The Corporate Governance Review

Third Edition

Editor
Willem J L Calkoen

Law Business Research

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Chapter 30

UNITED STATES

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I OVERVIEW OF GOVERNANCE REGIME

The sources of corporate governance law and regulation in the United States are state corporate law (predominantly Delaware, in which over half of all US publicly traded corporations are incorporated); the federal 1933 Securities Act and 1934 Securities Exchange Act and regulations of the Securities and Exchange Commission ('the SEC') under those Acts; stock exchange listing rules (predominantly the New York Stock Exchange ('the NYSE') and the NASDAQ); proxy advisory firms (predominantly Institutional Shareholder Services ('ISS')) and the influence those proxy advisers have on the institutional investor community; and federal statutes in regard to particular areas of corporate practice (for example, the Hart-Scott-Rodino Act requiring antitrust pre-clearance of most corporate acquisitions, the Federal Reserve and other federal and state agencies with respect to banks and other financial institutions, the Foreign Corrupt Practices Act prohibiting bribery and other corrupt practices in other countries by domestic entities and certain foreign issuers of securities). Because of the federal system of US law, these different sources of law are not always harmonised and corporations are often subject to different obligations to federal and state governments, as well as regulators at each level of government. This mosaic of rules and regulations, and the various authorities and mechanisms by which they are implemented and enforced, make for an environment of frequent change and evolution.

Securities laws and regulations are civilly and criminally enforced by the SEC, and the SEC must also grant clearance to certain important corporate disclosure documents (such as proxy statements and certain securities registration statements) before they become effective. Larger and older corporations with a history of securities

1 Adam O Emmerich and William Savitt are partners and Sabastian V Niles and S Iliana Ongun are associates at Wachtell, Lipton, Rosen & Katz.

law compliance are subject to fewer such pre-clearance requirements and may in certain cases file abbreviated forms of disclosure. Private investors may also bring actions under many provisions of the securities laws to recover damages for misstatements or omissions in public statements and in certain other circumstances.

State law fiduciary duties of directors and officers are predominantly enforced by private actions led by plaintiffs' lawyers. These private actions generally fall into one of two categories: class action suits on behalf of a particular group of the corporation's stockholders, and 'derivative' suits purportedly on behalf of the corporation itself. Putative class-action suits must satisfy the criteria under the Federal Rules of Civil Procedure or analogous provisions of state law before the judge will allow the case to proceed as a class action, including the numerousness of the class members, the commonality of legal and factual issues between members of the class, the typicality of the claims or defences of the representative parties to the class, and the fairness and adequacy of the representative parties' protection of the class interests. Derivative suits, also established by state corporate law, provide a mechanism by which private plaintiffs can in theory represent the corporation in suing the corporation's own board of directors or management, after complying with a 'demand' procedure in which the plaintiff must request that the corporation file suit and be rebuffed. In certain circumstances, especially when it can be shown that the board of directors is for some reason conflicted with respect to the alleged breach of duty, this 'demand' requirement is excused and the shareholder will be permitted to pursue a claim in the corporation's name without further inquiry.

The two primary US stock exchanges, the NYSE and the NASDAQ, each make rules with which corporations must comply as a condition for being listed on these exchanges. These listing rules address all aspects of corporate governance, including topics such as director independence, the composition of various board committees, requirements to submit certain matters to a vote of stockholders, regulation of dual-class stock structures, publication of and topics covered by corporate governance guidelines, and even requirements related to the corporation's public website. They are enforced by the threat of public reprimand from the exchanges, temporary suspension of trading for repeat offences, and permanent de-listing for perennially or egregiously non-compliant companies.

While proxy advisory firms are not a source of law, their guidelines now figure significantly in the corporate governance landscape, and more so than ever with the recent introduction of advisory 'say-on-pay' votes in the United States. These adviser firms, most notably ISS, exert pressure on corporations to conform to governance standards they promulgate by issuing director election voting recommendations to each publicly traded corporation's stockholders based on the corporation's compliance with the advisory firm's published standards. Perhaps because of the problem of 'rational apathy' – that is, because an individual shareholder bears all of the costs of becoming an informed voter but shares the benefits with all other shareholders, shareholders have little incentive to inform themselves – ISS wields outsized influence on corporate elections, especially among large institutional investors such as pension funds. One recent study found that a recommendation from ISS to withhold a favourable vote in an uncontested director

