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GOVERNANCE ROUND-UP

Dropbox Marks Third California Decision to Enforce a Federal Forum Provision for Securities Act Claims

On December 4, 2020, the California Superior Court of San Mateo County in *In re Dropbox, Inc. Securities Litigation* granted Dropbox's motion to dismiss a complaint brought by Dropbox stockholders alleging, among other things, a claim under Section 11 of the Securities Act of 1933 in connection with Dropbox's initial public offering. Dropbox, a Delaware corporation with its principal place of business in California, had moved to dismiss the complaint pursuant to a federal forum provision in its bylaws that designated U.S. federal district courts as the exclusive forum for Securities Act claims.

Dropbox is the third decision by a California court to enforce an exclusive federal forum provision in a Delaware corporation's charter or bylaws since the March 2020 Delaware Supreme Court decision in *Salzberg v. Sciabacucchi*, discussed here and here. *In Salzberg*, the Court held that such provisions are facially valid. The first two decisions by California courts were *Wong v. Restoration Robotics, Inc.*, decided by the California Superior Court of San Mateo County in September 2020, and *In re Uber Technologies, Inc. Securities Litigation*, decided by the California Superior Court of San Francisco County in November 2020.

The courts in *Restoration Robotics*, *Uber* and *Dropbox* provided similar reasons in support of their decisions to dismiss the complaints, including that, because the federal forum provisions at issue were contained in the corporation's charter (*Restoration Robotics* and *Uber*) or bylaws (*Dropbox*), the plaintiffs were on notice of the provisions and presumptively agreed to their terms by purchasing the corporation's securities. The courts also held that the federal forum provisions at issue were not unconscionable because they did not disrupt the substantive rights and remedies provided by the Securities Act or create additional expense or inconvenience for stockholders. The court in *Dropbox* viewed positively Dropbox's "legitimate business need" for the federal forum provision: to avoid the unnecessary costs and burden of defending multiple cases simultaneously in both state and federal courts and the possibility of inconsistent judgments and rulings.

Nasdaq Proposes New Listing Rules to Advance Diversity

On December 1, 2020, Nasdaq proposed new listing rules that would require all companies listed on Nasdaq's U.S. exchange to publicly disclose diversity statistics regarding their boards of directors and would also require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an "underrepresented minority" or "LGBTQ+". Foreign companies and smaller reporting companies would have additional flexibility in satisfying this requirement with two female directors.

Similar to the new California law discussed later in this Round-Up, an "underrepresented minority" is defined in the proposed rules as an individual who self-identifies in one or more of the following groups: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander or two or more races or ethnicities. "LGBTQ+" is defined as an individual who self-identifies as lesbian, gay, bisexual, transgender or a member of the queer community.

If approved by the Securities and Exchange Commission, the rules would require Nasdaq-listed companies to disclose board-level diversity statistics within one year of the SEC's approval. The required disclosure would follow a prescribed tabular format and be included in the company's proxy statement or information statement for its annual meeting of shareholders, or on its website. All companies would be expected to have at least one diverse director within two years of the SEC's approval. Depending on a company's listing tier, companies would be expected to have at least two diverse directors within four or five years of the SEC's approval. Companies not in a position to meet the board composition objectives within the required timeframes would not be subject to delisting if they provide a public explanation of their reasons for not meeting the objectives.

In a press release announcing the proposal, Nasdaq characterized the proposal as "one step in a broader journey to achieve inclusive representation across corporate America." The full text of the proposal is available here.

ISS and Glass Lewis Release 2021 Proxy Voting Guidelines

In November 2020, Institutional Shareholder Services and Glass Lewis each updated their proxy voting guidelines for the 2021 proxy season. Key updates include the following:

- *Board diversity*: In line with the heightened focus on board diversity by state governments, stock exchanges, investors and other stakeholders, ISS and Glass Lewis have adopted new or updated policies with respect to racial, ethnic and gender diversity

at the board level. Public companies should consider the new policies below, along with Nasdaq's proposed new listing rules (discussed earlier in this Round-Up), when preparing their 2021 proxy statements and should consult with counsel regarding specific disclosure.

