Corporate Governance

March 2019

Topics

Part I: New Paradigm of Corporate Governance

- Growing Recognition of Threat of Short-Termism
- New Paradigm of Corporate Governance

Growing Recognition of Threat of Short-Termism

- Recognition is growing of the damaging effects of short-termism—including from activist hedge fund attacks—on shareholders, employees, communities and the economy:
  - Academic studies discrediting the notion that activist attacks and shareholder-centric governance enhance long-term value.
  - *The Conference Board* report on decreased capital investment and increased shareholder payouts.
  - Calls by BlackRock, State Street, Vanguard and other institutional investors for corporations to resist financial engineering, pursue long-term strategies, embrace transparency and regularly engage with investors to cultivate an understanding of performance and strategy.
  - Selected activists seeking to distinguish themselves from short-term focused peers.
  - Major non-U.S. institutional investors sponsor launch of the S&P Long-Term Value Creation Global Index.
  - Business Roundtable's updated "Principles of Corporate Governance" (observing "a rising belief that shareholders cannot seek additional empowerment without assuming some accountability for the goal of long-term value creation for all shareholders").
  - Participation by institutional investors and other business leaders in organizations like FCLTGlobal ("Focusing Capital on the Long Term").
  - CII adoption of "Commitment to Long-Term Performance" policy, which "encourages companies to resist both internal and external short-term pressure and thinking."
  - International Business Council of the World Economic Forum's issuance of "The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth" (prepared by Martin Lipton).

Growing Recognition of Threat of Short-Termism

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- Discussion paper from the McKinsey Global Institute in cooperation with FCLTGlobal finding that long-term focused companies generally outperformed in both financial and other performance measures.
- Joseph L. Bower and Lynn S. Paine's *Harvard Business Review* article showing fallacies of economic theories and statistical studies used to justify shareholder-centric governance, short-termism and activist attacks on corporations, and espousing corporation-centric/constituency theory of governance.
- Vanguard *WSJ* op-ed responding to suggestions from academia that index funds should be deprived of their voting rights in order to further empower active managers and activist hedge funds (and Jack Bogle's subsequent *WSJ* piece evaluating options for addressing concentration of stock ownership).
- Coalition for Inclusive Capitalism and EY launch of The Embankment Project for Inclusive Capitalism "to help define how firms create long-term value and offer potential ways to measure and report on that."
- Investor Stewardship Group ("ISG") "Framework for U.S. Stewardship and Governance," focused on combating short-termism, "promoting long-term value creation for U.S. companies and the broader U.S. economy" and encouraging "responsible" engagement.
- Jamie Dimon and Warren Buffett *WSJ* op-ed "encouraging all public companies to consider moving away from providing quarterly earnings-per-share guidance," which "often leads to an unhealthy focus on short-term profits at the expense of long-term strategy, growth and sustainability."
- "Commonsense Principles 2.0" (October 2018 update), prescribing roles and responsibilities of boards and shareholders in contributing to good corporate governance (including focus on long-term value creation).
- Increasing concerns about precipitous drop in number of U.S. stock listings over the past two decades.
- Revised December 2018 version of Martin Lipton's *The New Paradigm*, including updates based on prevailing institutional investor policies and public statements and integrating concepts from other recently promulgated governance frameworks, codes and principles.

New Paradigm of Corporate Governance

Overview

- The "New Paradigm" of corporate governance conceives of corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value and resist short-termism.
  - Integrates long-term corporate strategy with substantive corporate governance.
  - May reduce outsourcing of governance and portfolio oversight to proxy advisors and activists.
- Major institutional investors and other industry participants are expressing that:
  - Clearly articulated plans are necessary to gain and keep their support. A company should not leave an opening for an activist with a more attractive long-term strategic plan.
  - Companies should communicate board participation in the development and approval of strategy in letters to these investors, annual reports and proxy statements.
  - Management of environmental and social issues is important.
  - Companies should develop and communicate procedures for engagement by management and directors with these investors and should facilitate direct engagement with directors if these investors request it.
  - Companies should support national policies encouraging long-term value creation.
  - Stock repurchases at the expense of long-term investment are disfavored.
  - There is no need for quarterly earnings guidance if a company has a clearly articulated long-term strategy.
- Corporations that implement the governance "best practices" advocated by these investors can expect that these investors will support the corporation in resisting short-term pressures.
  - The New Paradigm does not foreclose activism or episodic support by institutional investors of activist initiatives, but seeks to balance the playing field, so that activism is focused on improving companies that are truly mismanaged and underperforming.