election correlates with a 20.9 per cent decline in favourable voting.[2] ISS is estimated to control approximately 61 per cent of the proxy advisory market, with Glass, Lewis & Co, another proxy advisory firm, estimated to control approximately 37 per cent. The US Department of Labor and the SEC have raised questions regarding fiduciary responsibility in the context of the outsourcing of proxy voting decisions to proxy advisory firms, but no regulatory changes to address this issue have yet been adopted. Significantly, certain major institutional investors, such as BlackRock Inc (which invests over $3.5 trillion in client assets) have recently indicated that they intend to reach proxy voting decisions on the basis of their own internal guidelines, independent of proxy advisory firms, and have sought to engage directly and pragmatically with companies.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010, was passed in response to corporate governance practices perceived by some to have contributed to the 2008–10 economic crisis. The Dodd-Frank Act requires additional disclosure in corporate proxies, non-binding shareholder votes on various questions of corporate governance (mostly related to executive compensation) and contemplates greater access for shareholder-proposed director nominees to the company proxy. The full effects of the Dodd-Frank Act are not yet known, as the vast rule making contemplated by the Act has not yet been completed and the ultimate effect of the rules that have been adopted is not yet fully known.

II CORPORATE LEADERSHIP

Under Delaware law, 'The business and affairs of every corporation […] shall be managed by or under the direction of a board of directors […]'.[3] The corporation law of all other US states similarly assigns corporate managerial power to the board of directors.

i Board structure and practices

Boards of directors customarily organise committees to carry out specific functions without the presence of the entire board. State law generally permits most of the functions of the board of directors to be delegated to committees[4] and generally permits directors to rely on information, opinions, reports or statements presented to the board by its committees.[5] Boards are specifically required by federal securities law to have an audit committee with certain prescribed functions relating to the retention, compensation and oversight of the company's auditor. The Dodd-Frank Act and the NYSE and NASDAQ listing rules also require listed companies to maintain compensation and nominating or corporate governance committees. Boards will often voluntarily establish additional committees – for example, a company in the technology sector might establish a technology committee comprising directors with the most applicable expertise to stay

2 Stephen Choi, Jill Fisch and Marcel Kahan (2010) 'The Power of Proxy Advisors: Myth or Reality?', *Emory LJ*, Volume 59, pp. 869, 886-7.

3 Delaware General Corporation Law, Section 141(a).

4 See, e.g., Delaware General Corporations Law, Section 141(c)(2).

5 See, e.g., Delaware General Corporations Law, Section 141(e).

abreast of technological developments, and a company that has important relationships with labour unions might choose to establish a labour relations committee. By custom, many companies have established a risk committee (actually required of certain financial institutions by the Dodd-Frank Act), an executive committee, a finance committee, a public policy committee, or some subset thereof. Boards may also establish *ad hoc* committees in response to discrete or emergent developments.

A panoply of regulations and disclosure requirements bear on the composition of the board of directors. Federal securities laws require all of the directors who serve on audit, compensation and nominating committees to be independent from the management of the company, and NYSE and NASDAQ listing rules require a majority of the board of directors to be independent. Companies are required to disclose the experience, qualifications or skills of each director nominee that led the board to nominate that person to serve as a director. Companies must also disclose whether and how its nominating committee considers diversity in identifying director nominees, and must make extensive disclosure about the nominating committee and how it functions.

Most large corporations in the United States have a common CEO and chair of the board of directors. Companies contemplating separating the roles of chair and CEO should be careful not to damage the relationship between the board of directors and management in the process, and should consider alternative policies such as a lead executive director with additional rights, responsibilities and compensation. In 2012, about 43 per cent of companies listed on the S&P 500 index had separate chairs and CEOs, up from 22 per cent in 2002. ISS generally recommends a vote in favour of shareholder proposals requiring an independent chair unless the corporation maintains a 'counterbalancing governance structure', such as a strong lead director. In 2012, shareholders brought proposals at 54 companies to require an independent chair. These proposals enjoyed an average level of support of 35 per cent. The recent Dodd-Frank Act requires companies to disclose in their annual meeting proxy statements whether the same person serves as chair and CEO, and in either case to explain why. The gradual governance trend is thus toward separating the CEO and chair functions.

