

**CGC**

ABA Business Law Section Corporate Governance Committee

# INSIGHT

Keeping you **in the know** about recent developments in corporate governance



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Commentary on Avoiding  
Integrity Lapses**

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**CGC Leadership**

**Holly J. Gregory**, CGC Chair  
**John H. Stout**, Former CGC Chair

**CGC In Sight Leadership**

**Bruce Dravis**, Co-Editor  
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# RECENT DEVELOPMENTS

The ABA Business Law Section Corporate Governance Committee (CGC) has produced this quarterly newsletter, **CGC In Sight**, to advise members of recent developments in the corporate governance field. Articles link to source material for reference or additional research. For quick access to any section or article, click through the headline below.

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## ABOUT CGC IN SIGHT

The goal of **CGC In Sight** is to give practitioners a quarterly “heads-up” summary of recent and pending developments affecting corporate governance.

Each summary is linked to underlying source material for the practitioner’s reference or additional research. Members of the **CGC In Sight** Editorial Board monitor developments in the substantive topic areas listed to the right. That list is not confined solely to legal topics, but looks to other institutions whose actions can influence corporate governance. Over time, we expect to add columns and commentary from practitioners in the field.

Covering a particular topic does not necessarily mean that the Co-Editors or contributors endorse or agree with the content cited.

## GET INVOLVED

Members of the **ABA CGC** are encouraged to participate as members of the **CGC In Sight** Editorial Board and in preparing summaries and other items for publication.

Article proposals and submissions are welcome, but will be printed only with the approval of the Editorial Board.

E-mail any of the **CGC In Sight** Co-Editors with comments, questions, article proposals or to otherwise become involved:

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Federal Regulatory Developments

Federal Case Law Developments

State Law Developments

International Law Developments

SROs

Investor Organizations (CII, PERS, etc.)

Management Organizations (Chamber, BRT)

Activist Investors

Proxy Advisor Organizations (ISS, Glass Lewis)

Rating Agencies (S&P, Moodys, Fitch)

Professional Organizations (Society, COSO, AICPA)

Academic Developments

Directors Institutes

Governance in Other Entities

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# EDITORIAL IN SIGHT

## A Call for Commentary on Avoiding Integrity Lapses

Even in a post-Sarbanes-Oxley and Dodd-Frank world, allegations of corporate scandals and wrongdoing by executives continue to make headlines, with a number of public and private companies finding themselves in the middle of a firestorm with consumers, regulators and investors.

The following are three current examples that have gained the attention of many:

A publicly traded financial institution has faced allegations that employees were setting up sham client accounts – and charging fees to clients for the accounts – even though clients did not authorize the accounts or, in some cases, even know they existed.

A privately held media darling in the health care space that once touted a \$9 billion valuation on paper has faced allegations that its proprietary blood-testing technology did not work as reported, voided patient blood-test results for two years and shuttered its blood-testing facilities.

A publicly traded pharmaceutical company agreed to pay hundreds of millions of dollars to the U.S. Department of Justice for improperly classifying a lifesaving drug in order to pay lower rebates to Medicaid and has received considerable backlash for raising the price of the drug by more than 400 percent.

Before these scandals unfolded, in 2008, Ben Heineman, Jr., the former general counsel of General Electric, aptly identified the negative fallout that follows these types of integrity lapses when he stated,

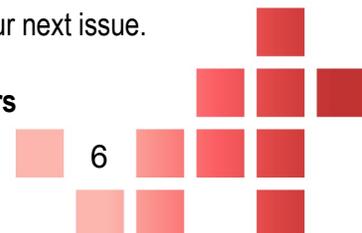
Business relationships are put through the grinder. A corporate reputation built over years or decades gets shredded overnight. The market cap tanks. Eventually, if the damage is deep enough, all stakeholders are hurt. Employees lose their jobs, retirees lose their pensions, shareholders lose their equity value, creditors eat bad debts, customers lose a supplier, suppliers lose a buyer, and communities suffer in a variety of ways from lost or reduced businesses.

Heineman further observes in *High Performance with High Integrity* that “[h]igh integrity – the adherence to formal requirements and the voluntary commitment to ethical standards and values – yields many affirmative benefits. . . . It helps create a culture of alignment between personal values and company values, thus improving morale, pride in the company, and productivity.” Notwithstanding the strength of the argument that fusing high performance with high integrity advances corporate growth, or the lessons of downside risks, there are still companies that fail to address the issue.

We raise this point for the purpose of asking you, our readers, what the governance community can do in working with clients and providing thought leadership to help change corporate cultures and perhaps prevent future scandals. We would also like to know how the answer to this question should impact the CGC’s agenda in the coming year.

We would be delighted to hear from you. We will summarize the responses we receive in our next issue.

