

CGC

ABA Business Law Section Corporate Governance Committee

INSIGHT

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



Editorial **In Sight: The Twin Forces of Regulation and Private Ordering**

Guest Commentary: The Erosion of Boardroom Lawyering

Reconsideration of Pay Ratio Rule Implementation

CGC Leadership

Holly J. Gregory, CGC Chair

John H. Stout, Former CGC Chair

CGC In Sight Leadership

Bruce Dravis, Co-Editor

Ellen C. Grady, Co-Editor

Jayne E. Juvan, Co-Editor

Anne C. Meyer, Co-Editor

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JOIN CGC IN SIGHT

E-mail any of the **CGC In Sight**
Co-Editors to become involved:

Bruce Dravis
bdraavis@downeybrand.com

Ellen C. Grady
egrady@cozen.com

Jayne E. Juvan
jjuvan@ralaw.com

Anne C. Meyer
ameyer@georgeson.com

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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CONTRIBUTORS

Guest Commentary

Adam J. Epstein

Securities and Exchange Commission

Ellen C. Grady

Anne C. Meyer

Delaware

Joseph Gracely

Brett M. McCartney

Ryan Philp

International

Lawrence Darby

Frédéric Duguay

John Elder

Investor and Business Groups

Bruce Dravis

The logo for the American Bar Association, featuring the letters 'ABA' in a large, bold, white serif font. The letters are set against a background of a red grid pattern that covers the entire right side of the page. The grid consists of squares of varying shades of red, creating a textured effect.

AMERICAN BAR ASSOCIATION

Business Law Section

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CGC LEADERSHIP

Holly J. Gregory
CGC Chair
Sidley Austin LLP
holly.gregory@sidley.com
212.839.5853

John H. Stout
Former CGC Chair
Fredrikson & Byron, P.A.
jstout@fredlaw.com
612.492.7012

Bruce Dravis
CGC Vice Chair
Downey Brand LLP
bdravis@downeybrand.com
916.541.5858

Charles Elson
CGC Vice Chair
University of Delaware
elson@udel.edu
302.831.6156

Philip Khinda
CGC Vice Chair
Steptoe & Johnson LLP
pkhinda@steptoe.com
202.429.8189

Frank M. Placenti
CGC Vice Chair
Squire Patton Boggs
frank.placenti@squirepb.com
602.528.4004

CGC IN SIGHT LEADERSHIP

Bruce Dravis
Downey Brand LLP
bdravis@downeybrand.com
916.541.5858

Jayne E. Juvan
Roetzel & Andress, LPA
jjuvan@ralaw.com
216.615.4837

Sheri Ellis
Assistant to CGC Chair
sherijellis@gmail.com

Ellen C. Grady
Cozen O' Connor
egrady@cozen.com
215.665.5583

Anne C. Meyer
Georgeson LLC
ameyer@georgeson.com
212.440.9818

CGC IN SIGHT EDITORIAL BOARD

Lawrence A. Darby, III
Law Offices of Lawrence A. Darby, III
ladarby@gmail.com
212.231.8185

Frédéric Duguay
Hansell LLP
fduguay@hanselladvisory.com
416.649.8492

Jonathan Kim
jkim@aya.yale.edu
617.899.2051

Ryan M. Philp
Bracewell LLP
ryan.philp@bgllp.com
212.508.6165

Catherine Dearlove
Richards, Layton & Finger
dearlove@rlf.com
302.651.7788

John Elder
Anchor Corporate Governance
anchorcorp.gov@rogers.com
647.344.6997

Brett M. McCartney
MorrisJames LLP
bmccartney@morrisjames.com

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:

Bruce Dravis at bdravis@downeybrand.com

Ellen C. Grady at egrady@cozen.com

Jayne E. Juvan at jjuvan@ralaw.com

Anne C. Meyer at ameyer@georgeson.com

TOPICS COVERED

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

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EDITORIAL IN SIGHT

The Twin Forces of Regulation and Private Ordering

The securities laws passed in 1933 and 1934 were, at their heart, anti-fraud legislation. Congress required publicly traded companies to internalize the cost of making standardized disclosures: the goal was to keep investors—typically unsophisticated individuals—from getting fleeced by conniving corporate operators.

It turned out that having each public company bear the marginal cost of securities law compliance was a collective investment in a robust securities market. Investors could rely on a common pool of information, rather than each inefficiently incurring the costs of seeking out the information case by case.

Corporate governance, until 2002, was essentially determined by the states, the securities exchanges, and individual company charters. Then the depredations by managements at Enron and WorldCom (accounting fraud), Tyco (self-dealing) and Adelphia (accounting fraud and self-dealing) created a crisis that resulted in the adoption of The Sarbanes-Oxley Act of 2002 (“SOX”), which federalized significant aspects of governance.