- Racial and ethnic diversity: Beginning in 2022, ISS generally will recommend voting against or withholding from the nominating committee chair (or other directors on a case-by-case basis) where the board of a Russell 3000 or S&P 1500 company has no apparent racially or ethnically diverse members. ISS will make an exception for a board that was racially or ethnically diverse at the company's preceding annual meeting, provided the board makes a firm commitment to restore that diversity by appointing at least one racially or ethnically diverse member within a year. ISS research reports issued during 2021 will highlight boards that lack racial or ethnic diversity to help investors identify companies with which to engage on this topic.
- Gender diversity: Beginning in 2022, Glass Lewis generally will recommend voting against nominating committee chairs of boards with seven or more members that have less than two women directors. Glass Lewis's existing policy requiring a minimum of one women director will remain in place for boards with six or fewer members. In addition, Glass Lewis will make voting recommendations in accordance with board diversity requirements under applicable state laws, such as the recently passed California law discussed later in this Round-Up.
- Proxy disclosure: Beginning in 2021, Glass Lewis reports for S&P 500 companies will include an assessment of the company's proxy disclosure relating to board diversity, director skills and the director nomination process. Specifically, Glass Lewis will reflect how a company's proxy statement presents: (i) the board's current percentage of racial and ethnic diversity; (ii) whether the board's definition of diversity explicitly includes gender, race or ethnicity; (iii) whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees (otherwise known as the "Rooney Rule"); and (iv) board skills disclosure.

- *Exclusive forum provisions*: ISS has updated its policy on shareholder litigation rights following the March 2020 Delaware Supreme Court decision in *Salzberg v. Sciabacucchi*, which held exclusive federal forum provisions to be facially valid under Delaware law. Companies contemplating adopting or amending a charter or bylaws to include an exclusive forum provision should consider the new policy provisions noted below.
  - Federal forum provisions: ISS will now generally recommend voting in favor of exclusive federal forum provisions for federal securities law matters in a company's charter or bylaws. If the provision designates a specific federal court, however, ISS will generally recommend voting against the provision, since ISS believes that

shareholders should have flexibility in choosing a court in a location convenient to them.

- State forum provisions: For Delaware companies, ISS will generally recommend voting in favor of charter or bylaw provisions designating courts within the state of Delaware as the exclusive forum for state corporate law matters. For states other than Delaware, ISS will maintain its prior policy of recommending voting on a case-by-case basis for provisions designating a specific court as the exclusive forum after considering a number of factors, including the company's rationale for the provision and the type of claims covered under the provision. ISS cited several reasons for its special treatment of Delaware, including that Delaware's court system specializes in corporate law, has a large body of case precedents and typically resolves cases quickly and efficiently.

- *Virtual shareholder meetings*: The COVID-19 pandemic resulted in a substantial majority of companies holding virtual-only shareholder meetings in 2020. Companies that continue to utilize this format should note the policy updates below.

  - Proxy disclosure: Glass Lewis removed the temporary exception to its policy on virtual shareholder meeting disclosure that was in effect for meetings held between March 1, 2020 and June 30, 2020. For companies holding such meetings, Glass Lewis expects "robust" proxy disclosure addressing the ability of shareholders to participate in the meeting. Examples of effective disclosure include: addressing the ability of shareholders to ask questions at the meeting; procedures, if any, for posting appropriate questions received during the meeting and the company's answers on its public website; and logistical details for meeting access and technical support. Where such disclosure is not provided, Glass Lewis will generally recommend voting against members of the governance committee.

  - Management and shareholder proposals: ISS adopted a new policy to generally recommend a vote in favor of management proposals allowing for the convening of shareholder meetings by electronic means, so long as they do not preclude in-person meetings. Companies are encouraged to disclose the rationale for and circumstances under which virtual-only meetings would be held, and to allow for comparable rights and opportunities for shareholders to participate electronically as they would have during an in-person meeting. In addition, the policy establishes a case-by-case approach on shareholder proposals concerning virtual-only meetings.

- *E&S risk oversight*: Consistent with the broader focus on environmental, social and governance (ESG) issues by many investors and other stakeholders, ISS and Glass Lewis have both updated their policies with respect to board-level oversight of environmental and social issues. Companies, especially those operating in sectors that face heightened environmental and social risks, should note the new policies below when preparing their 2021 proxy statements and assessing board oversight.

- Proxy and other disclosure: Beginning in 2022, Glass Lewis generally will recommend voting against governance committee chairs of S&P 500 companies that fail to provide explicit disclosure concerning board-level oversight of environmental and social issues in their proxy statements or governing documents, such as committee charters. Glass Lewis will note the absence of such disclosure as a concern beginning in 2021.
- Oversight generally: While ISS's existing policy calling for recommendations against directors in the event of material failures of governance, stewardship or risk oversight remains unchanged, ISS updated its list of examples of risk oversight failures to include "demonstrably poor risk oversight of environmental and social issues, including climate change."

The full text of the updated voting guidelines updates is available here (ISS) and here (Glass Lewis).