Corporations are generally permitted by state corporation law to have classified, or 'staggered', boards of directors, in which roughly one-third of the directors are elected each year for three-year terms, but classified boards have become less common in recent years. With a classified board, shareholder activists can replace a majority of the directors only in two election cycles, so a classified board can promote the continuity and stability of a corporation's long-term strategy, reduce a corporation's vulnerability to abusive takeover tactics, and ensure that the institutional experience of the board of directors will not be swept away in a single lopsided election. On the other hand, classified boards historically have not halted well-priced, all-cash takeover bids. The percentage of S&P 500 companies with staggered boards has steadily declined over the past several years, to approximately 17 per cent in 2012, down from approximately 31 per cent in 2011 and 53 per cent in 2005. Shareholder proposals to declassify boards of directors enjoy strong support from shareholders – shareholders voted on such proposals at 54 companies in 2012, and the proposals averaged approximately 82 per cent shareholder support. (Shareholders voted on 74 management-initiated proposals to declassify boards in 2012, and these averaged 99.5 per cent shareholder support.)

Delaware law currently permits corporations to choose whether and how to afford access to the company's proxy statement to insurgent director nominees, but new rules promulgated by the SEC (which were later struck down by court order in a successful legal challenge) would have permitted shareholders without control intent to nominate up to a maximum of 25 per cent of the company's entire board. The rules required that shareholders or shareholder groups had held both investment and voting power of at least 3 per cent of the voting power of a company's securities continuously for at least three years. Under the now defunct rules, if shareholders proposed more candidates than need be included in the proxy statement, priority would have been given in proportion to the voting power held by the shareholders or shareholder groups backing each shareholder candidate. While these mandatory proxy access rules were overturned and did not go into effect, the SEC has implemented other rules that enhance the ability of shareholders to propose company-specific forms of proxy access, and the interest in proxy access as a 'democraticisation' of corporate governance and voting remains strong in certain quarters. In 2012, shareholders at 12 companies voted on proposals to grant shareholders proxy access, and the proposals averaged 29 per cent shareholder support. It still remains to be seen whether and what form of proxy access will ultimately take hold at American corporations; such access will have significant effects on the relationship between a public corporation and its shareholders, and possibly also on the composition of the board of directors. Many companies are monitoring and proactively approaching their most significant shareholders, revising advance notice by-laws and reviewing director qualification by-laws, corporate governance policies and board committee charters.

Historically, brokers holding stock of a corporation on behalf of clients have voted that stock at their discretion when their clients do not provide specific voting instructions. However, the NYSE listing rules now prohibit broker discretionary voting for listed companies as to certain topics, and the Dodd-Frank Act eliminates broker discretionary voting in elections related to election of directors, executive compensation and 'any other significant matter' as determined by the SEC. As a result, directors in uncontested elections have more difficulty achieving majority votes. In addition, the NYSE recently expanded its list of areas where discretionary voting is not permitted to include governance-related proposals. Lack of broker discretionary voting also increases the influence of activist shareholders and increases the power of proxy advisory firms such as ISS. Further concentrating voting power in the hands of activists is the problem of 'empty voting', in which an activist uses derivatives and similar arrangements to purchase voting power without taking on commensurate economic exposure to the corporation's stock – for example, by simultaneously purchasing and short-selling a stock, resulting in no net economic exposure or investment costs aside from transaction fees.

In uncontested elections, directors were historically selected by plurality vote, but in recent years, 'majority voting' policies have been adopted by approximately 81 per cent of companies listed on the S&P 500 index. Under a majority voting policy, directors in uncontested elections must receive a majority of the votes cast, rather than the bare plurality required by Delaware law. If they do not, they must tender their resignation, although Delaware courts will generally defer to a board's business judgement in whether to accept or reject a resignation from a director in such circumstances. Because directors must win a plurality of votes regardless of a corporation's majority voting policies, these policies have relatively less effect in contested elections; their primary effect is to increase

the power of 'withhold' recommendations from ISS against incumbent directors running in uncontested elections.