From that point on, the evolution of corporate governance has been affected by two forces: (1) the regulatory process, as the SEC implemented SOX and the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, and (2) “private ordering” initiatives by the institutional investment and activist shareholder communities, which now hold the vast majority of shares of U.S. public companies.

Several changes in common corporate governance practices in the past 15 years have been led by the investment community, not by regulators. These initiatives include campaigns to limit the use of poison pills and staggered boards, and for the adoption of majority voting standards for directors. A number of companies, reacting to investment community concerns, voluntarily make disclosures on topics like realized and realizable executive compensation or business sustainability that are not required by regulators. Even proxy access, once a governance battleground, is finding increasing acceptance as a standard adopted by the market.

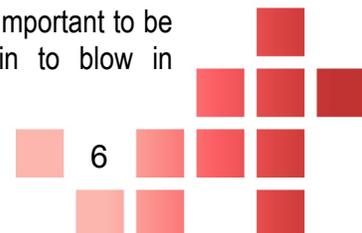
Use of private ordering can bring flexibility and speed to the evolution of governance standards. However, there are practical limits to private ordering, particularly as changes are adopted on a company-by-company basis and may be driven by specific investor agendas which may not benefit all investors.

Regulation serves to create a necessary shared good through universally applicable rules, particularly where free riders would undermine a voluntary compliance system or where collective action by shareholders would be cost-prohibitive.

The twin forces of regulation and private ordering should continue to shape corporate governance in the future as new technologies, industries, opportunities and economic challenges arise.

With trillions of dollars of investment wealth on the line, investors will not rely for protection solely on the efforts of regulators. At the same time, since corporate securities are ultimately only a bundle of legal rights connected to operating companies, investors need a strong regulatory framework that preserves the enforceability and value of those rights. There can be fruitful debate over such questions as whether conflict mineral or pay ratio disclosures are essential to investor protection. It will also be important to be on guard against expensive unintended consequences, as deregulatory winds begin to blow in Washington.

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



GUEST COMMENTARY

CGC In Sight is actively seeking articles and commentary from practitioners who have insights on corporate governance matters to share with the ABA Corporate Governance Committee membership. The following contribution comes courtesy of Adam J. Epstein, a former institutional investor and founder of Third Creek Advisors, LLC, which provides corporate governance advice to small cap companies.

The Erosion of Boardroom Lawyering

By Adam J. Epstein

Whether it's Warren Buffett, Jamie Dimon, BlackRock, CalPERS, CalSTRS, or any one of the growing list of shareholder activists, the spotlight on corporate governance efficacy has never burned brighter in the history of global capital markets. Given the uptick in scrutiny of boardroom practices, you would think that the quality of boardroom lawyering has correspondingly risen to the challenge. You would, however, be mistaken.

As a former lawyer and institutional investor who now advises myriad pre-IPO and small-cap boards about how to navigate the boardroom issues investors care most about, I am constantly in boardrooms. Whether it's solo practitioners, regional firms, or global titans, the quality of counsel I see day in and day out in boardrooms is underwhelming at best, and arguably declining with the passage of time. It's no wonder that many of my firm's clients repeatedly state that the leading cause of changing counsel isn't price or responsiveness, but the quality of advice.

To be sure, counseling public company boards is predominantly an exercise in ensuring that board members are discharging their multifaceted duties in accord with applicable laws and regulations. But today's capital markets don't reward companies overseen by boards that are principally in the business of "box checking" or "culpability avoidance."

To keep pace with a rapidly evolving public company ecosystem, boardroom lawyering needs to be fine-tuned to the "zeitgeist" of a given board. A nascent, cash-starved public company run and overseen by officers and directors with little public company experience is a fundamentally different situation than advising a large multinational company with a boardroom of internationally known business leaders. Board members know when lawyers do a poor job of differentiating the two.

There is a poignant rub in the marketplace: too many boardroom lawyers are focused only on compliance, while stakeholders are demanding governance excellence. Query whether you would invest in a company governed by model fiduciaries, who don't know the first thing about what constitutes governance best practices in 2017. For example, a board member could follow the letter of the law, and decline to meet individually with investors. But that company mightn't have too terribly many investors at the end of the day, since this dialogue is increasingly demanded by investors.

When I speak at law firms and advise lawyers keen on providing high quality boardroom counsel, I urge them to consider the following four measures.

