major institutional investors and specific actions taken to address the issues which led to the lack of support above 70%. ISS notes that cases where support was less than 50% will "warrant the highest degree of responsiveness." Given the low threshold of opposition votes triggering the more stringent review, companies may treat a say on pay vote with majority, but less than 70%, support as effectively a lost vote. It is more important than ever for companies to have a well thought out strategy for winning the say on pay vote by a significant margin. See our memorandum of November 8, 2011, "How to Win the Say on Pay Vote." In addition, companies that received less than 70% support last year should take these new policies into account when considering their course of action for the current year. ISS has established a process to engage with company representatives that is described on its website: http://www.issgovernance.com/policy/EngagingWithISS.

Pay for Performance Alignment. Previously, if a company fell in the bottom half of its GICS industry group in total shareholder return over both a one-year and three-year period, and the CEO's pay was not aligned with shareholder performance over time (with special emphasis on the immediately preceding year), ISS generally would recommend a negative say on pay vote. ISS has refined its pay for performance methodology for 2012. The new policy selects a narrower peer group of 12-24 companies, using as guidelines market capitalization and revenues (or assets for financial firms) within the applicable GICS group. This is a welcome change, as it was often noted that the slavish use of a company's GICS group as the applicable benchmark could lead to misleading peer group performance rankings. The revised policy also measures the relative alignment between CEO pay and company TSR within the peer group for a one- and three-year period (with a 40% emphasis on the one-year period and a 60% emphasis on the three-year period), as well as absolute alignment between CEO pay and company TSR over a five-year period. Where the alignment is perceived to be weak, ISS will consider how a number of factors affect alignment of pay with shareholder interests, such as a company's benchmarking practices, completeness of disclosure and ratio of performance-based pay to overall compensation.

Exclusive Venue Proposals. Proposals by management to establish an exclusive venue for shareholder litigation will now be evaluated on a case-by-case basis, with a focus on both whether the subject company has in place what ISS views as "good governance" features and whether the company has disclosed any "material harm" caused to it by shareholder litigation in other jurisdictions. The addition of this second prong is new this year; ISS' previous policy was to always recommend against such proposals unless the subject company had in place both "good governance" features and a "meaningful special meeting right." ISS does not provide guidance as to what types of material harm it would consider compelling in evaluating such proposals.

Political Spending and Lobbying. ISS has updated its position on proposals relating to both corporate political spending and lobbying activities, in each case in favor of additional corporate disclosures. ISS formerly considered on a case-by-case basis proposals requiring disclosure of political contributions and related spending, but now generally recommends the adoption of such proposals. ISS' case-by-case lobbying disclosure policy has been amended to broaden its application to all lobbying activities, including both direct and "grassroots" lobbying directed at the public.

Hydraulic Fracturing. ISS has adopted a policy of generally recommending in favor of proposals requiring disclosure of natural gas hydraulic fracturing activities. Factors to be considered in forming specific recommendations will focus both on the company's existing disclosure practices and operating activities (including any past incidents or litigation relating to hydraulic fracturing) and broader industry and regulatory developments.

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Due to ISS' influence in the investing community, it is more important than ever that companies be aware of ISS' methodology and take proactive steps to address anticipated or actual negative recommendations. Companies in potentially vulnerable positions should consider engaging both with their shareholders and with ISS in advance of the 2012 proxy season in order to avoid potentially disruptive election results, and particularly to help shareholders understand each company's unique business and governance situation, and avoid suffering "cookie-cutter" shareholder voting that may be destructive to the creation of long-term shareholder value.

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