ii Directors

Directors' most basic and important responsibility is to exercise their business judgement in a manner they reasonably believe to be in the best interest of the corporation and its shareholders. In most situations, directors do not and should not manage the day-to-day operations of the corporation, but should instead exercise oversight in reasonable reliance on the advice of management, outside consultants hired by the corporation and their own understanding of the corporation's business. The courts will generally defer to the decisions that boards make, granting them the 'presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company' – a presumption referred to as 'the business judgement rule'.[6] The business judgement rule applies to most decisions that a board of directors makes. When a shareholder challenges a board's business judgement, 'the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation's objectives'.[7] To obtain the protection of the business judgement rule, directors must satisfy their duty of care, which entails reviewing the available material facts, and their duty of loyalty, which requires disinterest and independence of the directors. In practice, the business judgement rule will protect directors when the corporate records reflect that they reviewed and considered the facts available to them and the advice of their advisers and when the directors did not have a conflict of interest in the decision.

The board of directors should work with management to set an appropriate 'tone at the top' of the corporation to encourage conscientiousness, transparency, ethical behaviour and cooperation throughout the organisation. It should approve the company's annual operating plan and guide its long-term strategy, and should monitor and periodically assess the corporation's performance in terms of these goals. The board should monitor and evaluate its own performance as well, noting any deficiencies in its expertise and composition with an eye toward rectifying them with future director nominations. It should monitor the organisation's compliance with applicable law and best practices, set standards for corporate social responsibility and oversee relations with regulators and the corporation's various constituencies. It should evaluate the corporation's CEO and senior management and ensure that a succession plan is in place for the CEO and senior management, an issue that has received heightened focus in light of increased turnover rates and visible succession crises. When the company receives a proposal for a large transaction that creates a conflict – or the appearance of a conflict – between the interests of the corporation's stockholders and its management, the board should take care to place itself at the centre of the transaction, and should consider the merits of a special committee of independent directors to oversee the company's response to the proposal.

6 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

7 *In re Dollar Thrifty S'holder Litigation* (Del. Ch. 8 September 2010).

Directors enjoy substantial protection against personal liability for failures of board oversight. Under Delaware law, directors can be held personally liable for a failure to monitor only where there is 'sustained or systemic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists', which is a 'demanding test'.[8] Delaware courts have repeatedly emphasised that they will not impose liability under this standard unless directors have intentionally failed to implement any reporting system or controls or, having implemented such a system, intentionally refused to monitor the system or ignored any red flags that it raised.

III DISCLOSURE

Public corporations are subject to a disclosure regime that generally requires annual and quarterly reports, as well as current reports, to be filed following the occurrence of certain events, such as entry into material agreements, completion of significant acquisitions or dispositions of assets, and changes in officers or directors and amendments to the corporation's charter or by-laws. Public disclosure is also required of certain transactions in the corporation's securities by corporate insiders such as officers and directors, and of material non-public information that a corporate insider has disclosed to certain individuals, such as stock analysts or stockholders. Additionally, the corporation must make significant disclosure whenever it solicits proxies for the votes of shareholders, as it must in connection with the election of directors or significant transactions, such as mergers or the sale of substantially all corporate assets.

Securities regulations require substantial annual disclosure of compensation awarded to the five named executive officers ('NEOs') of a corporation, which are generally the CEO, CFO and the three other most highly compensated executive officers. The disclosure must describe all material elements of the NEOs' compensation, including the overall objectives of the compensation programmes, the process for determining the amount of each element of compensation and the rationale underlying that process. The Dodd-Frank Act also requires disclosure about the relationship between executive compensation and the company's financial performance, the company's policies governing hedging transactions of the company's stock by employees and directors, and the ratio of the total compensation of the CEO to the median compensation of the company's employees.

IV CORPORATE RESPONSIBILITY

The board of directors should ensure that the corporation has a healthy and balanced attitude toward risk – keeping in mind that some degree of risk taking is necessary for business success, and that there is danger in excessive risk-aversion just as there is danger in excessive risk taking – and it should set standards for corporate risk management. When the corporation's risk management functions raise a red flag, the board of directors

8 *In re Caremark International Inc Derivative Litigation*, 698 A.2d 959, 971 (Del. Ch. 1996).

should investigate the occurrence and see that the corporation takes measures appropriate to remedy any problems that it uncovers. The board should periodically review the effectiveness of the corporation's risk management reporting functions (including how risks are identified and reported upward, how management responsibility for risk management is allocated and whether risk managers have access to the board of directors and senior management) and repair any deficiencies that it uncovers.