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1. While corporate governance best practices have historically been handed down from larger public companies in the United States, corporate oversight is not “one size fits all.” Governing Pfizer is nothing like governing a nascent, one-product biotech company. Inasmuch as the overwhelming preponderance of public companies are small (e.g., nearly 80% have market capitalizations below \$500 million), counsel need to be mindful of resources, experience (both in the C-suite and boardroom), and the unique capital markets realities that affect smaller public companies when providing advice.
2. Lawyers intent on providing great governance advice need to have a more rounded sense of business, including, but not limited to, accounting, capital markets, and corporate finance. Whether this education is undertaken formally or informally, the law industry needs to pay more than lip service to the fact that boardroom advisory doesn’t take place in a vacuum. Operating and governing public companies today is a complex, three-dimensional chessboard; firm command of relevant laws and applicable industry, market, and securities regulations is only part of the puzzle.
3. Lawyers should attend industry trade shows and investor conferences with their clients. Trade shows are a cost-effective way to get a sense of business trends and competitive landscapes; it’s challenging to proffer value-added legal advice to a client if you don’t understand their business. Investor conferences provide valuable insights into top-of-mind issues for institutional investors. Far too many lawyers fail to appreciate that institutional investors, who transact the majority of U.S. equities, are ultimately the most important arbiters of governance efficacy, not the remedial, after-the-fact judgments of the judiciary.
4. Lawyers should strongly consider attending corporate governance continuing education programs to get a better sense of what constitutes best practices (you might find the specialized programs geared towards directors particularly helpful). It’s shocking how few corporate lawyers have refined understandings of how issues like, for example, board composition, cybersecurity, strategic innovation, shareholder engagement, globalism, and diversity are impacting what transpires inside America’s boardrooms.

There are lots of superior boardroom counselors in the United States. But to those who are regularly in boardrooms, the gulf between the legends of boardroom lawyering and everyone else is growing . . . fast. Consequently, shareholders are suffering, and law firms of all sizes are losing business every day as a result.



*Adam J. Epstein is the founder of Third Creek Advisors, LLC, the only small-cap corporate governance advisory firm run by a former institutional investor. He is the author of *The Perfect Corporate Board: A Handbook for Mastering the Unique Challenges of Small-Cap Companies* (McGraw Hill, 2012) and contributing author to *The Handbook of Board Governance: A Comprehensive Guide for Public, Private and Not for Profit Board Members* (Wiley, 2016), and he writes the “Entrepreneurial Governance” column in *Directorship* magazine. He can be reached at ae@thirdcreekadvisors.com.*

SECURITIES AND EXCHANGE COMMISSION

Acting SEC Chairman Piowar Directs Reconsideration of Pay Ratio Rule Implementation

February 2017

Acting SEC Chair Michael S. Piowar has asked for public input on the so-called CEO pay-ratio rule and has directed the SEC staff to reconsider the implementation of the rule based on any comments submitted, including determining “as promptly as possible whether additional guidance or relief may be appropriate.” The pay ratio disclosure rule was adopted by the SEC in August 2015, as required by Section 953 of Dodd-Frank. The rule, which is first applicable to public companies for fiscal years beginning on or after January 1, 2017, requires public companies to disclose the ratio of the median of the annual total compensation of all employees to the annual total compensation of the CEO. Critics of the rule have suggested that the information presented by the ratio is of little value, particularly compared to the costs incurred by many issuers to collect and process the information necessary to prepare and present the ratio. The SEC is seeking comment on challenges that public companies have experienced as they begin to implement and test systems and controls to comply with the rule and whether relief from the rule is needed. Comments may be submitted [here](#). The comment period is open for 45 days.

SEC To Reconsider Conflict Minerals Rule Implementation

January 2017

Acting SEC Commissioner Michael S. Piowar directed the SEC staff to reconsider whether the SEC’s guidance on conflict minerals is still appropriate and whether additional relief from its disclosure requirements should be granted. The conflict minerals rules were adopted in November 2012 pursuant to the Dodd-Frank Act, which directed the SEC to issue rules requiring certain companies to provide disclosure to the SEC on their use of conflict minerals (including tantalum, tin, gold and tungsten) if those minerals are “necessary to the functionality or production of a product” manufactured by the companies. The conflict minerals provision of Dodd-Frank was enacted because of Congressional concerns that the exploitation and trade of conflict minerals by armed groups was helping to finance conflict in the Democratic Republic of the Congo and surrounding regions and contributing to an humanitarian crisis in Africa. The SEC has stayed partial implementation of the rule since May 2014 based on a U.S. Court of Appeals for the D.C. Circuit ruling that the rule violated the First Amendment. Acting Commissioner Piowar questioned whether the rule has helped the crisis in Africa and mentioned national security concerns posed by the rule. The SEC has requested comments on aspects of the rule and its implementation. Interested parties can submit comments [here](#).