New Paradigm of Corporate Governance

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Paradigm Components

- <u>Governance</u>
  - *Purpose and Strategy*. The board of directors and senior management should jointly articulate the company's purpose and oversee its long-term strategy, ensuring that the company pursues sustainable long-term value creation.
  - *Management and Oversight*. The board is responsible for overseeing the management of the company, monitoring company performance and preparing for senior management succession.
  - *Quality and Composition of Board of Directors*. Directors should have integrity, competence and collegiality, devote the significant time and attention necessary to fulfill their duties and represent the interests of shareholders and other stakeholders. The board as a whole should include diverse backgrounds, experiences and expertise that are tailored to the company's needs.
  - *Compensation*. Executive and director compensation should be designed to align with the long-term strategy of the company and incentivize the generation of long-term value, while dis-incentivizing the pursuit of short-term results at the expense of long-term results.
  - *Corporate Citizenship*. Consideration should be given to the company's purpose and its stakeholders—including shareholders as well as employees, customers, suppliers, creditors and the community in which the company does business—in a manner that contributes to long-term sustainability and value creation.
- <u>Engagement</u>
  - *By the Company*. The board and senior management should engage with major shareholders on issues and concerns that affect the company's long-term value and be responsive to those issues and concerns.
  - *By Shareholders*. Asset managers and investors should be proactive in engaging in dialogue with a company as part of a long-term relationship and should communicate their preferences and expectations.

New Paradigm of Corporate Governance

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Paradigm Components (cont'd)

- *Shareholder Proposals and Votes*. Boards should consider shareholder proposals and key shareholder concerns, but asset managers and investors should seek to engage privately before submitting a shareholder proposal.
- *Interaction and Access*. Companies, asset managers, shareholders and other key stakeholders should provide each other with the access necessary to cultivate engagement and long-term relationships.

- Stewardship
  - *Beneficial Owners*. Asset managers are accountable to their investors—the beneficial owners whose money they invest—and they should use their power as shareholders to foster sustainable, long-term value creation for their investors and for the companies in which they invest.
  - *Voting*. Asset managers should actively vote on an informed basis consistent with the long-term interests of their investors, which aligns with the long-term success of the companies in which they invest.
  - *Investor Citizenship*. Asset managers and investors should consider value-relevant sustainability, citizenship and environmental, social and governance ("ESG") factors when developing investment strategies.

Part II: Corporate Governance Landscape

- Corporate Governance Trends
- Director Duties
- Risk Management
- Board Structure
- Director Elections and Other Voting Issues

Corporate Governance Trends

- Many long-salient corporate governance debates have been settled, with “best practices” now codified in rules and regulations or voluntarily adopted by a majority of S&P 500 companies (*e.g.*, majority voting, proxy access).
  - Widespread adoption has transformed the profiles of U.S. public companies.
- Nonetheless, the drive for “reform” to enhance shareholder rights and weaken takeover defenses continues.
  - Activists persist in advocating for more purported “best practices” (*e.g.*, mandatory removal of directors receiving sub-majority vote, hybrid vs. virtual-only shareholder meetings, reducing supermajority-vote thresholds).
  - Scrutiny of governance of newly public companies has intensified (*e.g.*, by CII, ISS).
  - Domestic advocates are reaching globally to markets beyond the United States (*e.g.*, CalPERs, ISS).
- While corporate governance continues to be focused on the relationship between boards and shareholders, there has been a shift toward considering a more expansive view of the role and purpose of corporations.
  - Efforts to invigorate a more long-term perspective among both corporations and their investors highlight fundamental questions about the basic purpose of corporations.
  - Expanded notion of stakeholder interests (including employees, customers, communities, and the economy and society as a whole) is a developing theme with policymakers, academics and investors.
- Additionally, while governance debates in the last decade largely have been framed as board vs. shareholders, the next phase in governance evolution also features more debates among different *types* of shareholders (*e.g.*, activist hedge funds vs. index funds/large mutual fund groups, short-term vs. long-term investors, long vs. short activists).
- Increased recognition that corporate governance is inherently nuanced and less amenable to benchmarking and quantification. Evolution from a relatively binary, check-the-box mentality to tackling questions such as:
  - How to craft a well-rounded board with skills and experiences most relevant to a particular corporation.
  - How to forge relationships with shareholders that meaningfully enhance the company’s credibility.

Corporate Governance Trends

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- Companies and investors alike have sought to address these "next generation" governance issues in a way that facilitates comparability, objective assessment and accountability (*e.g.*, including board skills matrix in proxy).
  - Remains to be seen whether this will prompt new ways of defining "good" corporate governance that require a deeper understanding of companies and their businesses, and what impact that could have on the expectations and practices of stakeholders.
  - Shareholder engagement critical to this effort.
- Impact of Trump administration on corporate governance continues to develop.
  - Focus by SEC Chairman Jay Clayton on reform of the proxy process—including proxy solicitation and voting, the shareholder proposal process and the role of proxy advisors—with a view to serving Main Street investor interests.
  - The SEC is reviewing the nature and content of quarterly reports and earnings releases (though Chairman Clayton has stated that he does not "think quarterly reporting is going to change for our top names [*i.e.*, large companies] anytime soon").
- Legislative initiatives, as dissatisfaction with corporations is near the top of the political agenda for both the left and the right.
  - Senator Elizabeth Warren's "Accountable Capitalism Act," which would federalize all companies with annual revenues of $1+ billion, preempt state corporation law and mandate board fiduciary duty to all stakeholders, not just shareholders, and require not less than 40% of directors be elected by employees.
  - In a February 2019 *NYT* op-ed, Senators Chuck Schumer and Bernie Sanders discussed introducing federal legislation that would prohibit share buybacks (and perhaps dividends) if corporations do not meet specified employee wage and benefit levels.
  - Across the aisle, Senator Marco Rubio proposed ending the preferential tax treatment of stock buybacks, seeking to provide incentives for domestic investment.

