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MEMORANDUM

Date: October 29, 2014
To: ISS
From: Ning Chiu and Joe Hall
Re: Comment Letter on U.S. Draft Policy Update

We are writing in response to the request for comments on the ISS draft policy updates with respect to the policy changes proposed for “Independent Chair Shareholder Proposals.” We appreciate the opportunity to comment.

The Existing Policy Already Contains the Most Meaningful Factors for Evaluation of Independent Chair Shareholder Proposals.

ISS’ existing policy considers recommending a vote “for” shareholder proposals seeking independent board chairs unless the company has a “counterbalancing governance structure.” The policy recognizes that the critical issue of board leadership requires an evaluation based on a number of important factors, including whether: a company has a lead independent chair with “clearly delineated and comprehensive duties”; two-thirds independent board; fully independent key committees; strong financial performance; and no problematic governance or management issues. These factors represent well understood indicators of whether the right governance structure is in place to provide for independent board leadership.

A company must meet all of the criteria in order for ISS to not support the shareholder proposal. In addition, ISS retains the discretion to determine whether the company has any problematic practices that essentially override the other positive factors. In practice, it appears that ISS recommends in favor of shareholder proposals seeking independent chairs about half the time, which itself illustrates the robustness and comprehensive nature of the factors built into the policy. The current independent chair shareholder proposal policy has the benefit of transparency, and in large part, objectivity. The benchmarks against which these proposals are assessed by ISS are clear, relatively easy to understand and result in a consistent application across different companies.

The draft policy indicates a potential change toward a holistic review of each company’s leadership structure, governance practices and financial performance, so that any single factor that previously resulted in favorable or negative recommendations may be mitigated by other positive or negative aspects. But rather than using only the existing factors in the new holistic

review, the draft policy also asks about the weight of additional factors such as the recombination of roles previously separated, the presence of an executive chair and CEO/director tenure. In addition, the background and overview section of the draft policy inappropriately describes the recombination of roles and executive chair positions as problematic, so there is already a negative presumption which should not be made in the final policy for the reasons stated below.

Institutional Investors Agree That a Strong Lead Independent Director Can Provide Independent Board Leadership.

Perhaps the most important factor in ISS' existing policy is the presence of a lead independent director with considerable responsibilities. The roles for lead independent directors have expanded in recent years. Their increasing involvement in shaping independent board oversight has been recognized by major institutional investors, as evidenced by their own voting policies¹, as an acceptable alternative to independent chair shareholder proposals, so long as lead independent directors have sufficient duties evidencing strong oversight roles. ISS' existing policy is currently appropriately aligned with the viewpoint expressed by major institutional investors on this issue.

Independent Chair Shareholder Proposals Have Not Received Substantial Shareholder Support.

Shareholder perspectives are critically important to companies and their boards. In addition to the voting policies of major institutional investors, shareholders have also avoided casting majority votes in favor of independent chair shareholder proposals. While there may be a large volume of these proposals, only four proposals actually obtained majority support in 2014, even though ISS appeared to have supported slightly more than half (32) of them. Shareholders are clearly not convinced that an independent chair is generally in a company's best interest.

Other governance proposals that have received significantly greater shareholder support than independent chair shareholder proposals, such as majority voting proposals, declassification proposals or proposals requesting changes in bylaws on shareholder rights, are focused on the relationship between the company and its shareholders. The independent chair proposals are quite different, in that the proposals are inserting outside judgments into decisions on how boards should govern themselves. The existing policy should not be amended in such a way that effectively prejudices that an independent chair is always the optimal board leadership for all companies.

The Top Roles at the Company Should Be Considered in the Context of Succession Planning, and External Pressure Should Not Weigh on a Board's Selection of its Leadership Structure.

