Governance Round-Up

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Increasing Director Responsibilities and Scrutiny of "Overboarding"

SEC rules, stock exchange listing requirements, and increased regulatory and judicial scrutiny continue to add to the workload of public company directors. At the 2015 AICPA conference held in early December, SEC Chair White delivered a keynote address which focused, in part, on the responsibilities and composition of audit committees. In her remarks, Chair White noted growing concerns about the amount of work required of public company directors in general and audit committee members in particular, warning that when directors serve on multiple boards, including multiple audit committees, "we must question whether they can do the job effectively."

Determining whether an individual board member is doing his or her job effectively is challenging and multifaceted. One objective factor sometimes taken into account is the number of boards and committees on which a director serves. While NYSE listing standards require that boards make and disclose determinations with respect to audit committee members who serve on multiple public company audit committees, limits on board seats are not currently required and a board may reasonably determine that such limits are not necessary, as directors can balance their own personal workloads.

However, "overboarding" continues to be a subject of debate. Potentially bringing greater attention to the issue, Glass Lewis and ISS recently tightened their criteria for overboarding for the 2016 proxy season. During 2016, both proxy advisory firms will note if a director serves on more than five public company boards, but will continue to recommend against only those directors who sit on more than six boards. Beginning in 2017, both ISS and Glass Lewis will recommend against directors who sit on more than five public company boards. In addition, beginning in 2017, Glass Lewis will change its voting recommendations with respect to directors who are CEOs and will recommend against CEO directors who sit on more than two public company boards, including their own. ISS and Glass Lewis currently recommend against CEO directors sitting on the board of more than three public companies, including their own. ISS has retained this policy but has indicated that it will continue to monitor the issue.

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Investor Focus on Share Buybacks

Investors remain concerned about the link between share buybacks and board stewardship, particularly as it may relate to executive incentive compensation. We understand that at least one public company recently received an AFL-CIO sponsored shareholder proposal requiring that shares repurchased by the company be excluded for purposes of calculating per share performance metrics used to calculate executive and director compensation.

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In its 2016 proxy voting policy survey, ISS asked what types of five-year historical metrics would be helpful to investors in assessing capital allocation and share buyback decisions. ISS indicated that this query was intended to address concerns that "inappropriate buybacks may be value-destroying in the long term" and "potentially increase the value of executive compensation packages." In response, a reported 85% to 96% of investors indicated they would like to see five-year historical data on share buybacks, dividends, capital expenditures, and cash balances. ISS did not propose related changes to its proxy voting guidelines for 2016.

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Delaware Supreme Court Affirms "Narrow" *Rural/Metro* Ruling

On November 30, 2015, the Delaware Supreme Court affirmed a decision of the Delaware Court of Chancery holding that RBC Capital Markets aided and abetted a breach of fiduciary duty by the directors of Rural/Metro Corporation in connection with the company's 2011 sale. Despite upholding the lower court's rulings in all respects, the Delaware Supreme Court took care to characterize both its and the Court of Chancery's decisions as "narrow" and based upon exceptional underlying facts. The Supreme Court emphasized that its decision did not expand the Court's previous rulings, including as to the stage in the deal process at which *Revlon* duties attach, the elements of an aiding and abetting claim, or the responsibility of a financial advisor to its client. *See* the Debevoise Client Update at:

http://www.debevoise.com/insights/publications/2015/12/delaware-court-affirms-narrow

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Drafting Delaware Exclusive Forum Bylaws

Delaware corporations that have adopted, or are considering adopting, exclusive forum bylaws should consider clearly providing in the text of the bylaw that the board may waive the bylaw or otherwise consent to another jurisdiction on a unilateral basis. In recent remarks, members of the Delaware Court of Chancery noted that some Delaware corporations have waived their exclusive forum bylaws in order to pursue what they deemed to be an attractive settlement in an alternative jurisdiction. The justices questioned whether such a waiver would withstand a challenge by stockholders if the bylaw did not explicitly state that it may be waived by the board unilaterally, particularly in light of the fact that exclusive forum provisions are arguably adopted for the benefit of stockholders.