**Bruce Dravis, Ellen C. Grady, Jayne E. Juvan and Anne Meyer, CGC In Sight Co-Editors**



# CORPORATE GOVERNANCE COMMITTEE NEWS

## A Message from the CGC Chair on Access to Corporate Governance Programs

For those of you who were at the Annual Meeting in Boston, I hope you enjoyed the many meetings, events and CLE programs. If you were unable to attend in person or would like to revisit any of the program materials and audio recordings, you can access them via this link: [2016 Annual Meeting](#). Online listings for the CGC programs are:

- **CEO Succession & Crisis Management:** Fiduciary Duty, Securities Disclosure, and Practice Approaches - online listing #27 & 28
- **The SEC vs. the Unicorn:** Are High-Cap High-Tech Valuations a Fable? - online listing #152 & 153
- **Which Best Practice is Best?** Meeting the Many Demands of Shareholders, Proxy Advisors, and Regulators - online listings #170 & 171

— Holly J. Gregory

## FEATURED PUBLICATION

### The Inside Counsel Revolution: Resolving the Partner-Guardian Tension

Former general counsel of General Electric Ben Heineman, Jr. recently published a new book titled *The Inside Counsel Revolution: Resolving the Partner-Guardian Tension*. In the book, Heineman discusses the shift taking place in companies where general counsel, once seen mostly as second class citizens, are becoming prominent figures. Heineman argues that inside counsel should serve as “lawyer-statesman, motivated not just by desire for income but by broader values of integrity and corporate citizenship.” CGC member and Gibson, Dunn & Crutcher partner John Olson offered praise for the book, stating, “Based on his pioneering work in creating the modern corporate law department, lawyer-statesman teacher Ben Heineman ably sets out the core rules that must guide lawyers of skill and integrity as they advise businesses striving to achieve sustainable strong long term performance. The challenges he faced and the lessons he learned provide an invaluable and practical vision for both inside lawyers and the external counsel who work with them.”

— Jayne E. Juvan

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## FEDERAL SECURITIES LAW

### Proxy Access Proposals

*July, September 2016*

In July 2016, the Securities and Exchange Commission (“SEC”) staff declined a no-action request by H&R Block to exclude a shareholder proposal to amend selected terms of the company’s existing proxy access bylaw under Rule 14a-8(i)(10) on the grounds that proxy access had been “substantially implemented.” H&R Block had adopted its proxy access bylaw the prior year in response to a shareholder proposal from individual proponent James McRitchie. Under a line of no-action letters, the SEC generally has permitted companies that have not yet adopted proxy access to exclude a shareholder proposal seeking proxy access on the grounds that it has been “substantially implemented” where the company adopts a proxy access bylaw with generally acceptable thresholds for the key provisions, even if the company’s bylaws contained additional or differing ancillary terms.

In his 2016 proposal, Mr. McRitchie sought only to change certain terms of the adopted proxy access bylaw that he deemed to interfere with the right of shareholders to exercise proxy access. The provisions he targeted included the number of shareholders that should be able to form a group (unlimited versus a 20 shareholder limit in the adopted bylaw), the limitation on renominating shareholder nominees based on the number of votes received (eliminate), the counting of loaned securities toward the threshold ownership percentage, and the cap on board seats (the right to nominate the greater of two directors or 25% of the board versus up to 20% in the adopted bylaw). In declining no-action relief, the SEC differentiated between a proposal seeking to implement proxy access and one seeking only to change specific terms of an existing proxy access by law.

The H&R Block proposal received approximately 30% of votes in favor. Many large institutions supported management in rejecting the proposal, however, influential proxy advisory firm ISS recommended a vote in favor. While the H&R Block proposal did not receive majority support, it is likely that in the 2017 proxy season shareholder proponents will continue to submit proxy access proposals seeking to challenge the parameters of secondary terms and protections that many companies have adopted in proxy access bylaws.

— **Ellen C. Grady and Anne C. Meyer**

### SOX CEO and CFO Clawback Does Not Require Executive Misconduct

*August 2016*

In SEC v. Jensen, the Ninth Circuit held that the SEC could obtain a compensation clawback from a company CEO or CFO pursuant to Section 304 of The Sarbanes-Oxley Act (“SOX 304”) by showing that a restatement of financial statements had occurred due to misconduct by the company, without a need to show misconduct by the individual against whom the clawback was sought. The Ninth Circuit also held that Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) provides the SEC with a cause of action against CEOs and CFOs who sign false or misleading certifications. In holding that SOX 304 permits the SEC “to seek disgorgement from CEOs and CFOs even if the triggering restatement

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did not result from misconduct on the part of those officers,” the Ninth Circuit upheld a position that the SEC has taken in prior settlements of clawback enforcement actions.