The need for succession planning has rightly become a headline topic of shareholder interest. Boards understand the increasing emphasis on developing a proper transition for senior

¹ See BlackRock, *Proxy Voting Guidelines for U.S. Securities*, at 6 (April 2014) ("Where the chairman is also the CEO or is otherwise not independent[,], the company should have an independent lead director. The role of this director is to enhance the effectiveness of the independent members of the board through shaping the agenda, ensuring adequate information is provided to the board and encouraging independent participation in board deliberations. The lead independent board director should be available to shareholders where they have concerns they wish to discuss.") and Vanguard Group, *Our governance and executive compensation principles* (website posting as of June 2014) ("In those cases where the board chair is not independent, we believe that it is important for there to be an element of independent leadership on the board, in the form of a lead or presiding director.").

leadership, both at the management and board levels. There is widespread recognition that because these choices involve the selection of individuals who are vital to a company's success, succession planning may represent one of the most challenging responsibilities for any board.

In encouraging boards to continue to make these tough yet important decisions, boards should not be saddled with arbitrary benchmarks they need to meet or avoid, such that their judgment may be second-guessed. Boards who believe that it is in shareholders' best interest to recombine the roles of CEO and chair, or have an executive chairman, should be free to make those determinations consistent with their fiduciary obligations without concern that those particular arrangements raises a presumption of taint, regardless of the particular facts and circumstances that gave rise to the decisions.

Boards Should Be Supported Not Only in Making the Right Leadership Decisions for Their Companies, but Also in Constantly Reevaluating Those Decisions.

There is no question that a company's business must constantly evolve to meet changes in circumstances in order to thrive, and therefore there is no reason the selection of board leadership should remain fixed forever regardless of the myriad transformations the company may be facing. Yet ISS' existing policy already presumes that an independent chair is the favored structure because it requires "countervailing" practices to rebut that presumption. The draft policy also reinforces that presumption without recognizing that boards should not be required to stick with one structure when another may be more suitable at a later time, similar to how boards evaluate their own performance regularly and modify their composition if warranted.

Recombination of Roles Should Not Automatically Raise Concerns.

A holistic review would examine all factors such that no one single factor will result in a positive or negative recommendation. The application of a holistic policy could mean that it would not be assumed that the existence, or lack of, any particular leadership structure would in every instance merit a particular recommendation.

The draft policy asks for feedback on how much weight an organization gives to a change in leadership structure that recombines the roles of CEO and chair at a company. In keeping with the goals of the holistic approach discussed in the draft policy, a recombination of roles should not automatically raise concerns. One reason that the independent chair shareholder proposal has not resonated in the same way as some other proposals regarding governance structures, such as declassification proposals, is that there remains uncertainty that when it comes to questions about individual board leadership, that one type of structure is necessarily ideal for all companies. Along with that, given that CEO leadership will also change, a governance structure that makes sense during a certain period at a company may not be as suitable later on, when the company has changed. Having a strict view that an independent chair is always the right leadership structure will likely cause companies to be reluctant to adopt such a structure in the first place, out of concern that they can never move away from that choice, or will at least be penalized for doing so, no matter the reasons.

Should ISS determine to revise its current policy, ISS should examine each company on a case-by-case basis in terms of its rationale for recombining roles. Some of the items considered in this evaluation could include, for example: the company's discussion of the reasons the roles were separated in the first instance; the length of time since the roles were separated; whether board and/or management leadership has changed since the initial separation; the rationale for

the recombination; and whether the recombination was discussed with shareholders and their feedback sought.

The Presence of Executive Chairs Represents Succession Planning.

If ISS decides that the presence of an executive chair should be considered as a factor when making recommendations on independent chair shareholder proposals, ISS should not deem this to be de facto problematic in all cases. The presence of an executive chair is often a crucial function in CEO succession planning. It allows companies to continue to retain the benefit of the experience and industry knowledge of a prior executive while a new CEO can benefit from a transition period, with the ability to get guidance from the prior executive. For some companies, an executive chair can also assist in transitioning major client assignments or customer contacts.

A long-tenured CEO may also be associated with the company's particular brand in such a way that having the individual continue in a notable senior capacity at the company makes the most business sense. In other cases, a former CEO who becomes an executive chair may have substantial stockholdings in the company, so that the executive chair position is in part a recognition of a significant continued economic interest.

