
GOVERNANCE ROUND-UP

SEC Reports on Investigation of Cyber-Related Frauds Against Public Companies and Related Internal Accounting Controls Requirements

On October 16, 2018, the Securities and Exchange Commission issued a Report of Investigation conducted by the SEC's Division of Enforcement, in consultation with the Division of Corporation Finance and the Office of the Chief Accountant, which focused on the internal accounting controls of nine issuers that were the victims of schemes involving spoofed or compromised electronic communications from persons purporting to be company executives or vendors.

The report follows the SEC's February 2018 guidance, "Commission Statement and Guidance on Public Company Cybersecurity Disclosures," in which the SEC advised public companies that "[c]ybersecurity risk management policies and procedures are key elements of enterprise-wide risk management, including as it relates to compliance with the federal securities laws."

While the SEC ultimately determined not to pursue an enforcement action in any of the nine matters investigated, it issued the Report in part to underscore the importance of devising and maintaining a system of internal accounting controls attuned to cyber-related fraud and theft, as well as the critical role training plays in implementing controls to protect company assets as required by the federal securities laws.

The SEC clarified that not every issuer that is the victim of a cyber-related scam is, by extension, in violation of the internal accounting controls requirements of the federal securities laws. Given the prevalence of these attacks, however, companies should be mindful of the risks that cyber-related frauds pose and consider whether their internal controls are sufficient to provide reasonable assurances in safeguarding company assets.

Review of Disclosure Controls and Procedures in the Aftermath of the SEC's Settlement with Elon Musk and Tesla

On September 29, 2018, the SEC announced that Elon Musk, CEO and Chairman of Tesla, Inc., had agreed to settle securities fraud charges brought by the SEC against him after he tweeted about taking Tesla private. On October 16, 2018, the U.S. District Court for the Southern District of New York approved the settlement. This case exemplifies ongoing challenges of using social and other non-traditional media to make company-related disclosures and serves as a reminder for companies to review their disclosure controls and procedures to ensure that they remain up to date in light of new technologies.

In light of these developments, companies should take the following three steps:

- ensure that all relevant policies have been adapted to specifically address the appropriate use of social and other non-traditional media;
- review, test and remediate disclosure controls and procedures; and
- provide regular training to all relevant personnel.

ISS Announces Results of 2018 Governance Principles Survey

On September 18, 2018, ISS announced the results of its Governance Principles Survey. The survey is a key part of ISS's annual global benchmark policy development process which will see a release in November of ISS's final policies applicable to global shareholder meetings occurring on or after February 1, 2019.

Auditors and Audit Committees. ISS asked respondents to identify the factors they consider in evaluating the performance of external auditors. Investors cited as their primary matters of interest regulatory fines or other penalties assessed against the auditor for weaknesses or errors in audit practices, significant audit controversies, and the identity of the audit partner and any links the audit partner has to the company or its management. For non-investors, the primary areas of concern were generally the same.

ISS also asked respondents to identify information that shareholders should consider when evaluating a company's audit committee. Both investors and non-investors cited the skills and experience of audit committee members as the primary area of consideration.

Director Accountability and Track Records. ISS asked respondents whether it would be appropriate and useful to note in company-related proxy research whether a director has failed in his or her boardroom oversight responsibilities at another company resulting in a

Continued on page 3

negative ISS vote recommendation. Investors strongly favored this disclosure, with 84% voting yes, while 41% of non-investor respondents were in favor. Both investor and non-investor respondents indicated that risk oversight failures relating to fraud or other forms of corporate malfeasance were the primary matters relevant to assessing the situation. Investors generally favored a longer look-back (no time limit or five years), while non-investors favored a shorter timeframe (one to three years).

Gender Diversity on Boards. As it did last year, ISS asked respondents whether they considered it problematic if there were zero women on a public company board. In 2018, 80% of investors and 60% of non-investors indicated that they considered the lack of women directors to be problematic, up from 69% and 54%, respectively, in 2017. Both investors and non-investors indicated that engagement with the board and management was the most appropriate way to address this issue.

One-Share, One-Vote Principle. ISS asked respondents whether they would be in favor of receiving information detailing what vote results would have been if all votes were counted equally (where possible to determine). Respondents strongly favored receiving this information, with 92% of investors and 59% of non-investors responding in favor. ISS also asked if it should use adjusted vote results to measure board responsiveness to shareholder vote results in the following year. Investors voted 72% in favor, while non-investors were generally split on this question. With respect to the appropriate timing for sunset provisions on unequal voting rights structures, investors and non-investors were generally split between one to three years and four to six years.

ISS received 669 responses to this year's survey from 638 different organizations, an increase of 11% in the total number of responses over 2017.

