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GOVERNANCE ROUND-UP

Delaware Court of Chancery Invalidates Exclusive Federal Forum Provisions for Securities Act Claims

On December 19, 2018, the Delaware Court of Chancery in *Sciabacucchi v. Salzberg et al.* held invalid forum selection provisions in the certificates of incorporation of three Delaware corporations – Blue Apron Holdings, Inc., Stitch Fix, Inc. and Roku, Inc. – that required any claim under the Securities Act of 1933 to be filed only in federal court.

In its decision, the Court of Chancery distinguished between forum selection provisions that relate to the internal affairs of a corporation (such as derivative suits, fiduciary duty actions, and actions under the Delaware General Corporation Law (DGCL)), which were found to be permissible under the DGCL in the Court of Chancery's 2013 *Boilermakers Local 154 Retirement Fund v. Chevron Corp*. decision, and those that relate to the external affairs of a company, which involve rights and relationships not arising under the DGCL. The Court of Chancery determined that claims brought under the Securities Act fall into the latter category and, therefore, the federal forum provisions in question were invalid under the DGCL.

The Court of Chancery's decision follows the U.S. Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, in which the Court held that state courts have concurrent jurisdiction, without the possibility of removal, over class actions asserting Securities Act claims. In the wake of that decision, many commentators predicted that *Cyan* would ignite a race to file Securities Act claims in state courts. The Court of Chancery's decision in *Sciabacucchi* makes that all the more likely.

SEC Brings Enforcement Action for Violation of Regulation S-K's "Equal or Greater Prominence" Requirement

On December 26, 2018, the Securities and Exchange Commission settled an enforcement action against ADT Inc. for failure to comply with Item 10(e) of Regulation S-K's requirement that reporting companies, when presenting a non-GAAP financial measure, include "with equal or greater prominence" the most directly comparable GAAP financial measure. ADT was ordered to pay a $100,000 civil penalty and to cease and desist from further violations of Section 13(a) of the Securities Exchange Act of 1934 and Rule 13a-11 thereunder. The enforcement action and its implications are discussed further in our client debrief issued on January 10, 2019: Failure to Present GAAP Measures with "Equal or Greater Prominence" Brings Swift SEC Enforcement Action.

Governance Items on the SEC's 2019 Agenda

Recent statements of SEC Chairman Jay Clayton and Chief Accountant Wesley Bricker highlight two governance-related priorities of the SEC during 2019: improving the proxy process and fostering more effective internal control over financial reporting.

- *Proxy Process*. On December 6, 2018, Chairman Clayton included improving the proxy process in a speech outlining the SEC's significant initiatives for 2019. This reflected the consensus among panelists at the SEC's November proxy roundtable that proxy "plumbing" requires a major overhaul. Chairman Clayton encouraged market participants to explore what such an overhaul would entail and to consider how technology, including distributed ledger technology, could be employed. Chairman Clayton said the SEC should consider reviewing the ownership and resubmission thresholds for shareholder proposals under Rule 14a-8. He also noted a growing consensus that proxy advisor firms be required to provide greater clarity regarding (i) the division of labor, responsibility, and authority between proxy advisors and the investment advisers they serve and (ii) the analytical and decision-making processes advisers employ, including the extent to which those analytics are company- or industry-specific. He also said the SEC should consider: (i) the framework for addressing conflicts of interests at proxy advisory firms and (ii) ensuring that investors have effective access to issuer responses to information contained in reports from proxy advisory firms.
- *Internal Control over Financial Reporting*. In a statement issued on December 10, 2018, Chief Accountant Bricker highlighted the Office of the Chief Accountant's priorities for 2019, including fostering more effective internal control over financial reporting. Bricker emphasized the need for audit committees, auditors, and management to discuss internal control over financial reporting in all areas, from risk assessment to design and testing of controls, as well as the appropriate level of documentation. Noting the 2018 settlement of an SEC enforcement action involving internal control deficiencies, Bricker encouraged ongoing attention, including audit committee participation and training as needed, to the adequacy of and basis for a company's effectiveness assessment.