ABA BUSINESS LAW SECTION

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Transactional Attorney Nominated to Chair SEC

January 2017

President Trump nominated Jay Clayton, a partner at Sullivan & Cromwell, to chair the Securities and Exchange Commission. Unlike recent SEC Chairs, who have had an enforcement background, Clayton is a transactional attorney whose clients have reportedly included Goldman Sachs Group Inc. and Barclays PLC. If appointed, Clayton will replace outgoing SEC Chair Mary Jo White, a former prosecutor who left the SEC in January. Commentators have suggested that President Trump's nomination of a transactional attorney may signal a shift in the new administration's goals for the SEC away from enforcement and regulation, toward initiatives that promote capital formation. The SEC currently has only two sitting commissioners, Michael Piowar, a Republican who is currently acting as Chair, and Kara M. Stein, a Democrat. Fully constituted, the SEC has five commissioners, which gives President Trump the opportunity to nominate two commissioners in addition to Clayton. As an independent agency that is non-partisan, no more than three SEC commissioners may belong to the same political party.

SEC Experiences Departures of Senior Officials

December 2016 and January 2017

In addition to the departure of former Chair Mary Jo White, many high ranking SEC officials have announced their departures from or left the agency. Division of Corporation Finance Director Keith Higgins and Enforcement Director Andrew J. Ceresney left the SEC in early January and late December, respectively. Their replacements have not yet been named, pending appointment of a new SEC Chair. Shelley Parratt has been appointed Acting Director of Corporation Finance and Stephanie Avakian has been named Acting Director of Enforcement. In addition, SEC Chief Accountant James Schnurr retired from the SEC in December. He was replaced by Wesley R. Bricker, who had previously served as Deputy Chief Accountant at the SEC. Other high ranking officials to leave the agency include SEC General Counsel, Anne K. Small, and SEC Chief of Staff, Andrew J. Donohue.

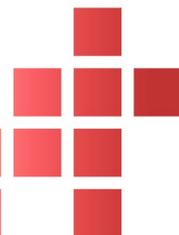
Resolution Invalidates SEC Resource Extraction Rule

February 2017

President Trump signed a congressional resolution to invalidate the SEC's resource extraction rule, which would have required publicly traded mining, oil and gas companies to disclose the payments that they make to governments for the commercial development of oil, natural gas or minerals. The measure had previously been approved by both the Senate and the House of Representatives under the Congressional Review Act ("CRA"). Passage of the resolution under the CRA causes the SEC's resource extraction rule not to take effect. In addition, under the CRA, the SEC may not reissue the rule "in substantially the same form" as the invalidated rule, unless specifically authorized by a law enacted after the date of the Congressional joint resolution.

The resource extraction rule was unpopular with companies in resource extraction industries, and had a difficult history. The rule was required to be promulgated by the SEC under Dodd-Frank, but its purpose was to promote U.S. foreign policy interests and transparency, rather than to promote financial reform. The resource extraction rule was initially adopted by the SEC in 2012, but that original rule was invalidated by the U.S. District Court for the District of Columbia. The SEC was subsequently sued to seek to enforce the SEC's

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obligation to adopt a rule under Dodd-Frank. Subsequently, the SEC published a final resource extraction rule in 2016 pursuant to a court-ordered schedule. The rule was scheduled to first apply to companies in 2019. Opponents of the rule have argued that the disclosure mandated would put U.S. public company issuers in the resource extraction industries at an economic disadvantage in the global economy, without providing any meaningful disclosure for investors.

DELAWARE LAW

Suit Advances Based on Failure of Board Independence

December 2016

In Sandys v. Pincus, the Delaware Supreme Court held that a majority of the board of directors of Zynga were not independent, and a derivative suit could move forward on the basis of demand futility. The holding was based on the Board's own determination that two directors were not independent under NASDAQ standards, and the Court's determination that a third director was not independent based on the relationship between the CEO/controlling shareholder and that director, including the shared ownership of an airplane. For discussion of the case, see these memos from Cleary Gottlieb and Morris James.

Delaware Decline in “Disclosure Only” Settlements Contributes to Record Rise in Securities Class Actions

January 2017

The review of securities class action litigation for 2016 conducted by Cornerstone Research and the Stanford Law School Class Action Clearinghouse (report can be found here) showed the level of class actions at its highest level in 20 years, since the passage of the Private Securities Litigation Reform Action. In discussing the report, the D&O Diary reports that a key contributing factor to the rise in 2016 federal securities class action litigation is the shift by plaintiffs' lawyers to federal court from Delaware court, following rulings by Delaware courts that are hostile to “disclosure only” settlements for such suit.