Glass Lewis to Integrate Sustainability Accounting Standards Board's Industry-Specific Materiality Guidance Across Research and Vote Management Products

Glass Lewis recently announced that guidance on material environmental, social, and governance topics from the Sustainability Accounting Standards Board ("SASB"), which develops and maintains sustainability and accounting standards for 79 industries in 11 sectors, will be integrated into its research reports and vote management application.

Glass Lewis' believes that incorporating the SASB standards will enable its clients to easily identify whether matters up for vote are aligned with the SASB standards to help inform proxy voting and engagement activities. SASB's standards will be incorporated into Glass Lewis' products in advance of the 2019 season.

Delaware Passes Law to Promote Disclosure of Sustainability Efforts

Delaware recently enacted the Certification of Adoption of Transparency and Sustainability Standards Act (the “Act”), which establishes a voluntary certification regime allowing entities incorporated or formed in Delaware to seek certification from the Delaware Secretary of State, beginning on October 1, 2018, that the entity has met statutory requirements regarding disclosure of its sustainability efforts.

In order for a Delaware entity to obtain the certification, among other things, the governing body of the entity must adopt resolutions setting forth the sustainability standards it will use and the measures it will use to assess the standards, make those standards and assessment measures public, and provide reports on the entity’s performance measured against such standards, both to the Delaware Secretary of State and on a public website. Upon complying with the requirements of the Act, an entity is permitted to disclose that it is a reporting entity under the Act.

Because the regime is voluntary and there is an express limitation of liability for actions or omissions made in connection with the certification, some practitioners have expressed skepticism over the Act’s potential to influence sustainability reporting.

Investors Petition SEC for ESG Rulemaking

On October 1, 2018, a group of investors and associated organizations representing more than \$5 trillion in assets under management petitioned the SEC for a rulemaking on environmental, social, and governance (“ESG”) disclosure. The group included the California Public Employees’ Retirement System (CalPERS), New York State Comptroller Thomas P. DiNapoli, Illinois State Treasurer Michael W. Frerichs, Connecticut State Treasurer Denise L. Nappier, Oregon State Treasurer Tobias Read, and the U.N. Principles for Responsible Investment.

The rulemaking petition:

- called for the SEC to initiate notice and comment rulemaking to develop a comprehensive framework requiring issuers to disclose identified ESG aspects of each public-reporting company’s operations;
- set forth the statutory authority for the SEC to require ESG disclosure;
- discussed the materiality of ESG issues;

Continued on page 5

- highlighted large asset managers' existing calls for standardized ESG disclosure;
- discussed the importance of standardized ESG disclosure for companies and the competitive position of the U.S. capital markets; and
- pointed to existing rulemaking petitions, investor proposals, and stakeholder engagements on topics such as human capital management, climate, tax, human rights, gender pay ratios, and political spending, and highlighted how these efforts suggest that it is time for the SEC to bring coherence to this area.

SEC Staff Announces Roundtable on Proxy Process and Withdraws No-Action Letters Regarding Proxy Advisory Firms

The Staff of the SEC's Division of Investment Management announced that it will host a "Roundtable on the Proxy Process" on November 15, 2018 to hear investor, issuer, and other market participant views about the proxy process and rules. The Roundtable is expected to focus on key aspects of the U.S. proxy system, including proxy voting mechanics and technology, the shareholder proposal process, and the role and regulation of proxy advisory firms.

In advance of the Roundtable, the Staff has been considering whether prior Staff guidance about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms should be modified, rescinded, or supplemented.

With the pending Roundtable and other policy considerations in mind, in September the Staff withdrew the no-action letters issued in 2004 to Egan-Jones Proxy Services (May 27, 2004) and Institutional Shareholder Services, Inc. (September 15, 2004), which provided guidance about investment advisers' reliance upon voting recommendations of proxy advisory firms as independent third parties.

The Staff indicated that it withdrew these no-action letters in order to facilitate the discussion at the Roundtable, including with respect to the Staff's guidance in Staff Legal Bulletin No. 20 (June 30, 2014), which also provides guidance about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms.

California Becomes First State to Require Women on Boards

On September 30, 2018, California became the first state to require publicly traded companies to include women on their boards of directors.

The new law, which applies to companies whose principal executive offices are in California according to the companies' Forms 10-K, requires these companies 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, a company may be required to have a minimum of two or three women on its board. Hundreds of companies are expected to be affected by the new law. Companies that fail to comply can be fined \$100,000 for the first violation and \$300,000 for each subsequent violation.

Legal scholars have questioned whether the new law is constitutional and will withstand judicial scrutiny. California Governor Jerry Brown noted when signing the bill into law that there have been "numerous objections to this bill and serious legal concerns have been raised," and that the potential flaws "may prove fatal to its ultimate implementation."

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