Glass Lewis Releases 2019 Policy Guidelines

On October 24, 2018, Glass Lewis released its policy guidelines applicable to shareholder meetings held after January 1, 2019. Noteworthy updates to the guidelines include:

- *Board Gender Diversity*. As announced in November 2017, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no women members. Depending on other factors, including the size of the company, the industry in which the company operates, and the governance profile of the company, Glass Lewis may extend this recommendation to vote against other nominating committee members.
- *Conflicting and Excluded Proposals*. During 2018, Glass Lewis observed that broadly, companies had three different types of responses to shareholder resolutions regarding special shareholder meeting rights. The 2019 guidelines codify how Glass Lewis will generally recommend voting in these different scenarios:
  - Where companies place on the ballot both a management and shareholder proposal requesting different thresholds for the right to call a special meeting, Glass Lewis will generally recommend voting in favor of the lower threshold and against the higher threshold.
  - If there are conflicting management and shareholder special meeting proposals and the company does not currently maintain a special meeting right, Glass Lewis will consider recommending voting in favor of the shareholder proposal and abstaining from voting on management's proposal.
  - Where companies have excluded a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, Glass Lewis will generally recommend voting against the ratification proposal as well as members of the nominating and governance committee. Glass Lewis may also, in very limited circumstances, recommend voting against members of the governance committee when the SEC has allowed a company to exclude a shareholder proposal.
- *Diversity Reporting*. Glass Lewis will now generally recommend voting in favor of shareholder proposals requesting disclosure regarding a company's workforce diversity and its initiatives to promote workforce diversity.
- *Environmental and Social Risk Oversight*. Glass Lewis codified its approach to reviewing how boards oversee environmental and social issues. For large cap companies and in instances where Glass Lewis identifies material oversight issues, this includes reviewing a company's overall governance practices, identifying which directors or board committees have been charged with oversight of environmental or social issues, and noting instances where such oversight has not been clearly defined by companies in their governance documents.

- *Executive and Director Compensation*. Glass Lewis expanded and enhanced its policies regarding excise tax gross-ups, severance and sign-on arrangements, grants of front-loaded awards, clawback provisions, and CD&A disclosure for smaller reporting companies. It also clarified its approach to peer groups, pay-for-performance, the use of discretion in incentive plans, director compensation, and bonus plans.
- *Auditor Ratification*. Glass Lewis codified additional factors it will consider when reviewing auditor ratification proposals, including the auditor's tenure, any pattern of inaccurate audits, and any ongoing litigation or significant controversies which call into question an auditor's effectiveness.
- *Virtual-Only Shareholder Meetings*. As announced in November 2017, Glass Lewis may recommend voting against members of the governance committee of a company that holds a virtual-only shareholder meeting, unless the company's disclosure of its virtual meeting procedures provides that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting.
- *Written Consent Shareholder Proposals*. If a company has adopted proxy access and its shareholders are entitled to call a special meeting if they own 15 percent or less of the company's common stock, Glass Lewis will generally recommend against shareholder proposals requesting that the company adopt a shareholder right to act by written consent.
- *Other updates*. Glass Lewis clarified its approach in a number of additional areas, including director and officer indemnification, quorum requirements, director recommendations on the basis of company performance, and OTC-listed companies.

ISS Releases 2019 Updates to Proxy Voting Guidelines

On November 19, 2018, Institutional Shareholder Services released updates to its proxy voting guidelines for the Americas and other regions applicable to shareholder meetings held on or after February 1, 2019. The most significant update is a revised policy promoting gender diversity on boards of U.S. companies.

Starting with the 2018 proxy season, ISS proxy research reports have noted when a company's board lacks gender diversity, but ISS has not issued adverse vote recommendations on director elections on this basis. Under the new policy, ISS will generally issue recommendations to vote against or withhold shareholder approval from the chair of the nominating committee if there are no women on the company's board. Where there is no formal nominating committee, ISS may recommend against the election of other directors who are responsible for the board nomination process. ISS will consider on a case-by-case basis any mitigating factors, including a firm commitment by the board to appoint at least one woman director to the board in the near term, or the presence of a woman director on the board at the preceding annual meeting. The new policy applies to companies in the Russell 3000 or S&P 1500 indices after a one-year grace period and will be effective for meetings held on or after February 1, 2020.

ISS also made technical updates regarding director performance and shareholder ratifications and left for a later date changes related to multiclass voting structures, director track records, and non-GAAP (EVA) pay-for-performance metrics. These items are discussed in further detail in our client update issued on November 26, 2018: ISS Updates for 2019 Spotlight Gender Diversity.