Corporate Governance Trends

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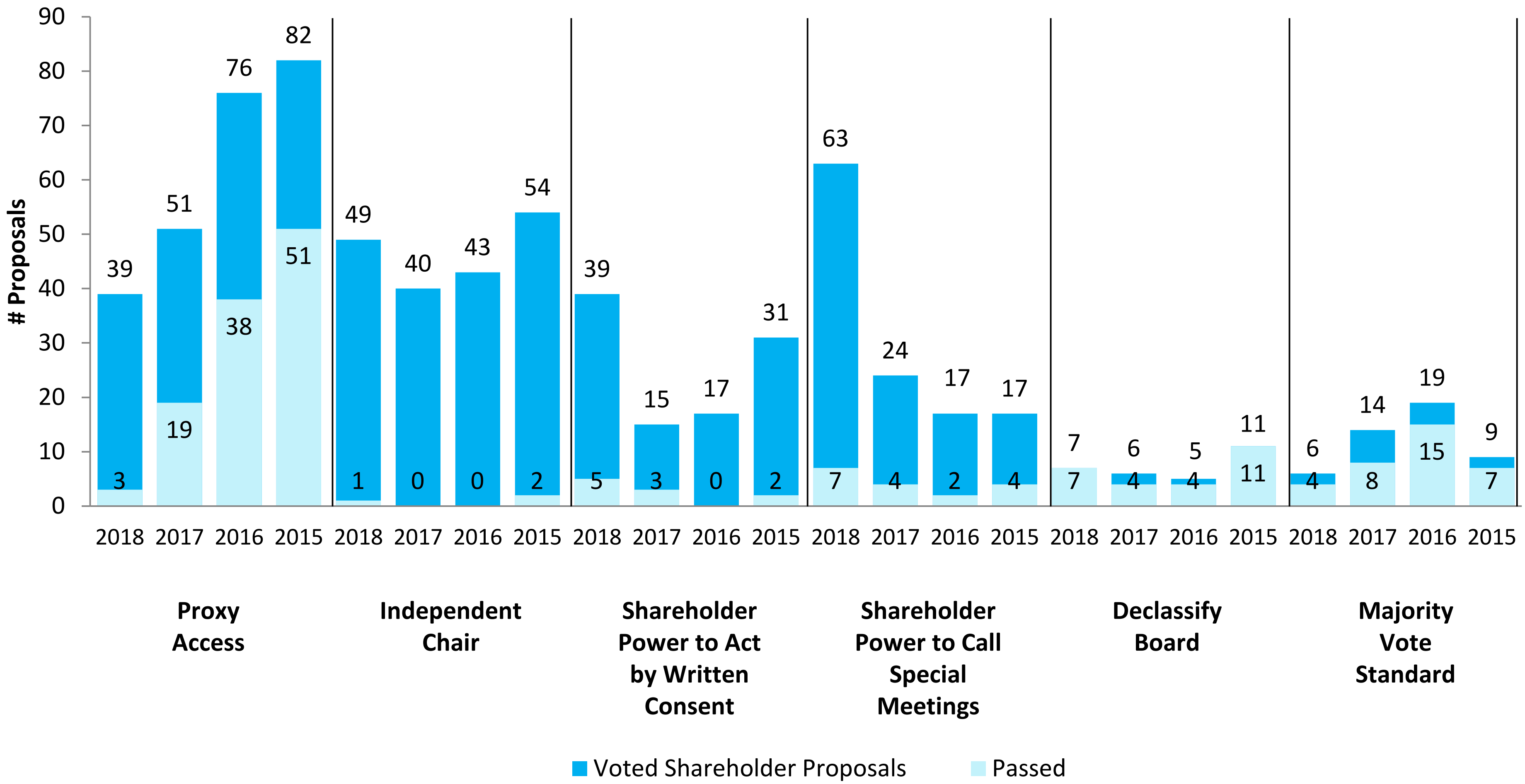
- Independent chair and proxy-access amendment shareholder proposals remained prominent on 2018 ballots, while individual proponents drove a sharp increase in special meeting and written consent proposals.
- Proxy-access adoption, board declassification and majority voting proposals have waned as these practices have been more widely implemented, particularly by larger companies.



Source: ISS.