Some corporations have a dedicated board-level risk management committee, which the Dodd-Frank Act requires of certain publicly traded bank holding companies and non-bank financial holding companies, but most boards situate the risk management function at the audit committee, in response to a listing rule of the NYSE that requires the audit committee to discuss risk assessment and risk management policies. Companies are required to disclose in their annual proxy statement the extent of the board's role in risk oversight activities and how the board administers its oversight function. The reputational damage to boards and companies that fail to properly manage risk is a major threat, and ISS now includes specific reference to risk oversight as part of its criteria for choosing when to recommend withholding votes in uncontested director elections.

V SHAREHOLDERS

i Shareholder rights and powers

Shareholders are permitted to vote at annual and special meetings. State corporation law typically entitles shareholders to vote on matters including elections of directors, amendments to the corporation's charter, transactions in which the corporation is acquired and sales of substantially all of the corporation's assets. The NYSE requires a shareholder vote prior to the issuance of stock that will exceed 20 per cent of the voting power or common stock outstanding after the issuance. In addition, Rule 14a-8 under the federal Securities Exchange Act permits shareholders to propose and vote on additional non-binding resolutions, which typically concern issues of social justice or corporate responsibility. Of the 358 such 'social' shareholder resolutions proposed in 2012, 90 concerned environmental policy, 118 concerned political contributions or ties, 30 concerned human rights and global labour standards, 19 concerned animal welfare, 32 concerned sexual orientation and equal employment opportunity policy, nine concerned the link between executive compensation and social issues, and eight concerned diversity on the board of directors.

The Dodd-Frank Act requires corporations to conduct a non-binding shareholder vote at least every three years to approve the compensation of the corporation's NEOs – votes that ISS policy also encourages – and an additional non-binding shareholder vote at least every six years to determine the frequency of these 'say-on-pay' votes. Non-binding advisory votes are also now required with respect to 'golden parachute' compensation arrangements triggered by a merger or acquisition transaction. However, the Jumpstart Our Business Startups Act, or the JOBS Act, signed into law in January 2012, exempts newly public 'emerging growth companies' from say-on-pay votes and certain other requirements for the earlier of five years or until the company meets specified size thresholds.

ii Shareholder activism

Shareholder activism – the capture of corporate control or influence over corporate policy by discrete groups of shareholders, typically to subjugate the corporation's long-term strategy in pursuit of short-term profits – is a significant threat to American corporations. The most important defence against shareholder activism available to corporations under current law is the shareholder rights plan, or 'poison pill'.

The shareholder rights plan entails a dividend of special 'rights' to each of the corporation's stockholders. In the event that a stockholder amasses equity ownership in excess of a predetermined threshold – often 15 per cent – without the approval of the board of directors, the rights held by every other stockholder 'trigger' and convert into the right to purchase stock of the corporation at a price substantially below the current market value. Alternatively, most rights plans provide that the board of directors may instead choose to exchange one share of common stock for each right held by stockholders other than the activist stockholder. Either way, the result of this conversion or exchange is that the ownership position of the triggering stockholder is substantially diluted.

The rights plan is the only structural takeover defence that allows a board to resist a hostile takeover attempt. While it does not provide complete immunity from a takeover, it allows the board to control the process and provides the corporation with leverage to bargain for a higher acquisition price and the power to reject underpriced or otherwise inappropriate bids. It is also implemented exclusively by the board of directors and does not require stockholder approval, so it can be put in place in very short order.

The principal disadvantage of the rights plan is that ISS will typically recommend a withhold vote for all directors after the adoption of a rights plan that the company does not subject to stockholder ratification within a year of adoption. As a result, and because a rights plan can be adopted quickly, most corporations adopt a rights plan only after a takeover threat appears – and prior to that time, the plan is kept 'on the shelf'.