NYSE Releases 2019 Compliance Guidance Memo

On January 10, 2019, the New York Stock Exchange released its annual memo detailing important rules and policies applicable to NYSE-listed companies. The memo highlights amendments to the NYSE Listed Company Manual that took effect in 2018. In particular, as of February 1, 2018, companies must notify the NYSE at least ten minutes before making any public announcement regarding a dividend or stock distribution, even when the notice is outside of NYSE trading hours. In addition, as of March 15, 2018, companies are no longer required to provide physical copies of proxy materials to the NYSE if they are filed electronically with the SEC.

The memo also provides helpful policy reminders for NYSE-listed issuers, including with respect to the NYSE's timely alert/material news policy, earnings release date changes, share reporting procedures, annual meeting requirements, record date notifications, annual report website posting requirements, corporate governance requirements, and supplemental listing applications. The memo also flags requirements specific to domestic issuers and to foreign private issuers, including the requirement that NYSE-listed foreign private issuers must submit a Form 6-K to the SEC containing semi-annual unaudited financial information no later than six months following the end of the company's second fiscal quarter.

Additional CEOs Back "Commonsense" Corporate Governance Principles

On October 18, 2018, the CEOs of more than 20 leading public companies, pension funds, and investment firms signed the Commonsense Corporate Governance Principles 2.0. The Commonsense Principles 2.0 update the original principles published in 2016, which were a collaborative effort by representatives of the United States' largest corporations and institutional investors to establish corporate governance guidelines that would serve the best interests of both public corporations and financial markets. In addition to the original signatories to the principles, which included Berkshire Hathaway and J.P. Morgan, the signatories to Commonsense Principles 2.0 include, among others, AT&T, Bank of America, Coca-Cola, IBM, Johnson & Johnson and Proctor & Gamble.

Key recommendations reflected in Commonsense Principles 2.0 that were not included in the original principles include:

- *Board of Directors*
  - *Director elections*. In uncontested elections, directors that fail to receive a majority vote should offer to resign, which the board should accept or explain its rationale for not doing so. Further, directors ordinarily should refrain from joining a board unless they are committed to serving for at least three years. If a company elects directors on a staggered basis or otherwise less frequently than annually, the board should explain its rationale for doing so.
  - *Independent leadership*. If a board combines the chair and CEO roles, the board should have a strong designated lead independent director. The role of a company's lead independent director should be clearly defined and sufficiently robust to ensure effective and constructive leadership. The responsibilities of the lead independent director and the executive chair should be clearly delineated, agreed upon by the board, and disclosed to shareholders.
- *Shareholder Concerns*
  - *Shareholder proposals*. Companies should consider engaging with shareholders who submit shareholder proposals under Rule 14a-8 early in the process, preferably before the proposal appears in the proxy. If a proposal receives majority shareholder support, the company should consider further shareholder engagement and either implement the proposal (or a comparable alternative) or promptly explain why doing so would not be in the best long-term interests of the company. As a best practice, the company also should consider further shareholder engagement for proposals that receive significant, but less than majority, support.
  - *Management proposals*. Companies should also consider early engagement with shareholders in connection with management proposals. If the proposal is defeated or receives significant shareholder opposition, the company should consider further shareholder engagement and formulate an appropriate response.
- *Shareholder Rights*
  - *Proxy access*. Public companies should allow for some form of proxy access by shareholders, subject to reasonable requirements that do not make proxy access unduly burdensome for significant, long-term shareholders.
  - *Poison pills and other anti-takeover measures*. If a company adopts a poison pill or another anti-takeover measure, the board ordinarily should put the item to a vote of the shareholders and explain why its adoption is in the best interests of the

shareholders. On a periodic basis, the board should review such measures to determine whether they remain appropriate.

- *The Role of Investors in Corporate Governance*
  - *Asset managers*. Asset managers should disclose the use of proxy advisory recommendations in their decision-making processes and their policies for dealing with potential conflicts in their proxy voting and engagement activities. Compensation of portfolio managers investing in public companies should be structured to consider performance over an appropriate term, given the strategy and investment time horizon of the portfolio.
  - *Institutional asset owners*. When investing through asset managers, institutions such as pension plans and endowments may wish to encourage sound corporate governance practices through, for example, the use of benchmarks and performance reports consistent with the ultimate asset owner's strategy and investment time horizon, dialogue with asset managers concerning corporate governance issues, and the evaluation of how asset managers discharge their role in corporate governance matters.