Delaware Court Applies *MFW* Framework To Dismiss Claim Against Controlling Stockholders

October 2016

In *In re Books-A-Million, Inc. Stockholders Litigation*, the Court of Chancery provided further guidance regarding how it will apply the *Kahn v. M & F Worldwide* (“*MFW*”) framework to controlling stockholder going-private transactions. Under the *MFW* framework, the business judgment rule is applied instead of entire fairness review where the controller conditions the transaction on approval by (1) an independent special committee – empowered to select its own advisors and reject the transaction – that meets its duty of care to negotiate a fair price, and (2) an informed, uncoerced majority vote of the minority stockholders. Applying *MFW*, the Court found that the company’s controlling stockholders satisfied each requirement when they took the company private through a squeeze-out merger. The Court determined that the plaintiffs did not plead facts supporting a reasonable inference that the *MFW* elements had not been met. Therefore, applying the business judgment rule, the Court granted the defendants’ motion to dismiss.

In so holding, the Court rejected the plaintiffs’ argument that the defendants could not satisfy the *MFW* framework because the special committee members acted in bad faith. The Court recognized that pleading subjective bad faith is a “theoretically viable” means of attacking the application of the *MFW* framework. The Court noted, however, that pleading subjective bad faith is a difficult task and rejected plaintiffs’ contention that the special committee members acted in bad faith by rejecting a higher third-party bid.

Recent Decision Clarifies Contours of “Dual-Natured” Stockholder Derivative Claims

December 2016

In *El Paso Pipeline GP Company, L.L.C. v. Brinckerhoff*, the Delaware Supreme Court addressed whether a limited partner’s overpayment claims against a general partner were direct or derivative in nature. The Court of Chancery found the general partner liable for breach of the partnership agreement arising out of a dropdown transaction between the partnership and the general partner’s corporate parent. The general partner appealed, arguing that the limited partner’s claim was derivative and, as such, had been extinguished by the merger. The Delaware Supreme Court agreed, holding that the limited partner’s claim was purely derivative under the standard set in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), because it alleged harm to the partnership only and any recovery would flow to the partnership.

In so holding, the Court addressed its decision in *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), which held that certain claims may be both derivative and direct. Such dual-natured claims, the Court explained, arise where – as in *Gentile* – there is an improper transfer of both economic value and voting power. Because the *El Paso* plaintiffs never alleged or proved that the challenged transaction affected the limited partners’ voting power, the Court found that they failed to meet the *Gentile* standard. Concurring in the opinion but writing separately to address *Gentile*, Chief Justice Strine questioned *Gentile*’s continuing viability, noting, in particular, that *Gentile* should be overruled to the extent it permits a direct dilution claim when the stock issuance does not result in an entity’s voting power shifting from the hands of a diversified group of public equity holders to the control of a particular interest.

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Delaware Court Signals Relaxing Standard For Director Impartiality In Demand Excusal Context

December 2016

In a non-unanimous decision in Sandys v. Pincus, the Delaware Supreme Court signaled a shift toward a less exacting standard for assessing director impartiality in the pre-suit demand context. In Sandys, the Court concluded that the plaintiff had pleaded facts sufficient to create a reasonable doubt regarding the impartiality of a majority of the board of directors in two ways. First, and perhaps most noteworthy, plaintiffs alleged one director co-owned a private airplane with the company's controlling stockholder, Pincus. The Court determined that this co-ownership was suggestive of an "extremely intimate personal friendship between their families" that could be expected to heavily influence a person's ability to exercise impartial judgment. Second, plaintiffs alleged that two additional directors were partners of a venture capital firm investing alongside an interested director in projects that included a company co-founded by Pincus's wife; plaintiffs further pointed to the board of directors' own determination that these two directors were not independent under NASDAQ rules. Though, as the dissent noted, no facts were pleaded as to the size, profits, or materiality of the cited investments, the Court found that the allegations were sufficient to raise a reasonable doubt as to the directors' impartiality.