Keeping a rights plan on the shelf offers almost all of the protection of an active rights plan without any risk from an adverse ISS recommendation, but it can leave a corporation vulnerable to 'stealth acquisitions,' in which an activist shareholder purchases just under 5 per cent of the company's stock, and then buys as much as possible on the open market within the next 10 days. Because Regulation 13D under the Securities Exchange Act gives stockholders 10 days after acquiring over 5 per cent of a company's stock to publicly disclose their ownership stake, this technique can result in an acquisition of a substantial portion of a company's equity before it is ever disclosed. Similarly, Regulation 13D patrols a narrow beat with regard to derivatives. While all interests must be disclosed after a stockholder crosses the 5 per cent threshold, only some derivative interests are counted toward that threshold – generally, only those that are settled 'in kind' (for stock of the corporation rather than for cash from the derivatives counterparty), and only those that can be exercised within the next 60 days.[9] However

9 Regulation 13D discourages stockholders from employing contracts or arrangements that divest beneficial ownership of a security as part of a 'plan or scheme to evade the reporting requirements' of Section 13(d) of the Securities Exchange Act by counting such securities

an activist may accumulate its position in a corporation, without public disclosure, the board of directors may not have any warning of the activist's behaviour, and there is thus some risk that a company may not be able adopt a rights plan in time to avoid a significant accumulation of stock in unfriendly and opportunistic hands.

Other defences against activist shareholders include a classified board of directors (used by 17 per cent of S&P 500 corporations), limiting stockholders' ability to call a special meeting, adopting an 'advance notice' by-law that requires rigorous disclosure of a stockholder's holdings and other interests in a corporation to nominate a director candidate or propose other items of business at a special or annual meeting, and limiting stockholders' ability to act by written consent (71 per cent of S&P 500 companies prohibit stockholder action by written consent).

Overall, the availability of takeover defences has been steadily eroded over the years, predominantly as a result of shareholder activism led by ISS, union and public pension funds and academics. Today, only 7.6 per cent of S&P 500 companies have a rights plan in effect, down from 45 per cent in 2005 and 60 per cent in 2000. In 2012, shareholders at 18 companies voted on proposals to grant shareholders the right to call special meetings, with an average level of support of 45 per cent, and shareholders at 22 companies voted on proposals to grant shareholders the right to act by written consent, with an average level of support of 45 per cent.

iii Contact with shareholders

Shareholder relations have become increasingly complicated as a result of activist trends and have required greater attention at the board level, prompting a renewed focus on the proper role of direct dialogue between boards and shareholders, as well as the benefits and disadvantages of more open, regular lines of communication. Recent disclosure reform efforts have also sought to require institutional shareholders to report their share positions on a more current basis as of the end of each quarter than is now the case, as well as suggesting more frequent reporting. Management generally serves as the primary caretaker of shareholder relationships, with the board providing oversight as to the presence of an effective shareholder relations programme. However, where shareholders request direct communications with the board, it may be desirable for directors, in appropriate circumstances and following consultation with management, to accommodate such requests. Some activists have been seeking direct dialogue generally with companies in which they invest, independent of whether operational or other performance issues exist. Towards the beginning of 2011, Walden Asset Management suggested that, in addition to quarterly earnings results calls, companies should have

toward the 5 per cent threshold (Securities Exchange Act Rule 13d-3(b)). One court applied this provision to impute beneficial ownership to a stockholder of securities in which the stockholder had acquired derivative interests. *CSX Corp v. Children's Inv Fund Management*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008). Still, no bright line has emerged to determine when a stockholderís use of derivative instruments is suspicious enough to constitute such a plan or scheme to evade the reporting requirements, so the case offers only marginal protection from raiders and activist stockholders.

an annual conference call with institutional investors to discuss corporate governance and other matters in the proxy statement for the meeting. This practice has not become widespread.

In 2000, the SEC promulgated Regulation FD to prevent companies from selectively disclosing material and non-public information to large investors and analysts. Under Regulation FD, certain employees of a company – including directors, officers, public relations or investor relations professionals and others with similar responsibilities or who regularly communicate with market professionals or stockholders – may intentionally disclose material non-public information about the company only if the material is simultaneously disclosed to the public. If they disclose the information unintentionally, the same information must promptly be disclosed publicly. Disclosures made to the press and disclosures made in the ordinary course of business (e.g., customary communications with distributors or customers) are exempted. Intentional disclosures include disclosures in which the employee was reckless in not knowing that the information is material and non-public – that is, cases in which a reasonable person under the circumstances would have made the same determination.