— Anne C. Meyer

### **SEC Seeks Comment on Disclosure Requirements Relating to Management, Security Holders and Corporate Governance Matters**

*August 2016*

The SEC sought public comment on certain disclosure requirements in Subpart 400 of Regulation S-K, particularly those relating to management, security holders and corporate governance. The request for comment is part of the SEC’s Disclosure Effectiveness Initiative to review disclosure requirements in Regulation S-K to consider ways to improve and simplify reporting for the benefit of investors and issuers. As part of this initiative, in April 2016, the SEC published a concept release seeking public comment on modernizing the business and financial disclosure requirements in Regulation S-K. This update of disclosure requirements is part of a comprehensive evaluation by the SEC of disclosure requirements recommended in the SEC staff’s Report on Review of Disclosure Requirements in Regulation S-K, as mandated by the Jumpstart Our Business Startups Act (“JOBS Act”). Comments received will also be used to inform the SEC’s study on Regulation S-K required by the Fixing America’s Surface Transportation Act (“FAST Act”), which requires, among other things, that the Regulation S-K study emphasize a company-by-company approach that permits relevant material information to be disseminated without boilerplate language or static requirements, while preserving comparability of information across registrants, and that the SEC evaluate information delivery and presentation that discourages repetition and disclosure of immaterial information. The SEC anticipates that comments received will result in recommendations and proposals to improve the SEC’s disclosure requirements. Comments were due by October 31, 2016.

— Ellen C. Grady

### **SEC Fees Increased for Fiscal Year 2017**

*August 2016*

Effective October 1, 2016, the fees that registrants pay to register securities with the SEC under Section 6(b) of the Securities Act of 1933, as amended, increased to \$115.90 per million dollars, from the previous rate of \$100.70 per million dollars. The increased fee rate also applies to repurchases of securities under Section 13(e) of the Exchange Act, proxy solicitations under Section 14(g) of the Exchange Act, and statements in corporate control transactions. The adjustment is required annually under federal securities laws.

— Ellen C. Grady



## **ABA BUSINESS LAW SECTION**

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## SEC Proposes Rule Amendments to Require Issuers to Include Hyperlinks to Exhibits In Filings

*August 2016*

The SEC proposed amendments to its forms and rules that would require issuers that file registration statements and periodic and current reports that include exhibits under Item 601 of Regulation S-K, or Forms F-10 or 20-F, to include in these filings a hyperlink to each of the exhibits listed in the exhibit index. The proposed amendments also would require issuers to submit all filings in HyperText Markup Language (HTML) format to enable inclusion of these hyperlinks (filers currently can submit filings using either ASCII format or HTML format, although the majority of all filings are submitted in HTML format). SEC Chair Mary Jo White stated that “[t]he proposed changes should make it significantly easier to locate documents attached to company filings,” which “will benefit both investors and companies.” The comment period on the proposed rule amendments has expired.

— Ellen C. Grady

## SEC Proposes Rule to Shorten the Securities Transaction Settlement Cycle

*September 2016*

The SEC proposed a rule amendment to shorten the standard settlement cycle for most broker-dealer securities transactions from three business days following the trade date (“T+3”) to two business days following the trade date (“T+2”). If adopted, the proposal would amend Rule 15c6-1(a) of the Exchange Act. T+3 was first implemented in 1993, and the SEC noted the significant technological developments in the industry since its adoption. The proposed amendment would standardize and shorten the settlement cycle for most securities transactions and is designed to enhance market efficiency and reduce the credit, market and liquidity risks that arise from unsettled trades. The SEC is seeking comments on the proposed change and also asking commentators to submit any relevant data or analysis along with comments. The comment period will be open until December 5, 2016 (60 days following publication of the proposing release in the Federal Register).

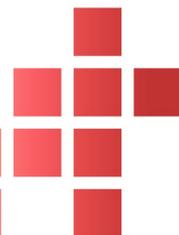
— Ellen C. Grady

## SEC Issues Whistleblower Awards

*August-September 2016*

In September 2016, the SEC announced a \$4 million whistleblower award to an individual whose information assisted the agency in identifying a fraud, bringing the total awards to date under the whistleblower program, which has been in place since 2011, to \$111 million. Previously, in August 2016, the SEC announced a \$22 million award, the second largest award under the program to date, to a whistleblower whose tip helped the SEC to halt well-hidden fraud at a company where the whistleblower worked. The SEC whistleblower program continues to “incentivize whistleblowers to come forward with solid information” that assists the SEC in identifying and prosecuting securities law violations. The program, which was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, is not without controversy. The SEC has faced criticism that

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the whistleblower program does not require whistleblowers to first report violations internally through corporate compliance and reporting programs, which would provide the company with an opportunity to investigate and remedy an alleged violation.

— Ellen C. Grady

## **SEC Enforcement Results Reach A New High In Fiscal Year 2016**

*October 2016*

The SEC announced that it had filed 868 enforcement actions in fiscal year 2016, reaching a new single year high, compared to 807 in fiscal year 2015, and 755 in fiscal year 2014. Overall disgorgement and penalties ordered by the SEC remained relatively constant across all three fiscal years, totaling over \$4 billion in fiscal year 2016, compared to \$4.19 billion in fiscal year 2015, and \$4.16 billion in fiscal year 2014, suggesting that the SEC is continuing to follow the so-called “broken windows” approach to enforcement, which involves pursuing a large number of actions even if the dollar amounts involved are relatively small. The fiscal year 2016 statistical information consists of 548 standalone or independent enforcement actions, 195 follow-on actions, and 125 delinquent filings. Fiscal year 2016 includes the most ever cases involving investment advisers or investment companies and also reached a new high for Foreign Corrupt Practices Act-related enforcement actions and awards to whistleblowers, which totaled \$57 million for the year. Calling the enforcement program a “resounding success holding executives, companies and market participants accountable for their illegal actions”, SEC Chair White stated that the agency had changed its approach during the past three years to focus on using new data analytics to uncover fraud, expanding the range of actions the agency can pursue “to better protect investors and our markets.”