Director Duties

Business Judgment Rule and Directors' Key Responsibilities

- Directors' fundamental responsibility is to exercise business judgment and act in a manner they reasonably believe to be in the best interests of the company and its shareholders.
- Today, boards are expected to:
  - Recognize the heightened focus of investors on "purpose" and "culture" and an expanded notion of stakeholder interests that includes employees, customers, communities, the economy and society as a whole and work with management to develop metrics to enable the corporation to demonstrate its value.
  - Be aware that ESG and sustainability have become major, mainstream governance topics that encompass a wide range of issues, such as climate change and other environmental risks, systemic financial stability, human capital management, worker retirement, supply chain labor standards and consumer and product safety.
  - Oversee corporate strategy (including purpose and culture) and the communication of that strategy to investors, keeping in mind that investors want to be assured not just about current risks and problems, but also about threats to long-term strategy from global, political, social and technological developments.
  - Work with management to review the corporation's strategy, and related disclosures, in light of the annual letters to CEOs and directors, or other communications, from BlackRock, State Street, Vanguard and other investors, describing the investors' expectations with respect to corporate strategy and how it is communicated.
  - Set the "tone at the top" to create a corporate culture that gives priority to ethical standards, professionalism, integrity and compliance in setting and implementing both operating and strategic goals.
  - Choose the CEO, monitor the CEO's and management's performance and develop and keep current a succession plan.
  - Have a lead independent director or a non-executive chair of the board who can facilitate the functioning of the board and assist management in engaging with investors.

Director Duties

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Business Judgment Rule and Directors' Key Responsibilities (cont'd)

- Together with the lead independent director or the non-executive chair, determine the agendas for board and committee meetings and work with management to ensure that appropriate information and sufficient time are available for full consideration of all matters.
- Determine the appropriate level of executive compensation and incentive structures, with awareness of the potential impact of compensation structures on business priorities and risk-taking, as well as investor and proxy advisor views on compensation.
- Develop a working partnership with the CEO and management and serve as a resource for management in charting the appropriate course for the corporation.
- Oversee and understand the corporation's risk management and compliance efforts and how risk is taken into account in the corporation's business decision-making; respond to red flags if and when they arise.
- Monitor and participate, as appropriate, in shareholder engagement efforts, evaluate corporate governance proposals, and work with management to anticipate possible takeover attempts and activist attacks in order to be able to address them more effectively, should they occur.
- Meet at least annually with the team of company executives and outside advisors that will advise the corporation in the event of a takeover proposal or an activist attack.
- Be open to management inviting an activist to meet with the board to present the activist's opinion of the strategy and management of the corporation.
- Evaluate the individual directors', board's and committees' performance on a regular basis and consider the optimal board and committee composition and structure, including board refreshment, expertise and skill sets, independence and diversity, as well as the best way to communicate with investors regarding these issues.
- Review corporate governance guidelines and committee workloads and charters and tailor them to promote effective board and committee functioning.

Director Duties

(cont'd)

Business Judgment Rule and Directors' Key Responsibilities (cont'd)

- Be prepared to deal with crises.
- Be prepared to take an active role in matters where the CEO may have a real or perceived conflict, including takeovers and attacks by activist hedge funds focused on the CEO.

- To meet these expectations, major public companies should seek to:
  - Have a sufficient number of directors to staff the requisite standing and special committees and to meet investor expectations for experience, expertise, diversity and periodic refreshment.
  - Compensate directors commensurate with the time and effort that they are required to devote and the responsibility that they assume.
  - Have directors who have knowledge of, and experience with, the corporation's businesses and the geopolitical developments that affect it, even if this results in the board having more than one director who is not "independent."
  - Have directors who are able to devote sufficient time to preparing for and attending board and committee meetings and engaging with investors.
  - Provide the directors with the data that is critical to making sound decisions on strategy, compensation and capital allocation.
  - Provide the directors with regular tutorials by internal and external experts as part of expanded director education and to assure that in complicated, multi-industry and new-technology corporations, the directors have the information and expertise they need to respond to disruption, evaluate current strategy and strategize beyond the horizon.
  - Maintain a truly collegial relationship among and between the company's senior executives and the members of the board that facilitates frank and vigorous discussion and enhances the board's role as strategic partner, evaluator and monitor.

Director Duties

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Shareholder Engagement

- Engagement is no longer limited to the "proxy season," and traditional governance outreach has evolved to address financial and strategic matters.
  - Failure to engage adequately on these topics may lead to shareholders' withholding support.
- Engagement is increasingly a board-level issue with limited direct participation by independent directors, as appropriate and necessary.
- Expanded interaction with investors stems from many factors:
  - All parties seeking more regular dialogue on business and corporate governance matters.
  - Annual say-on-pay vote requires companies to explain compensation practices and consider feedback.
  - Appreciation for how dialogue can enhance board and management credibility, preempt shareholder resolutions and proxy fights and defuse potentially contentious situations.
  - Significant "behind-the-scenes" interaction and coordination among institutional investors.
  - Elevation of institutional ownership and passive investing, along with concomitant stewardship role.
- Disclosure and transparency are becoming more integrated with engagement strategy.
  - Companies are including disclosures about engagement efforts in their proxy statements, especially in response to negative say-on-pay votes.
  - Companies are proactively adding disclosures of particular interest to certain institutions to their proxy statements, SEC filings and websites.
- Institutional investors are articulating specific expectations regarding engagement and investor relations.
  - Investors are also setting ground rules with respect to engagement practices around activism (*e.g.*, T. Rowe Price: "If an activist or any other investor claims to represent T. Rowe Price's view on any investment or voting matter related to your company, please disregard this claim and contact us directly.").