Information is considered material if there is a substantial likelihood that a reasonable investor would consider the information important when making investment decisions, and if the information adds significantly to the total mix of information available. Even if information is quantitatively insignificant, it may still be considered qualitatively material, and information is more likely to be deemed material after the fact in light of subsequent reaction by the market. The SEC has issued guidance that certain categories of information are more likely than others to be considered material – among them, information related to earnings; corporate events like mergers, bankruptcy, tender offers or changes in control; and products, discoveries and developments with respect to material contracts, customers or suppliers. And while purported clarifications to previously announced information can themselves be considered material and non-public, 'Regulation FD does not require that corporate officials only utter verbatim statements that were previously publicly made'.[10]

Regulation FD makes unscripted dialogues between company officials and individual analysts and shareholders risky. While it is unusual for companies to prohibit such meetings altogether, they should be approached carefully and by professional spokespeople only. Boards of directors should adopt corporate governance guidelines that ensure that the company's media strategy is executed only through approved channels, and with the understanding that analysts and shareholders will often engage in such private dialogues with the hope of ferreting out exactly the sort of information that Regulation FD forbids company officials from disclosing in such a forum.

VI OUTLOOK

Corporate governance in the United States has changed dramatically over the past 30 years, and it will undoubtedly continue to evolve in significant ways in the coming

10 *SEC v. Siebel Systems, Inc*, 384 F. Supp. 2d 694, 704-05 (S.D.N.Y. 2005).

years. With respect to corporate governance regulation, the Dodd-Frank Act provides substantial authority for further regulation by the SEC, particularly in areas related to the listing of insurgent director nominees on the company proxy, racial and gender diversity on boards of directors, disclosure related to compensation consultants and further criteria for the independence of compensation committee members. In particular, the SEC has signalled its interest in 'proxy plumbing', including with respect to accuracy, transparency and efficiency of the voting process; and shareholder communications and retail participation in the voting process; misalignment of voting power and economic interests (including through 'empty voting' strategies involving purchasing voting securities and then hedging away the economic exposure with derivatives). The SEC has also indicated that it is considering the role of proxy advisory firms such as ISS and Glass-Lewis in the voting process, which, in light of ISS's substantial influence in the evolution of corporate governance norms over the past decades, may have long-term and far-reaching implications. The SEC has also received many proposals for the reform of the Regulation 13D reporting regime, including to encompass additional forms of economic interests and to close the 10-day reporting window that raiders have used in recent years to facilitate stealth acquisitions of control blocks without paying a premium. The SEC has also received proposals to accelerate the time in which institutional investors must disclose their shareholdings under the Schedule 13F reporting regime.

At the state level, the courts of Delaware have been refining the fiduciary duty rules applicable to conflict transactions and review of merger and acquisition proposals in recent years, often so as to increase the scrutiny the directors will face in connection with such transactions and more generally to recalibrate the relative power of shareholders and directors. Spurred on by the accounting scandals of the early 2000s and the financial crisis at the end of the last decade, the political and public appetite for ever more corporate governance remains strong. However, recent years have seen a heightened awareness of short-termist pressures in the markets and its impact on boards of directors charged with guiding the company's strategy to achieve long-term value creation and an increased focus on the extent to which new corporate governance reforms may exacerbate, rather than ameliorate, short-termist pressures. A central aspect of the continuing debate is whether initiatives styled as governance reforms operate to shift the locus of control over the corporate enterprise from those with direct knowledge, involvement in and fiduciary responsibilities for the enterprise towards entities lacking in those attributes, and whether imposing some forms of duties, regulations or mandated best practices on such entities is needed. Continued debate over and the evolution of US governance rules thus appears likely.

Appendix 1

ABOUT THE AUTHORS

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Adam O Emmerich practises in Wachtell Lipton's corporate department, focusing primarily on mergers and acquisitions, securities law matters, and corporate governance. His practice has included a broad and varied representation of public and private corporations and other entities in a variety of industries throughout the United States and abroad in connection with mergers and acquisitions, divestitures, spin-offs, joint ventures, and financing transactions. He also has extensive experience in takeover defence. Mr Emmerich is recognised as one of 500 leading lawyers in America by *Lawdragon*; as one of the world's leading lawyers in the field of mergers and acquisitions in the *Chambers Guide to the World's Leading Lawyers*; as an expert in each of M&A, corporate governance and M&A in the real estate field by *Who's Who Legal*; and as an expert in M&A and in corporate governance by Euromoney Institutional Investor's Guides to the world's leading mergers and acquisitions and corporate governance lawyers.

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