— Ellen C. Grady

## **SEC Will No Longer Require “Tandy” Representations In Filing Review Correspondence**

*October 2016*

The staff of the Division of Corporation Finance of the SEC announced that they will no longer require “Tandy” language in issuer comment letters on disclosure filing reviews. Previously, the SEC staff included language in its comment letters, known as “Tandy” language (after Tandy Corporation, which was the first company to receive a letter containing the language), requesting an issuer to acknowledge in writing that the company was responsible for the accuracy and adequacy of its disclosures, notwithstanding review and comment by the SEC staff. In changing the SEC staff’s filing review and comment process in this manner, the SEC noted that issuers remain responsible for the accuracy and adequacy of the disclosure in their filings, but the staff no longer believe it is necessary for companies to make this affirmative representation in their filing review correspondence.

— Ellen C. Grady

## SEC Proposes Amendments to Require Use of Universal Proxy Cards

October 2016

The SEC has proposed amendments to the proxy rules that would require the use of universal proxy cards in all non-exempt contested director elections (other than those involving registered investment companies and business development companies). The proposed amendments also would amend the form of proxy and require additional proxy statement disclosure to clearly specify the applicable voting options and voting standards in all director elections subject to the proxy rules. By requiring use of a “universal proxy” that includes the names of all duly nominated director candidates, the proposed amendments would eliminate the difference that currently exists in a contested election between voting by proxy, and voting in person using a ballot. Use of a universal proxy would allow a shareholder who does not attend a shareholders’ meeting to vote for candidates from both the management and dissident shareholder slates of nominees. “The proposed changes would allow shareholders to vote by proxy in a manner that more closely replicates how they can vote in person at a shareholder meeting,” said SEC Chair Mary Jo White. “This change would allow shareholders through the proxy process to more fully exercise their vote for the director nominees they prefer.”

To further facilitate shareholder voting in director elections, the SEC also proposed amendments to the proxy rules to ensure that proxy cards specify the applicable shareholder voting options in all director elections and to require that proxy statements disclose the effect of a shareholder’s election to withhold its vote. The SEC is proposing to amend Rule 14a-4(b) to (1) mandate the inclusion of an “against” voting option in lieu of the “withhold authority to vote” option on the form of proxy where there is a legal effect to such a vote; and (2) provide shareholders the opportunity to “abstain” in a director election governed by a majority voting standard (rather than “withhold authority to vote”). The proposed amendments would eliminate the current ability to provide a “withhold” voting option when an “against” vote has legal effect. In addition, the proposed amendments would amend Item 21(b) of Schedule 14A to expressly require disclosure about the effect of a “withhold” vote in an election of directors.

The public comment period on the proposed rules will remain open for 60 days following publication of the proposing release in the Federal Register.

— Ellen C. Grady

## SEC Adopts Final Rules to Facilitate Intrastate and Regional Securities Offerings; Amends Rule 504 And Repeals Rule 505

October 2016

The SEC adopted final rules designed to modernize how companies raise money through intrastate and small offerings. According to SEC Chair White, “These final rules, while continuing to provide investor protections, update and expand the capital raising avenues for smaller companies, allowing them to more fully take advantage of changes in technology and business practices.” The final rules amend existing Rule 147 and adopt new Rule 147A under the Securities Act of 1933, as amended (the “Securities Act”) to modernize the safe harbor provided by Section 3(a)(11) of the Securities Act. Existing Rule 147 was retained so issuers could continue to rely on state law securities offering exemptions that are conditioned

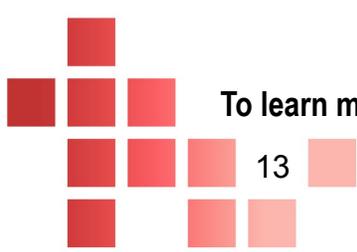
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upon compliance with both Section 3(a)(11) of the Securities Act and Rule 147 thereunder. New Rule 147A establishes a new intrastate offering exemption almost identical to existing Rule 147, but also permits offers to be made to out-of-state residents and allows companies that are organized out-of-state to conduct offerings under Section 3(a)(11) if their principal business operations are located in that state.