In Appraisal Action Delaware Court Holds That Merger Price Following Properly Conducted Sale Process Is Fair Value

December 2016

In Merion Capital L.P. v. Lender Processing Servs., Inc., the Court of Chancery afforded 100 percent weight to the merger price in an appraisal action after concluding that the transaction was the product of a properly conducted sale process. In its analysis, the Court reasoned that the Lender Processing Services' board achieved meaningful competition during the pre-signing phase where all bidders received equal access to the company's information, and there was a lack of favoritism towards particular bidders, in contrast to certain management led buyouts. The Court also performed its own discounted cash flow analysis which resulted in a value of \$38.67 per share, just above the merger consideration of \$37.14 per share. Interestingly, the Court noted that a timely argument on the value placed on the synergies of the transaction could have caused a reduced fair value determination; however, the respondent failed to present a timely and sufficient analysis quantifying the deal's synergies.

In its holding, the Court stated that the facts at hand better fit recent cases, such as Huff Fund Investment P'ship v. CKx, Inc., In re Appraisal of Ancestry.com, Inc. and Merion Capital L.P. v. BMC Software, Inc., where exclusive weight was given to the deal price, noting that the Company ran a reliable sale process, the Company created a reliable set of cash flow projections, and that the Court's DCF analysis came within 3% of the final merger consideration.

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INTERNATIONAL

Canadian Government Moves to Legislate "True" Majority Voting

October and December 2016

Proposed amendments to one of Canada's corporate statutes (the Canada Business Corporations Act) would legislate "true" majority voting in a manner that leaves no discretion with the board. As proposed under the amendments, directors who do not receive a majority of votes in favor of their election would not be elected and the size of the board would be reduced accordingly. The directors who are elected would have the authority to carry on until the next annual meeting (provided that the number of directors elected constitutes at least a quorum). The directors could enlarge the now reduced size of the board by up to one-third and appoint new directors to fill those vacancies (but may not fill a vacancy with a director who was defeated in most recent election of directors).

Canadian companies have voluntarily adopted majority voting policies in the style enacted in Delaware and under the ABA's Model Business Corporation Act. In total, approximately 88 percent of the issuers listed on the S&P/TSX Composite Index (representing the 240 largest issuers in Canada) adopted majority voting policies between 2006 and 2013. Many adopted the majority voting policy recommended by the Canadian Coalition for Good Governance in 2011. In 2014, the Toronto Stock Exchange made majority voting mandatory for its listed issuers. Shareholders have criticized the director resignation policy approach to majority voting as having no teeth and refer to directors who remain on the board without the support of the majority of shareholders as "zombie directors". In 2014 (the year the majority voting became mandatory for TSX-listed issuers) there were at least 12 zombie directors across five TSX-listed companies. However, only one director failed to receive majority support in multiple consecutive years.

Notwithstanding the fact that "zombie directors" are not common in Canada, the federal government is proposing amendments to the CBCA that would represent a significant shift away from the accepted director resignation policy regime and remove the board's flexibility to manage its internal affairs to prevent failed elections. At this time, the bill has been referred to a parliamentary committee for further study.

The text of the CBCA amendments is available [here](#).

The draft regulations are available [here](#).

INVESTOR AND BUSINESS GROUPS

Investors Holding \$17 Trillion of Assets Launch Framework for U.S. Stewardship and Governance

January 2017

The Investor Stewardship Group (“ISG”), a collective of large U.S.-based institutional investors and asset managers and several international counterparts, has announced its Framework for U.S. Stewardship and Governance (the “Framework”), designed to establish basic principles of investment stewardship and corporate governance for U.S. institutional investors and boardroom conduct. At its inception, ISG includes BlackRock, CalSTRS, State Street Global Advisors, TIAA Investments, T. Rowe Price Associates, Inc., ValueAct Capital and Vanguard, among others, representing \$17 trillion in assets under management. The Framework sets out stewardship principles for institutional investors and governance principles for U.S. listed companies.

The stewardship principles include: institutional investors are accountable to the investors whose money they manage, institutional investors should demonstrate how they evaluate corporate governance principles in companies in which they invest, institutional investors should disclose how they manage potential conflicts of interest in voting and engagement activities, and institutional investors are responsible for their proxy voting decisions. The corporate governance principles include: the Board of Directors is accountable to shareholders, shareholders are entitled to voting rights in proportion to their economic interests, Boards of Directors should be responsive to shareholders, and Boards should have a strong independent leadership. The ISG states that the Framework is not intended to be prescriptive, static or comprehensive, but to (i) outline the investors’ commitment to accountability and to articulate the standards the investors consider when evaluating investment companies, (ii) codify fundamental principles of good corporate governance for U.S. corporations and institutional shareholders, and (iii) affirm investment managers’ responsibility for engagement and proxy voting decisions. The Framework will go into effect on January 1, 2018, to provide U.S. listed companies with time to adjust to the corporate governance principles prior to the 2018 proxy season.