A former CEO can also help acclimate a new CEO to the board room. Now that so many companies only have one insider, the CEO, on their boards, new CEOs may have little board experience. Having an executive chair retain board duties helps the new CEO focus on the business as the first and primary objective, and allows for an adequate transition toward developing familiarity as a director.

The ISS draft policy criticizes the retention of a former CEO as the chair by citing a study that suggests that the executive chair may get in the way of the new CEO and also questions whether a lead independent director can act as a counterbalance to both. Setting aside what seems to be contradictory concerns that the executive chair will not get along with the new CEO, while at the same time the two will collude to thwart the lead independent chair, studies that purport to provide empirical evidence in these areas of board judgment should not be substitutes for sound governance decisions by boards deciding what is best for their companies. Without entering into a debate over dueling academic studies, all of this misunderstands the key role that executive chairs play and the designation of responsibilities that come with that role, which varies among companies. Some may have a broad range of roles that involve strategic business functions, and others may play a more limited role.

In any case, a board can decide whether an executive chair properly supports, and does not hamper, either the CEO or the lead independent director. The draft policy at the same time underestimates the presence of a strong lead independent director, who can continue to provide independent oversight. The lead independent director is well-positioned to oversee both the executive chair and the new CEO, since the lead independent director has experience in the board room like the executive chair, but is also focused on long-ranging strategy like the new CEO. The board is also comprised of other independent directors, who also contribute to effective independent oversight.

In making case-by-case assessments, ISS may wish to consider a company's disclosure of each of the duties of the executive chair, CEO and lead independent director in assessing how to recommend for an independent chair shareholder proposal, including, for example: the rationale for having an executive chair; whether it was discussed with shareholders and their feedback

sought; and the possibility that the position is for an interim period to ensure a successful CEO transition.

CEO/Director Tenure Should Have No Bearing on These Discussions.

Without any further explanation, the draft policy adds a general reference to CEO/director tenure as a possible additional factor. Since there is no description provided as to the background for this reference, it is not even clear whether this could be viewed as a positive or a negative in terms of ascertaining whether a company has appropriate independent board leadership.

The short shrift given to CEO/director tenure in the policy makes it difficult to comment on how it should be considered in reviewing independent chair shareholder proposals. ISS does not have a voting policy on director tenure and has not proposed one, and this would be an indirect attempt to propose such a policy. Perhaps this factor is proposed because of some concerns raised generally about whether long-tenured directors should continue to be classified as independent. That debate raises a host of complex issues that seem to be outside the scope of this discussion, beginning with whether there is any generally accepted understanding of what constitutes a long tenure. We urge ISS not to mix questions of tenure into this particular evaluation until some of those issues are more fully aired and debated.

The Draft Policy Comment Process Needs to Be Revised.

While we appreciate the opportunity to provide feedback as requested during this 2015 benchmark consultation policy, we note several challenges to being able to adequately respond in the timeframe provided. First, as the 2015 policy survey did not have any questions about independent chair shareholder proposals, market constituents were unprepared for the potential revision of that policy, and it took some time to review, understand and evaluate the possible impact of the policy for a broad range of constituents.

The proposals subject to comment were released on October 15, with a deadline for comments two weeks later. While the draft policy is fairly succinct, there is little specific information provided. There are only general references to a "holistic review" of new factors, citing several examples, without indicating whether the existing factors remain unchanged (other than the performance period), or would be adjusted as well. The draft mentions that any single factor could be mitigated by positive or negative aspects, but then there is no explanation of what factors would be considered positive or negative. The lack of detail makes it difficult to target comments meaningfully.

ISS indicates that the final policy will be issued on or around November 7, only seven business days after comments are due. This seems to be a fairly limited window to thoroughly review comments received and to properly take them into account in formulating final policies, which may discourage additional persons from commenting.

We support ISS' efforts in encouraging interested persons to comment on the draft policies before making a determination about the final policies that will affect 2015 annual meetings. Please contact Ning Chiu or Joe Hall at Davis Polk if you have any questions as to the foregoing. Thank you for your consideration.