The SEC also amended existing Rule 504 of Regulation D under the Securities Act to increase the aggregate amount of securities that may be offered and sold in any 12-month period under that exemption to \$5 million from \$1 million, to facilitate capital formation by smaller companies. Rule 504 also is being amended to apply the bad actor disqualifications in Regulation D to Rule 504 offerings to provide additional investor protection and to make Rule 504 offerings consistent with other offering exemptions under Regulation D. In light of the increased offering size provided by amended Rule 504, the final rules adopted by the SEC also repeal Rule 505 of Regulation D.

Amended Rule 147 and new Rule 147A will be effective 150 days after publication of the adopting release in the Federal Register. Amended Rule 504 will be effective 60 days after publication in the Federal Register, and the repeal of Rule 505 will be effective 180 days after publication in the Federal Register.

— **Ellen C. Grady**



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## STATE LAW

### New York Proposes Cybersecurity Regulation for Financial Services Companies

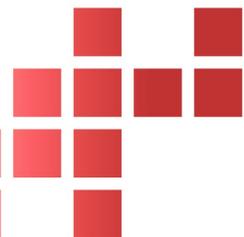
*September 2016*

New York has proposed “first-in-the-nation” cybersecurity requirements for banks, insurance companies and other financial institutions regulated by the New York State Department of Financial Services (NYDFS): [Cybersecurity Requirements for Financial Services Companies](#). The sector-specific regulation could have wide-ranging impact, since the NYDFS supervises nearly 1,900 banking and other financial institutions with assets of more than \$2.9 trillion and all insurance companies that do business in New York, which includes nearly 1,700 insurance companies with assets exceeding \$4.2 trillion.

The proposed rules are highly detailed and more prescriptive than mandatory cybersecurity standards that many private firms must currently navigate such as the Gramm-Leach-Bliley Act, the National Institute of Standards and Technology Cyber Security Framework and the Interagency Guidelines Establishing Information Security Standards, as well as voluntary industry standards such as the International Standards Organization 27000 (ISO) or the Payment Card Industry Security Standards. Beyond base obligations, such as the establishment of a cybersecurity program and the implementation of a cybersecurity policy, financial institutions would be subject to a number of potentially onerous governance, risk management and operational requirements as laid out in the 19-page text of the proposed rules. Covered Entities would also be required to notify the NYDFS of any “Cybersecurity Event” that has a reasonable likelihood of materially affecting the normal operation of the Covered Entity or that affects “Nonpublic Information” no later than 72 hours after becoming aware of the incident. Covered Entities would also be required to certify compliance with the new requirements annually and to maintain all records, schedules, and data supporting the certification for five years.

The proposed rules are subject to a 45-day comment and review process, which began on September 28, 2016.

— Jonathan Kim



## Supreme Court Affirms Chancery's Stock Option Ruling; Dissent for Consideration of "Hindsight Bias"

June 2016

In *CDX Holdings Inc. v. Fox*, Delaware's Supreme Court applied the deferential "clearly erroneous" standard of review to the Court of Chancery's finding that the company's board failed to determine the value of stock options as required under the controlling equity plan and that the determination was not made in good faith. In the underlying transaction, the company's option holders were cashed out in a merger. Under the governing stock plan's terms, the company's full board (serving as Plan Administrator) was entitled to make a conclusive determination of the value to be paid to option holders in the merger, if such decision was made in good faith and not arbitrary and capricious. After trial, the Court found that the company's board did not fulfill its role as Plan Administrator and had instead let management make a determination selected to generate favorable tax treatment for the transaction, rather than fair market value.

On appeal, the Supreme Court found no reason to overturn the trial court's findings, including the determination that the valuation was not a good faith decision and that the process was arbitrary and capricious. The Supreme Court, in a 4-1 vote, deferred to the trial court's factual determinations because they were "based in part on testimony of live witnesses" whose "demeanor and credibility" the trial judge could evaluate. Notably, Justice Valihura wrote a lengthy dissent disagreeing with the majority's decision to affirm the trial court's ruling. Justice Valihura would have reversed the trial court's finding that the company's board breached its contractual obligations to make a good faith determination because the trial court did not make board-level findings of bad faith, as she read into the plan, and relied upon factual findings based "hindsight bias."

— Brett McCartney

## Chancery Holds that Stockholder Acceptance of Tender Offer Has Same Cleansing Effect as Stockholder Vote

June 2016

In *In re Volcano Corp. Stockholder Litigation*, the Court of Chancery held that the tender of a majority of outstanding Volcano Corporation shares into a tender offer by shareholders acting on a fully informed, uncoerced, and disinterested basis was legally equivalent to a shareholder vote in favor of a merger. Accordingly, the business judgment rule applied to the transaction, and the resulting merger could only be challenged on the grounds that it constituted waste. The Chancery Court further held that the transaction did not constitute waste. Based on *Corwin v. KKR Financial Holdings LLC* and *Singh v. Attenborough*, the Chancery Court stated that the business judgment rule applies to the approval of a merger by a majority of a company's outstanding shares pursuant to a statutorily required vote of a company's fully informed, uncoerced, disinterested stockholders, even when the transaction would otherwise be subject to the *Revlon* standard of review. The Chancery Court found that stockholder approval of a merger by accepting a tender offer under DGCL Section 251(h) has the same cleansing effect as a stockholder vote, stating that the Delaware Supreme Court did not intend that its holding in *Corwin* apply only to stockholder votes. The Chancery Court noted that numerous Delaware decisions equate stockholder acceptance of a tender offer

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with a stockholder vote in favor of a merger. Because the Chancery Court found that the complaint was largely devoid of allegations regarding Volcano's merger-related disclosures to the stockholders, it ruled that the stockholders were fully informed, disinterested, and uncoerced.