CII Advocates for “Consequential” Majority Voting

January 2017

The Council for Institutional Investors (“CII”) published a [FAQ on majority voting for directors](#), advocating for “consequential majority voting,” which CII described as a form of majority voting in director elections that effectively removes board discretion in connection with a director’s resignation if that director receives less than majority support. The vast majority of S&P 500 companies have adopted a form of majority voting under which uncontested director nominees must receive more “for” than “against” votes to be elected. In the usual case, a director who receives less than a majority vote is not automatically removed; he or she offers to resign from the board and the board makes the ultimate decision on whether to accept the resignation. CII cited concerns that these “zombie directors” are not removed from the board at many companies and continue to serve.

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Under the FAQ, CII said it will accept the above-described widely-adopted form of majority voting if it is already in place and the board has a good faith commitment to replace directors who do not receive a majority vote within a reasonable period of time. However, CII advocated for “consequential” majority voting as a “best practice.” Under “consequential” majority voting, a director submits an irrevocable resignation upon appointment to the board. The FAQ contains a form of Delaware bylaw that requires the resignation to automatically become effective if the director fails to receive a majority of votes cast upon the earlier of (a) the selection of a replacement director by the board or (b) up to 90 or 180 days after the election. CII acknowledged common arguments that such a provision could cause the company to breach contracts, listing standards or other documents, but believes that the holdover period is sufficient to alleviate such concerns.

CII cited Microsoft’s majority voting policy as an example of consequential majority voting. Under the company’s bylaws, an incumbent nominee in an uncontested election who does not receive a majority vote serves as a holdover director until the earliest of 90 days after the voting results are determined, the date on which the board fills the seat as a vacancy or the date of the director’s resignation.

CII has similarly expressed concerns with so-called “plurality plus” director election standards, more commonly adopted by small-cap and mid-cap companies, under which a plurality voting standard is tweaked to provide that a director who receives more “withhold” votes than “for” votes would tender a resignation to the board, notwithstanding that the director had been legally elected to the board (with the board retaining discretion to accept or reject the resignation). According to CII, between 2013 and 2016, only 24% of directors at companies with plurality plus election standards departed from their boards after tendering a resignation. By comparison, more than 75% of directors at companies with majority voting who were not elected in the same period left their boards.

CII, Business Groups Weigh In on Reg S-K 400 Series Disclosures

October 2016

In response to the request of the SEC for comments on Regulation S-K Subpart 400, both CII and the Corporate Governance Coalition for Investor Value (“Coalition”), an umbrella group of business organizations including the American Insurance Association, National Association of Manufacturers, the U.S. Chamber of Commerce and others, provided detailed letters to the SEC. While taking different tacks on many topics, the letters appeared to show common ground on the idea that public companies ought to disclose more on the rationale for executive pay decisions.

CII noted its continued support of the SEC’s pay versus performance regulation, and suggested additional disclosure requirements by a company’s compensation committee in the Compensation Discussion and Analysis section of the proxy, specifically describing why it chose to use certain performance measures or metrics, and benchmarks (including peer groups) to determine executive compensation.

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The Coalition letter cited studies showing investor dissatisfaction with the executive compensation information provided in proxy disclosures, both as to quantity (too much) and relevance (too little). The Coalition cited a study that also indicated that disclosure on pay rationale would have value. Citing the Director of Governance Research at Equilar, the Coalition letter states that “Corporations must do a better job of articulating the rationale behind plan design, . . . It is not enough that disclosure in the Compensation Discussion & Analysis (CD&A) section of the proxy meets regulatory requirements. Companies should take renewed effort to be clear and concise in explaining their choices.”

Business Roundtable Suggests Shareholder Proposal Changes

October 2016

The Business Roundtable (“BRT”) has posted on its website a detailed set of suggestions for amending the shareholder proposal process. Specific elements of the proposal include: increasing the \$2,000 holding requirement (adopted in 1983 and last updated in 1998); increasing the length of the holding requirement; enhancing proponent disclosure requirements to allow shareholders to understand the interests of proponents; limiting or eliminating use of images; strengthening the resubmission thresholds for proposals that have been voted on and rejected; improving the definition of the “ordinary business” exclusion; reevaluating the standard for excluding proposals that are contrary to proxy rules; and revising the no-action letter process. While BRT has in the past submitted and supported petitions for SEC rulemaking, this proposal did not take the form of a petition for rulemaking.