Director Duties

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Shareholder Engagement (cont'd)

- No "one-size-fits-all" structure for shareholder engagement.
  - Companies may consider a range of approaches to facilitating meaningful long-term relationships, such as:
    - Ensuring general board-level oversight of company's investor relations and engagement efforts (board updated regularly at meetings).
    - Being open to providing major institutional investors with director access if specifically requested.
    - Coordinating director attendance alongside management at investor visits or at investor day events.
    - Designating the chair/lead independent director as a primary liaison for director-level shareholder communication (with other directors involved as the subject matter warrants).
  - The policies and arrangements best suited to any given company will depend on, among other things, directors' preferences, nature of existing relationships with shareholders, expressed preferences of shareholders and structure/staffing of existing shareholder relations programs.
    - Growing appreciation that shareholder engagement can be handled in a practical and targeted manner in which quality of focused engagements, rather than quantity, delivers the most benefit.
  - The Shareholder-Director Exchange (SDX) provides additional guidance on engagement protocols.
- In case of an activist attack or other contested situation, the company's approach must be supplemented by an intensive campaign with participation by directors.
- Advance preparation, including regarding Regulation FD compliance and communication plans, is critical.
- Proactive, productive and effective engagement can yield significant benefits to a company's relationship with its largest institutional investors.
  - By forging relationships of trust and credibility with long-term shareholders, a company may expect to gain support for its long-term strategy.

Risk Management

Risk Management in the Current Environment

- Global political, legal and economic uncertainty, as well as increased operational risks, have sharpened scrutiny of oversight of risk management (including crisis management and preparedness).
  - Social and environmental issues—including the focus on income inequality and economic disparities, scrutiny of sexual misconduct issues and evolving views on climate change and natural disasters—have become increasingly salient in the public sphere and with institutional investors, requiring companies to exercise utmost care to address legitimate issues and avoid public relations crises and liability.
    - State Street 2019 stewardship letter: "[F]lawed corporate culture has resulted in high-profile cases of excessive risk-taking or unethical behaviors that negatively impact long-term performance."
  - Heightened focus on cybersecurity risk due to pervasive attacks/data breaches and corporate reliance on data aggregation, cloud computing, mobile devices and other networked technologies. Additionally, responses to severe cyber incidents are drawing criticism, with questions raised about post-incident communication and disclosure strategies, remediation efforts and securities trading by insiders.
    - Greater lawmaker and regulator attention to management and disclosure of cybersecurity risk (*e.g.*, SEC guidance on cybersecurity disclosures by public companies and subsequent report on cyber threats and internal accounting controls), as well as more aggressive enforcement actions.
    - Institutional investors engaging with companies on oversight of cybersecurity risk management.
    - National Institute of Standards and Technology ("NIST") Framework for Improving Critical Infrastructure Cybersecurity as a guide and benchmarking tool.
    - EU General Data Protection Regulation ("GDPR") May 2018 effectiveness and nascent enforcement.
  - Foreign Corrupt Practices Act enforcement policy encourages voluntarily disclosure of misconduct.
- Crises, or their perceived mismanagement, may invite governance (including vote-no) or activist campaigns.

Risk Management

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Risk Management in the Current Environment (cont'd)

- Corporate governance structures and concepts impact effectiveness of risk oversight and management (*e.g.*, board organization and composition, management compensation arrangements).
- A board's risk-oversight responsibilities derive primarily from state law fiduciary duties, federal and state laws and regulations, stock exchange listing requirements and certain established (and evolving) best practices, both domestic and worldwide.
  - Delaware courts have taken the lead in formulating the national legal standards for directors' duties for risk management (*e.g.*, *Caremark*, *Citigroup*, *Goldman Sachs*).
  - SEC rules require enhanced disclosure of the board's role in risk oversight.
  - To the extent that risks arising from compensation policies are reasonably likely to have a "material adverse effect" on a company, SEC proxy rules also require the company to discuss how its compensation policies and practices relate to risk management and risk-taking incentives.
  - Dodd-Frank Act mandated certain risk-management procedures principally for financial institutions.
  - Major institutional shareholders and proxy advisory firms evaluate risk-oversight matters in considering withhold votes in uncontested director elections and routinely engage companies on risk-related topics (*e.g.*, Vanguard's fourth "pillar" of risk and strategy, and its increased engagement on risk oversight).
    - In recent years, investors have pushed for more meaningful and transparent disclosures on boards' activities and performance with respect to risk oversight.
  - Various industry-specific regulators and private organizations publish suggested best practices for board oversight of risk management (*e.g.*, National Association of Corporate Directors Blue Ribbon Commission, Committee of Sponsoring Organizations of the Treadway Commission and The Conference Board).