This clarification and expansion of *Corwin* and *Attenborough* effectively insulates a Section 251(h) merger from challenge on any ground except for waste, a claim that is almost impossible to allege successfully under Delaware law. To a company hoping to obtain the cleansing effect of stockholder ratification, the disclosure of accurate and complete material information to stockholders is all the more important.

— Brett McCartney

### **Chancery Applies the Transitive Property of Entity Litigation in Determining Fee Award**

*August 2016*

In *Baker v. Sadiq*, the Court of Chancery awarded attorneys' fees to counsel for the minority stockholders of NavSeeker, Inc. after the parties settled their dispute but declined to base the fee award on the implied derivative recovery value of \$25 million. The Court of Chancery also refused to hold the defendants jointly and severally liable for the fee amount awarded. The Court of Chancery held the benefit conferred was \$3.25 million (the recovery for the minority stockholders and forgiveness of debt). Because the plaintiffs had used entity litigation to achieve a stockholder-level benefit, rather than a higher value company level derivative settlement, the Court of Chancery did not award fees based on would have been the greater settlement value to the company. This precedent will affect plaintiffs and counsel in representative litigation, especially in cases involving smaller-cap companies with minority stockholders. Here, the plaintiffs received a benefit they might not have otherwise received as minority stockholders (the ability to have their shares cashed out). However, because the benefit was not conferred to the company as a whole, the amount of attorneys' fees awarded was based solely on the benefit actually conferred to the minority stockholders, and not on the amount that might have been conferred on the company as a whole, as had occurred in the 2011 case of *In re Southern Peru Copper Corporation*.

— Brett McCartney

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# SECURITIES EXCHANGES

## New Exchange Begins Operations

*September 2016*

Investors' Exchange, LLC (IEX) has commenced operations as a registered national securities exchange. The SEC approved IEX's application to become a national securities exchange in June 2016 following a SEC review period and receipt of public comments. IEX is intended to address the advantage high frequency traders have in other exchanges by using market information milliseconds more quickly than other market participants (see the book *Flash Boys*, by Michael Lewis). The IEX adopted listing standards to get SEC approval, but is not currently a "listing exchange." Additional details can be found in this [Sidley Austin memo](#).

— **Bruce Dravis**



# INVESTORS

## **CII Adopts Revisions to Policies on Long-Termism and Shareholder Voting Rights**

*September 2016*

Members of the Council of Institutional Investors (CII) adopted revisions to CII's Corporate Governance Policies to encourage companies to “resist both internal and external short-term pressure and thinking, to prioritize creating sustainable value over the long run through long-term investment and to engage with shareholders with long-term ownership and investment horizons (Sec. 1.10 of the Policies).” The revision at Sec. 1.5 of the Policies advocates investors having “voting rights on fundamental decisions affecting corporate viability, such as those that would significantly dilute existing shareholders' equity,” but CII noted that the change was “not intended to extend shareholders' voting authority into novel areas lacking a connection to shareholder value.”

— **Bruce Dravis**

## **State Street Opposes Quick Settlements with Short-Term Focused Activists**

*October 2016*

State Street Global Advisors issued a statement calling on corporations to engage with activist investors to protect long-term shareholder interests and value creation, rather than being quick to settle by adding an activist representative to the board. The statement was in response to a recent report indicating that through August 2016, 49 companies have given 104 board seats to activists in settlements. This compares to 106 seats conceded by 54 companies in all of 2015. State Street cites concerns that some activists favor short-term gains at the expense of long-term interests and that this uptick in settlements, which are often reached without input from long-term investors, will favor such activists.

State Street advises boards to consider potentially troublesome issues in settlement agreements, including: (1) duration of agreements – companies and activists may be more focused on long-term factors if the agreement is multi-year; (2) time period for holding shares – requiring activists to hold their shares for long periods from the settlement date may align interests with long-term shareholders; (3) minimum ownership requirements for board representation – consider requiring minimum ownership levels for longer periods of time as a prerequisite to board representation as opposed to typical agreements that permit activists to reduce their stake to 1-2% below the level at the time of settlement; and (4) ability to pledge shares – the ability to pledge shares may create unwanted incentives for activist investors, including pursuing aggressive strategies to maintain short-term share prices.

State Street acknowledges that some activists can drive positive change, but warns that it will engage with companies that pursue unplanned “financial engineering strategies” within a year of an activist settlement.