Commonsense Principles 2.0 are hosted on the website of Columbia Law School's Millstein Center for Global Markets and Corporate Ownership, accessible here, along with the list of companies, pension funds and investment firms that have backed them.

U.S. Senators Introduce Corporate Governance Fairness Act

On November 13, 2018, six U.S. senators introduced the Corporate Governance Fairness Act, intended to protect investors, improve corporate governance, and hold proxy advisory firms accountable as fiduciaries to the investors that rely on their advice. To accomplish these goals, the Corporate Governance Fairness Act proposes to:

- require certain proxy advisory firms to register as investment advisers under the Investment Advisers Act of 1940, thus subjecting them to SEC regulation;
- require the SEC to conduct periodic inspections of the records of proxy advisory firms and review (i) whether any proxy advisory firm knowingly made any false statement to any of its clients, or omitted to state a material fact that would be necessary to make the statement to the client not misleading, and (ii) policies and programs regarding conflicts of interest at proxy advisory firms;
- grant the SEC discretionary authority to conduct other examinations of proxy advisory firms and their records that the SEC determines are necessary and appropriate in the public interest and for the protection of investors; and

- require the SEC to produce a report to Congress within two years after enactment of the bill (and periodically thereafter) that evaluates existing proxy advisory firm policies and procedures regarding conflicts of interest and avoidance of misleading communications to clients, and whether additional protections to investors would be helpful.

The bill has been endorsed by the NYSE and the Society for Corporate Governance.

Congressmen Introduce House Companion to Senator Warren's Accountable Capitalism Act

On December 13, 2018, five U.S. congressmen introduced a House companion bill to the Accountable Capitalism Act that was introduced by Elizabeth Warren in the Senate on August 15, 2018. Citing studies indicating that large American corporations have dedicated 93 percent of their earnings to shareholders over the last decade compared to less than half in the early 1980s, the bill aims to "return to the era when American corporations produced broad-based growth that helped workers and shareholders alike." The bill seeks to compel company directors to consider the interests of all corporate stakeholders, including employees, customers, shareholders, and the communities in which the company operates. To meet these objectives, the Accountable Capitalism Act proposes to:

- require U.S. corporations with more than $1 billion in annual revenue to obtain a federal charter from a newly formed Office of United States Corporations at the Department of Commerce;
- require that these corporations ensure that no fewer than 40% of their directors are selected by the corporations' employees;
- prohibit directors and officers of these corporations from selling company shares within five years of receiving them or within three years of a company stock buyback;
- require these corporations to receive the approval of at least 75% of their directors and shareholders before engaging in political expenditures; and
- permit the federal government to revoke the charter of a corporation that has engaged in repeated and egregious illegal conduct.

New Jersey Follows California in Effort to Add Women to Boards

On November 26, 2018, the New Jersey legislature introduced a new bill that would require publicly traded companies to include women on their boards of directors. The bill is substantially similar to a California law passed in September 2018.

The bill would require publicly traded companies whose Form 10-Ks state that their principal executive offices are in New Jersey to have at least one woman on the board by the end of the 2019 calendar year. By the end of the 2021 calendar year, depending on the size of the board, certain companies would be required to have a minimum of two or three women on the board. Companies that fail to comply would be fined $100,000 for the first violation and $300,000 for each subsequent violation.

In introducing the bill, the New Jersey legislature noted studies that have found that public companies with women on their boards "perform significantly better and have higher reported earnings per share, higher average return on equity, stronger governance structures and transparency, improved stock performance, and higher net income growth" as compared to companies with only men on their boards.

Editors

Matthew E. Kaplan
Partner
+1 212 909 7334
mekaplan@debevoise.com

Steven J. Slutzky
Partner
+1 212 909 6036
sjslutzky@debevoise.com

William D. Regner
Partner
+1 212 909 6698
wdregner@debevoise.com

Joshua M. Samit
Counsel
+1 212 909 6414
jmsamit@debevoise.com

Jeffrey J. Rosen
Partner
+1 212 909 6281
jrosen@debevoise.com

C. Chloe Orlando
Associate
+1 212 909 6914
corlando@debevoise.com

Please address inquiries regarding topics covered in this publication to the editors.