Risk Management

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Observations

- Boards should regularly assess the adequacy of companies' risk-management processes, including by considering:
  - Primary elements comprising the company's risk culture, including the "tone at the top."
  - Risk appetite and risk tolerance; consistency of strategy with agreed-upon risk appetite and tolerance.
  - Framework for holding CEO/senior management accountable for maintaining risk-appetite framework and reporting to board.
  - Risk categories, including concentrations and interrelationships, as well as likelihood and impact of risks.
  - Measurement and hedging of risk; setting of risk limits and actions to be taken if limits are exceeded.
  - Assumptions and analyses underpinning determination of company's principal risks.
  - Company's preparedness for a possible cybersecurity breach (including sufficiency of internal audit function) and its action plan in the event that a cybersecurity breach occurs.
  - How risks are identified and reported up through company (including quality of information provided), how risk-management and oversight responsibilities are allocated and how management is incentivized.
  - Management's design and implementation of risk policies and procedures.
  - Independence of risk-management function and processes for addressing internal conflicts.
  - Means by which risk-management strategy is communicated to all appropriate groups within company.
  - Internal and external reports and communication regarding risks and risk-management functions.
  - Qualifications of directors, committees and board to oversee all facets of company's risk profile—including in specialized areas such as cybersecurity—and advisability of subject-specific risk education.
- Recent experience highlights importance of board sensitivity to potential excessive risks posed by strategies that activists advocate.

Board Structure

Elimination of Classified Boards

- With a classified-board structure, generally one-third of directors are elected each year for three-year terms.
- Percentage of domestic S&P 500 companies with classified boards has sharply declined in recent years.
  - Approximately 11% as of year-end 2018 (down from 60% of all S&P 500 companies in 2000).
  - Many newly public companies feature a classified board, but in some cases these companies may have concentrated ownership, which would mitigate the effect of an adverse ISS recommendation.
- Declassification proposal activity has waned in light of sustained success in this arena by activist campaigns—most notably Lucian Bebchuk's Harvard Law School Shareholder Rights Project ("SRP").
  - Between 2012 and 2014, the SRP advised institutional shareholders in connection with 196 declassification proposals at 129 S&P 500 and Fortune 500 companies that resulted in 121 companies agreeing to move towards declassification.
  - In 2018, shareholders at just seven companies voted on shareholder-initiated declassification proposals—proposals averaged 87% support and all passed (vs. six proposals with 66% average support in 2017, four of which passed).
    - Shareholders at 60 companies voted on management-initiated declassification proposals—proposals averaged 99% support and 48 passed (vs. 39 proposals with 99% support and 33 passes in 2017).
- In its updates for 2016, ISS revised its unilateral bylaw/charter amendment policy to provide explicitly for negative recommendations in the event that directors classify the board. For newly public companies, ISS will also generally issue an adverse recommendation if, prior to or in connection with a company's public offering, the company or board adopted bylaw or charter provisions "materially adverse to shareholder rights" (considering enumerated factors).
- In its updates for 2018, ISS codified its policy providing for adverse director recommendations if companies opt into or do not opt out of state laws mandating classified boards.

Source: SharkRepellent; ISS.

Board Structure

(cont'd)

Separation of Chair and CEO

- Fifty percent of S&P 500 companies separate the CEO and chair roles; 30.5% have an independent chair.
  - Eighty percent of S&P 500 boards have an independent lead or presiding director (includes those for which independent chair is also designated as lead or presiding director).
- Required disclosure in annual meeting proxy statement of whether CEO and chair are combined or separate, and, if combined, whether there is a lead independent director and what is its role. Also must disclose rationale for leadership structure.
- ISS recommends generally voting <u>for</u> shareholder proposals requiring an independent chair, considering factors including the scope of the proposal, current board-leadership structure, the company's governance structure and practices and the company's performance.
- FAQs for 2016 set forth ISS policy on board responsiveness to majority-supported independent chair proposals:
  - <u>Full implementation</u>: separating chair and CEO positions, with an independent director serving as chair; policy that company will adopt this structure upon current CEO's resignation considered responsive.
  - <u>Partial responses</u>: evaluated <u>case-by-case</u>, depending on the disclosure of shareholder input obtained through outreach, the board's rationale and the facts and circumstances of the situation.
- Independent-chair shareholder proposals rarely receive majority support.
  - In 2018, shareholders at 49 companies voted on shareholder-initiated proposals to require an independent chair—proposals averaged 32% shareholder support and one passed. Forty proposals voted on in 2017 averaged 30% support; none passed.
  - Notwithstanding lagging support for these proposals, supporters can apply pressure through a substantial, sub-majority vote.