— Anne C. Meyer

## PROXY ADVISORY FIRMS

### ISS Issues 2017 Policy Survey Results

*September 2016*

ISS recently released the results of its annual global benchmark survey. The survey, which will inform ISS’s 2017 voting policy update, garnered 439 responses from 417 organizations, including 270 corporate issuers and 120 institutional investors, as well as other market participants. ISS expects to release a draft of its 2017 policy updates in late October for public comment and to issue its final policy updates, which will apply to meetings occurring on or after February 1, 2017, in mid-November. The questions and responses from the global policy survey provide valuable insight into issues that ISS and investors may consider important in formulating voting policies. However, topics investigated in the survey may not be addressed in the ISS policy update and, conversely, ISS could include new updates not covered by the survey.

Following is an overview of the responses from investors to survey questions that may impact U.S. corporate issuers:

- **Director Tenure:** The survey asked whether the following factors raise concern about a board’s nominating and refreshment process: (a) the absence of new independent directors in a recent period, such as the last five years (53% of investors said yes); (b) lengthy average tenure on the board, such as greater than 10 or 15 years (51% of investors said yes); or (c) a high proportion of directors, such as three-fourths of the board, having long tenures of 10 or more years (68% said yes). Additional factors identified by investors as areas of concern include directors’ ages, a high degree of overlap between the tenure of the CEO and the tenure of the non-executive directors, and lengthy average tenure coupled with underperformance.
- **Overboarding:** The survey asked whether ISS’s overboarding standard that applies to a firm’s CEO (no more than three total boards) or the standard that applies to a non-executive director (no more than five total boards) should apply to an executive chairman who is not also the company’s CEO. 64% of investors favored the stricter three board limit.
- **Pay-for-Performance Metrics:** ISS’s quantitative pay-for-performance modeling, intended to identify misalignment between CEO pay and company performance, uses total shareholder returns over multiple periods, both on an absolute basis and relative to peers. ISS identified additional metrics in the survey and asked which, if any, might be appropriate to include in initial quantitative screens. 79% of investors indicated that they support the use of additional metrics

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(compared to 42% of non-investors). Metrics supported by investors include return on investment metrics, such as ROIC (47%), return metrics, such as ROA or ROE (35%), cash flow metrics, such as OCF or FFO (25%) earnings metrics such as EPS or EBITDA (26%), and economic profit metrics (22%).

- **Say-on-Pay Frequency.** Many companies will have a say-on frequency vote in 2017. 66% of investor respondents favored annual voting; 11% and 7% favored biennial and triennial votes, respectively. Some investors indicated that frequency should depend upon company-specific factors.
- **Dual-Class IPO Structures.** ISS asked whether it should recommend against the election of directors at IPO companies, or companies emerging from bankruptcy, with a capital structure that includes multiple classes of stock with unequal voting rights. 57% of investors supported negative recommendations, 19% opposed any negative recommendations, and 24% opposed negative recommendations where there is a sunset provision on the unequal voting rights.

— Anne C. Meyer

## BUSINESS ORGANIZATIONS

### World Economic Forum Posts “The New Paradigm” Governance Framework

September 2016

The publication, [The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth](#), posted by the International Business Council of The World Economic Forum, sets out a framework for cooperation by corporations and long-term investors in the development and operation of corporate governance structures to achieve long-term value. *The New Paradigm* proposes that “In this framework, if a corporation, its board of directors and its CEO and management team are diligently pursuing well-conceived strategies that were developed with the participation of independent, competent and engaged directors, and its operations are in the hands of competent executives....institutional investors will work to understand corporations’ strategies and operations and engage with them to provide corporations with opportunities to understand the investors’ opinions and to adjust strategies and operations in order to receive the investors’ support.” Martin Lipton and others prepared *The New Paradigm*.

— Bruce Dravis

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## The Conference Board Suggests Governance Code Adoption

September 2016

The publication in Summer 2016 of the Commonsense Governance Principles has prompted Gary Larkin, a research associate at The Conference Board Governance Center, to advance the notion that the U.S. adopt a corporate governance code, akin to governance codes adopted in other countries. Larkin writes, “The [ ] themselves may not have broken new ground – they addressed such basic issues as director independence, board refreshment and diversity, the need for earnings guidance, and shareholder engagement. But . . . it’s a first step toward a true principles-based approach to good corporate governance in a country that is used to following rules and hiring attorneys to find the loopholes.”

— Bruce Dravis

## Chamber Group Releases 2017 Regulatory and Governance Recommendations

September 2016

The U.S. Chamber of Commerce’s Center for Capital Markets Competitiveness (CCMC) released its publication Restarting the Growth Engine: A Plan to Reform America’s Capital Markets, setting out its recommendations for regulatory and governance changes for 2017 and beyond. With respect to corporate governance issues, Restarting the Growth Machine advocates changes to the handling of shareholder proxy proposals, repeal or reconsideration of certain SEC regulations such as clawback and pay for performance, and focus on materiality as a key element in evaluating SEC disclosure effectiveness.