California Enacts Diversity Requirements for Corporate Boards

On September 30, 2020, California Governor Gavin Newsom signed legislation that will require the boards of publicly traded companies whose principal executive offices are located in the state to have at least one director from an "underrepresented community" by the end of 2021. The new law follows a similar law enacted in September 2018, discussed here, which required California publicly traded companies to include women on their boards of directors.

As defined in the new law, a director from an "underrepresented community" means an individual who self-identifies as Black, African American, Hispanic, Latinx, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender.

By the end of 2022, depending on the number of directors on the board, California-headquartered public companies may be required to increase the number of directors from an underrepresented community to two or three directors. Similar to the 2018 gender diversity law, violations for failure to comply with the new law range from $100,000 for a first violation to $300,000 for subsequent violations. The full text of the new law is available here.

SEC Amends Rule 14a-8 to Modernize Shareholder Proposal Requirements

On September 23, 2020, the SEC adopted final amendments to modernize Rule 14a-8 of the Securities Exchange Act of 1934, which governs the process for shareholder proposals to be included in a company's proxy statement. The amendments revise the procedural requirements pertaining to a shareholder's initial proposal as well as resubmitted proposals, but do not change the substantive bases for inclusion or exclusion of shareholder proposals. Key amendments to Rule 14a-8 include:

- *Ownership requirements*: The shareholder ownership and holding requirements for a proposal submission have been increased from (i) at least $2,000 or 1 percent of a company's securities for at least one year to (ii) at least $2,000 (if held for at least three years), at least $15,000 (if held for at least two years) and at least $25,000 (if held for at least one year). Shareholders are prohibited from aggregating their holdings to satisfy these increased thresholds (a practice previously permitted by the SEC).
- *Proposal resubmission thresholds*: The shareholder support thresholds for resubmitting shareholder proposals of substantially the same subject matter have been increased from 3/6/10 percent to 5/15/25 percent for matters voted on once, twice, or three or more times, respectively, in the past five years.
- *One-proposal limit*: Submissions for a shareholders' meeting are now limited to one proposal for "each person" as opposed to "each shareholder," to prevent a shareholder from submitting more than one proposal by submitting a proposal both in its own name and also as a representative of another shareholder.
- *Shareholder engagement*: Shareholders must now submit a written statement providing their availability to meet with the company in person or by teleconference within 10 to 30 calendar days after submission of a proposal.
- *Shareholder representative assurances*: Shareholders who elect to use a representative for the purpose of submitting a shareholder proposal must provide documentation to make clear that the representative is authorized to act on the shareholder's behalf and to provide a meaningful degree of assurance as to the shareholder's identity, role and interest in a proposal that is submitted for inclusion in a company's proxy statement.

The rule amendments generally will apply to shareholder proposals submitted for an annual or special meeting to be held on or after January 1, 2022. The amendments are discussed in further detail in our client update issued on October 7, 2020, available here.

SEC Chairman Discusses Measures to Foster "Good Corporate Hygiene"

On September 14, 2020, then-SEC Chairman Jay Clayton delivered a letter to House Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets Chairman Brad Sherman on the importance of "good corporate hygiene" and a robust control environment for senior executives. In his letter, Chairman Clayton highlighted the following measures relating to insider trading policies, Rule 10b5-1 plans and stock option issuances that he believed would improve compliance, market integrity and investor confidence during times of heightened market volatility and uncertainty.

- *Insider trading policies*: Chairman Clayton noted that insider trading policies are not difficult to adopt or administer, and that "the integrity bang for the compliance buck is large." A well-designed policy, he explained, has controls in place to prevent senior executives and members of the board of directors from trading once a company is in possession of material non-public information, even if an individual officer or director did not personally have knowledge of the information.
- *Rule 10b5-1 plans*: Chairman Clayton believed Rule 10b5-1 plans can facilitate "long-term interest alignment and other principles of good corporate governance." In his letter, he urged companies to strongly consider requiring that Rule 10b5-1 plans for senior executives and board members include mandatory "seasoning periods" – waiting periods after adoption, amendment or termination – before trading under the plan may begin or recommence. Such seasoning periods, he noted, "not only help demonstrate that a plan was executed in good faith, but they also can bolster investor confidence in management teams and in markets generally."
- *Stock option issuances*: Chairman Clayton cautioned that companies should consider carefully whether to issue executive stock options while in possession of material non-public information. When a company grants an award based on the trading price of its stock while in possession of materially positive non-public information, he explained, the premise that equity awards are intended to incentivize future performance is diluted. Chairman Clayton has asked the Staff of the Division of Corporation Finance to be mindful of the pricing of executive equity awards when reviewing compensation disclosures in Exchange Act reports filed with the SEC.

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