Source: 2018 Spencer Stuart U.S. Board Index; ISS.

Board Structure

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Board Composition and Refreshment

- Increasing focus on board composition and refreshment—as well as on associated disclosure—especially as to age, tenure, independence, expertise, gender and diversity:
  - Policies tying director tenure to independence (*e.g.*, CalPERS).
  - Mandatory retirement ages (at least 71% of S&P 500 boards) and, to a lesser extent, term limits (5%).
  - International focus on attaining at least 30% representation of women on boards.
  - Tightened proxy advisory firm policies on director "overboarding."
  - ISS QualityScore's new Board Diversity subcategory (including four new and five existing factors).
  - Closer attention to board evaluation practices and effectiveness.
  - Demands for board refreshment as a response to (perceived) mismanagement/poor performance (may be accompanied by calls for implementation of proxy access or other governance changes).
- Other notable recent developments:
  - In 2017, the NYC Comptroller and Pension Funds launched the "Boardroom Accountability Project 2.0," calling for 151 U.S. companies (targets of the Project's initial proxy-access phase) to disclose director gender, race and skill information "in a standardized 'matrix' format," establish a "structured process" for institutional investors to propose candidates and discuss the board refreshment process.
    - As of mid-2018, the project touted that "over 85 companies have adopted improved processes and increased transparency regarding board quality, diversity and refreshment, and over 35 companies are now disclosing not only the qualifications of their board members, but also details on boardroom gender and racial/ethnic diversity..."
  - CalPERS has been employing letter-writing, majority-voting proposal submission and voting power in a multifaceted campaign to increase board diversity.

Source: 2018 Spencer Stuart U.S. Board Index.

Board Structure

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Board Composition and Refreshment (cont'd)

- Recent spotlight on gender diversity and equity on the board, in executive ranks and beyond:
  - Boards overseeing implementation of enhanced anti-harassment policies, protocols for addressing allegations and employee training.
  - Shareholders introducing new categories of proposals on topics, including combating sexual harassment, making inroads with gender pay-gap proposals and maintaining pressure with board gender-diversity proposals (including to require the inclusion of diverse candidates in director searches).
  - Invigorated policies, public statements and engagement efforts by institutional investors regarding gender diversity on boards and in management.
    - State Street Fearless Girl campaign, featuring adverse votes at 500+ companies in each of 2017 and 2018, as well as announced policy beginning in 2020 to vote against the entire nominating committee slate of a company with an all-male board that has not "engaged in successful dialogue on State Street Global Advisors' board gender diversity program for three consecutive years."
    - BlackRock and Vanguard have also prioritized gender diversity on boards and in leadership.
  - Proxy advisors developing/tightening policies on board gender diversity.
    - *E.g.*, in its updates for 2019, ISS announced that it will begin providing for adverse recommendations (after a year's grace period—effective February 1, 2020) for the nominating committee chair (or other directors case-by-case) at Russell 3000/S&P 1500 companies with no female directors, considering mitigating factors, including a near-term commitment to appointing at least one female director, the presence of a female director at the prior annual meeting and other relevant factors.
  - On the legislative front, the California Governor signed the first U.S. state law mandating quotas for women on boards—however, given potential legal challenges, its impact remains to be seen.
  - Concerns about impact of activist hedge fund campaigns on gender diversity of management/boards (although selected dissidents putting forth diverse slates in alignment with institutional investors' focus).

Board Structure

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Observations

- There is no one structure that is suitable for all public-company boards.
- Recent studies rebut the proposition that classified boards are associated with lower firm value and inferior outcomes for shareholders; they conclude that, to the contrary, staggered boards enhance long-term value.
- The board should have an independent leader, and should decide, based on the circumstances, whether to have separate or combined chair and CEO roles. The board should explain its decision to shareholders, and, if the roles are combined, should appoint a strong lead independent director.
  - Board leadership structure remains an area in which major institutional shareholders have shown flexibility where a company conducts effective outreach.
- The composition of a board should reflect a complementary diversity of thought, background, skills, experiences and tenures. The board should develop a system for identifying diverse candidates, including women and minority candidates, and for effectively integrating new members into the board dynamic.
- Board composition also should reflect a range of tenures. The board should consider whether policies such as a mandatory retirement age or term limits are appropriate, but board refreshment should be tempered with the understanding that age and experience can bring wisdom, judgment and knowledge.
  - Substantive director evaluation and re-nomination decisions will serve better than arbitrary policies.
- A substantial majority of the board should be independent. The board should consider all relevant facts and circumstances when evaluating independence.
  - Long-standing board service should not by itself disqualify a director from being considered independent.
- Conveying to shareholders the composition, quality and involvement of the board, including through annual proxy statement disclosure and other means, remains important.
  - Shareholders are also increasingly examining director selection and nomination processes.
- The board should evaluate the performance of directors, the full board and committees on a continuing basis.