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New SEC "Unbundling" Interpretations Give Target Stockholders Non-Binding Vote on Material Governance Matters

In November 2015, the SEC issued two new C&DIs with respect to Rule 14a-4(a)(3), the SEC's "unbundling rule", which requires that proxy statements identify clearly and impartially each separate matter intended to be acted on at a stockholder meeting. Existing SEC guidance provides that if a material amendment to an acquiror's organizational documents to be made in connection with an acquisition transaction would, if presented on a stand- alone basis, require the approval of its shareholders under state law, the rules of a national securities exchange, or its organizational documents, then the acquiror's form of proxy must present any such amendment separately from any other material proposal, including, if applicable, approval of the issuance of securities to target stockholders or approval of a transaction agreement. Under the existing guidance, material amendments would include governance matters such as the adoption of a classified board, limitations on the removal of directors, and the adoption of supermajority voting requirements.

New C&DI 2.01 provides that if, consistent with existing SEC guidance, the acquiror is required under Rule 14a-4(a)(3) to present an amendment or multiple amendments separately on its form of proxy, or would be so required if it were conducting a solicitation subject to Regulation 14A, then a target subject to Regulation 14A also must present any such amendment separately on its form of proxy. The C&DI notes the SEC staff position that target stockholders should have an opportunity to express their views separately on those material provisions that will establish their substantive rights as stockholders, even if they would not otherwise be entitled to vote on these matters under state corporate law.

These new C&DIs are widely seen as a response to inversion transactions, which frequently involve substantive governance changes resulting from the change in jurisdiction of incorporation of the acquiror, while the resulting company may continue to have a large percentage of U.S.-based stockholders. However, given that the required vote is non-binding, the outcome may have little practical effect. The C&DIs note that the transaction may, but need not, be conditioned on target approval of the corporate governance changes. The C&DIs also clarify that in transactions where a new acquisition vehicle is formed that will issue securities in the transaction (such as in a "double-dummy" structure), the party whose stockholders are expected to own the greater percentage of equity following the closing would be treated as the acquiror for purposes of the unbundling rule.

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ISS and Glass Lewis Update Proxy Voting Guidelines

ISS and Glass Lewis have updated their proxy voting guidelines for the 2016 proxy season. The following is a summary of the most significant updates applicable to U.S. public companies:

- **Unilateral Charter and Bylaw Amendments**. ISS and Glass Lewis continue to be critical of unilateral amendments by the board of directors to a company's charter or bylaws in a manner that they deem to "materially diminish" stockholder rights. For IPO companies, ISS will evaluate whether to recommend against directors based on pre-IPO amendments, taking into account a number of factors, including the level of impairment of shareholders' rights, the board's rationale for adopting the amendments, and future impacts on governance, including limits on stockholder rights to amend charters or bylaws, and the ability to hold directors accountable through annual elections.
- **Proxy Access**. ISS posed several specific questions about the terms of proxy access bylaws in its policy survey. While ISS did not adopt any specific proxy access voting guidelines, it has issued two new FAQs which provide specific guidance on what it deems to be "overly restrictive" proxy access provisions and how it will evaluate proxy access nominees. Among other things, ISS highlights two types of proxy access provisions as "especially problematic": counting individual funds within a mutual fund complex as separate shareholders for purposes of an aggregation limit; and the imposition of post-meeting shareholding requirements for the nominating shareholder. Glass Lewis will continue to review proxy access stockholder proposals and terms of proxy access bylaws on a case-by-case basis.
- **Exclusive Forum Provisions**. Glass Lewis will continue to recommend against directors of public companies that adopt exclusive forum provisions (ISS generally does not) and will, in the case of IPO companies, evaluate the provision alongside other bylaw provisions, such as supermajority vote requirements and classified boards.
- **Overboarding**. *See* the discussion above under "Increasing Director Responsibilities and Scrutiny of 'Overboarding'".

Complete copies of the ISS and Glass Lewis proxy voting guidelines and the ISS FAQs on U.S. proxy voting policies and procedures are available at *www.issgovernance.com* and *www.glasslewis.com*.

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