SEC Receives Responses on Universal Proxy Ballot

January 2017

The U.S. Chamber of Commerce, through its Center for Capital Markets Competitiveness (“Chamber”) and the Council of Institutional Investors (“CII”), provided feedback to the SEC in connection with the proposal to adopt universal proxy ballots in director elections. While the CII response was generally supportive of the SEC proposed rules as written, CII also suggested that the universal ballot requirement be extended to smaller reporting companies and to emerging growth companies. The Chamber registered its disagreement with the proposed rule, citing concerns that adoption of the rule could, among other issues, increase “the frequency and ease of proxy fights for dissident shareholders” and “favor activist investors over rank-and-file shareholders and other corporate constituencies.”

The Society for Corporate Governance submitted a comment letter which contained many of the same arguments put forth by other corporate respondents, including “the potentially significant adverse consequences of the rule raised in the proposal’s Economic Analysis, such as the potential for an increase in the number of proxy contests and a reduction in board effectiveness resulting from “mix and match” boards.”

OTHER DEVELOPMENTS

Report: Few Companies Disclose CEO Succession Details

December 2016

A report by Equilar on CEO succession noted that, while more than one-third of the S&P 500 companies disclose that they have CEO succession plans, a much smaller number (3.3%) disclose the details of such plans. The report notes that in the last five years, CEO retirements, resignations or terminations increased incrementally year over year, and within the S&P represented more than 10% annual turnover at the CEO position. Through October 31, 2016, 59 CEOs had either left or announced plans to leave, an increase from 56 in all of 2015 and from 48 in 2012. The report discusses ways to balance internal company needs with communications to stakeholders, noting that while shareholders “have a deep interest in how their portfolio companies prepare to handle major events like a CEO transition, [for companies] strategic, competitive and talent retention issues may take precedent over full transparency.”

Is the Long Term Over-Rated?

November 2016

In a recent paper, “The ‘Long Term’ in Corporate Law,” attorney J.B. Heaton challenges the frequently used framework for discussing corporate governance questions. Heaton writes: “there is virtually no evidence that shareholders prefer short-term gains that are smaller than larger (discounted) long-term gains.... It is difficult – if not impossible – in the framework of modern financial economics to generate a logical argument (i.e., a model) for how a short-term gain can be larger than a properly-valued and larger longer term gain that would otherwise be available, keeping constant risk and the like. After all, shareholders, it seems, care about risk-adjusted wealth, and want more of it rather than less.”

Heaton’s proposition is that “short term/long term rhetoric in Delaware corporate law masks the real battle, one between a rational desire by clear-sighted shareholders for shareholder value maximization, on the one hand, and a desire by courts and others for corporate longevity – i.e., long-term corporate survival – on the other....[T]here are problems with masking longevity as a legitimate concern with shareholder welfare....A much under-emphasized empirical fact is that most stocks do poorly in the long run. If the empirical facts teach us anything, it is that pushing off the day of corporate reckoning to the long run often will turn out poorly....It may not be as bad for corporations as Keynes said of people, that “in the long run we are all dead,” but for many corporations, it gets pretty grim in the long run. At a minimum, long-run superior performance is quite rare. Shareholders know that.”

OF SPECIAL NOTE

The Activist Director: Lessons from the Boardroom and the Future of the Corporation (Columbia Business School Publishing, 2017)

by *Ira M. Millstein*

Ira Millstein has, for decades, has been one of the leaders in the evolution of corporate governance practice. His new book combines his up to the moment insights on the state of governance practice with his recollections of key moments in his own practice that helped shape the governance landscape we see today. In dealing with boards in public companies and in private sector agencies, he experienced, and had to help solve in real time, the problems that an organization can encounter when an insufficiently-accountable manager deals with an under-involved board. An enhanced governance process may not have solved all of GM’s problems in the early 1990s, for example—the company still needed strategies to confront changes in the industry—but it helped GM avoid continuing harm from erratic decisions by an imperial CEO. While modern boards and their advisors understand the need for active board involvement in governance, Millstein provides specific forward looking ideas for boards to identify directors with the right temperments and backgrounds to provide active board direction.

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SELECTED LAW FIRM MEMORANDA AND OTHER ARTICLES OF INTEREST

Wachtell Lipton: [Risk Management and the Board of Directors](#)

Equilar: [Hot Button Issues For 2017 Proxy Season](#)

Jones Day: [SEC Enforcement in Financial Reporting and Disclosure—2016 Year in Review](#)

Hunton & Williams: [The Corwin Effect: Stockholder Approval of M&A Transactions](#)

Delaware Supreme Court Chief Justice Leo Strine: [Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System](#)

Vinson and Elkins: [Proxy Fights: Don't Underestimate the Risk](#)

Cozen O'Connor: [Rollback of SEC Regulations Promulgated Under Dodd-Frank Has Begun](#)

GOVERNANCE CALENDAR

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