— Bruce Dravis



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## ACCOUNTING AND AUDITING

### SEC Brings Enforcement Action on Independence Failure Arising from Personal Relationship

*September 2016*

The SEC settled charges that two Ernst & Young audit partners had violated auditor independence rules by becoming too close personally to clients. The settlement terms included payment by E&Y of \$9.3 million. The SEC charged that in one case the senior partner on an engagement team for the audit of a New York-based public company had conducted an “improperly close friendship” with the company’s CFO. In the second case, a different audit partner serving on an engagement team for the audit of a different public company was romantically involved with the client’s chief accounting officer. “These are the first SEC enforcement actions for auditor independence failures due to close personal relationships between auditors and client personnel,” said Andrew J. Ceresney, Director of the SEC’s Division of Enforcement. “Ernst & Young did not do enough to detect or prevent these partners from getting too close to their clients and compromising their roles as independent auditors.”

### EY Reports on Trends in Audit Committee Proxy Statement Disclosures

*September 2016*

The Ernst & Young Center for Board Matters has released its fifth report on proxy statement reporting by audit committees of Fortune 100 companies regarding committee activity. The report notes that the disclosures generally include voluntary additional disclosures by audit committees that exceed the mandatory requirements.

## INTERNATIONAL

### Canadian Securities Regulators Report on Modest Progress on Board Gender Diversity

*September 2016*

Gender diversity on boards, and in organizations more generally, is identified as a top priority by institutional shareholders and regulators internationally. In Canada, companies listed on the Toronto

Stock Exchange are required to disclose annually in their proxy circulars information about their gender diversity policies and practices at the board and executive officer level. The disclosure requirements came into force for the 2015 proxy season and require companies to disclose, among others, the number and percentage of women on the board and in executive officer positions, whether the company has adopted gender representations targets and whether the company has director term limits or other mechanisms of board renewal.

The Canadian securities regulators reviewed disclosures filed by 677 companies this year and recently reported on the findings of this review. As this is the second year since the requirements came into force, the review also compares the results against those reported last year. Overall, the findings indicate a modest improvement in the number of women on boards. Only 12% of the total board seats in the companies reviewed were occupied by women, up from 11% last year. In the case of companies with over \$10 billion market capitalization, 23% of board seats are now occupied by women. In addition, 31% of companies over \$10 billion market capitalization disclosed they adopted a board representation target compared to 5% of companies under \$1 billion. Regardless of size, companies with board targets have an average of 25% female representation on their boards compared to companies without a target that have an average of 10% female representation, supporting the maxim that "what gets measured gets done". The review also found that 132 companies adopted director term limits, with 48% setting age limits, 23% setting tenure limits and 29% having both.

The Chair of the Ontario Securities Commission stated that she is disappointed with the level of progress made thus far and focused on board vacancies as an opportunity to increase the number of women on boards. For example, she noted that of the 521 board positions vacated last year, only 15% were filled by women. The review also found that 10% of companies added one or more women to their boards in the past year, compared to 15% last year. Without a meaningful improvement on these statistics, she stated that reaching the 30% female board representation target set by the Canadian securities regulators will not be achieved absent more formal measures, such as mandatory quotas.

The underlying data for the review will also be published on the website of the Ontario Securities Commission later this fall.

— **Frédéric Duguay**

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# SELECTED LAW FIRM MEMORANDA AND OTHER ARTICLES OF INTEREST

**Sidley Austin:** [Key Takeaways from the Commonsense Principles of Corporate Governance](#)

**Securities and Exchange Commission:** [The SEC's Whistleblower Program: The Successful Early Years](#)

**White & Case:** [Implementing Dodd-Frank: Current Status of SEC Mandatory Rulemaking](#)

**Orrick Herrington:** [The Delaware Plaintiff's Bar Mines a New Vein of Liability: Limits on Director Compensation](#)

**Simpson Thacher:** [Optimizing Board Evaluations](#)

**Duke University Law School:** [Too Big to Fool: Moral Hazard, Bailouts, and Corporate Responsibility](#)

**Davies:** [Governance Insights](#)

**PwC:** [Board Governance in the Age of Shareholder Empowerment \(2016 Annual Corporate Directors Survey\)](#)

**Harvard Law School:** [Universal Proxies](#)

**Harvard Law School:** [ISS Proposes New 2017 Voting Policies](#)

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*CGC Committee Dinner at the*  
*Business Law Section Fall Meeting in*  
*Washington, D.C.*

# GOVERNANCE CALENDAR

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## 2016

### November 18-19

**Business Law Section Fall Meeting**  
Ritz-Carlton Washington DC  
Washington, DC

## 2017

### April 6-8

**ABA/Business Law Section Spring Meeting**  
Hyatt Regency New Orleans  
New Orleans, LA

### September 14-16

**Business Law Section Annual Meeting**  
Sheraton Chicago Hotel & Towers and The Gleacher Center  
Chicago, IL

### November 17-18

**Business Law Section Fall Meeting**  
Ritz-Carlton Washington DC  
Washington, DC