Director Elections and Other Voting Issues

Reform and Disintermediation of Proxy Advisory Firms

- Major institutional investors have established significant proxy departments and/or guidelines, making decisions independent of ISS and Glass Lewis.
- Governance codes such as the ISG Framework are designed to operate independently from proxy advisors.
- Regulatory and legislative activity has also gained momentum.
  - SEC Staff regulatory guidance (Staff Legal Bulletin No. 20):
    - Confirms that rote outsourcing of voting discretion to proxy advisory firms without engaging in ongoing and active oversight is inconsistent with investment adviser's fiduciary duties to clients.
    - Rejects notion that proxy advisory firm recommendations fall outside ambit of proxy rules and confirms that furnishing of proxy voting advice generally constitutes a "solicitation."
    - Confirms that investment advisers are not required to vote every proxy or at every meeting; instead, advisers and clients have flexibility to determine the extent to which they exercise proxy voting authority (if at all).
    - Clarifies that, where an investment adviser does vote, it must adopt—and follow—reasonably designed protocols to ensure that proxies are in fact voted in the best interests of its clients.
    - Requires proxy advisory firms to make specific, non-generic disclosure of certain conflicts.
  - In 2017, the House passed (and the Senate in 2018 held hearings on) the "Corporate Governance Reform and Transparency Act of 2017," which would mandate registration and disclosure by proxy advisory firms, as well as afford companies the right to review and comment on draft recommendations. (Similar proposals had appeared in the "Financial CHOICE Act of 2017," which the House also had passed.)
  - In 2018, six Republican Senators sent letters to ISS and Glass Lewis requesting information regarding their eligibility for exemption from the proxy rules, accuracy of reporting and potential conflicts of interests.

Director Elections and Other Voting Issues

(cont'd)

Reform and Disintermediation of Proxy Advisory Firms (cont'd)

- Ahead of a November 2018 SEC staff roundtable on the proxy process, the Division of Investment Management staff withdrew two 2004 no-action letters that in practice have facilitated reliance by investment advisors on the recommendations of proxy advisors (but the staff left in place SLB No. 20, which draws on those letters).
- Also in anticipation of the roundtable, a bipartisan group of six Senators introduced the "Corporate Governance Fairness Act" to "help protect investors, strengthen corporate governance, and ensure proper oversight of proxy advisory firms" by requiring registration with the SEC under the Investment Advisers Act of 1940 (with exclusions for smaller firms) and periodic SEC examinations (including reviews of conflicts of interest policies and knowing false statements to clients) and consultations with stakeholders regarding additional investor protections.
- Following the roundtable, SEC Chairman Clayton commented that "[f]or proxy advisory firms, I believe there is growing agreement that some changes are warranted." Moreover, he stated that issues regarding proxy advisory firms "will not improve on their own with time, and I intend to move forward with the [requested] staff recommendations, prioritizing those initiatives that are most likely to improve our markets for our long-term Main Street investors."
- Demonstrating building momentum toward potential legislative or regulatory reform in this area, the Senate Committee on Banking, Housing, and Urban Affairs in December 2018 held a full committee hearing that featured debate over and continued scrutiny of the role of proxy advisors. (The hearing additionally addressed the shareholder proposal process and retail shareholder participation, topics also covered at the roundtable.)
- In February 2019, over 300 companies joined the Nasdaq in signing a letter urging the SEC to regulate proxy advisory firms, as well as modernize the shareholder proposal process, streamline shareholder communications and update the proxy voting process.

Director Elections and Other Voting Issues

(cont'd)

Shareholder Proxy Access

- Under proxy access, a company must include in its proxy statement and on its proxy card director nominees proposed by shareholders or groups of shareholders that meet specified share-ownership and other criteria.
- In light of large companies' widespread implementation of proxy access, the number of such proposals on company ballots continued to wane in 2018.
  - While some companies avoided a vote by settling with proponents, a total of 39 proxy access shareholder proposals went to a vote in 2018:
    - 12 proposals to adopt proxy access (averaged 39% support), with three passing.
    - 27 proposals to amend proxy access right (averaged 28% support), with none passing.
  - Shareholder proponents continued attempting to combat "proxy access lite" through proposals seeking to amend existing proxy access provisions or otherwise restrict companies from adopting proxy access provisions that deviate from CII and pension funds' "best practices" (*e.g.*, no/higher group caps, no re-nomination restrictions, counting of loaned shares).
    - But companies appear to be able to include reasonable restrictions and defeat proxy access structures without group caps.
  - Hundreds of U.S. companies, including 73% of domestic S&P 500 companies, have adopted proxy access.
    - Typical terms include: 3%/three-year eligibility formula; capping the number of shareholders who may form a group to meet the ownership threshold, typically at 20; and capping the number of nominees, most often at 20% of the board with a minimum of two.
- November 2016 marked the first U.S. proxy access campaign (but the nominee later withdrew after the company had rejected the nomination as violating the proxy access bylaw provision regarding control intent).
- A second proxy access campaign is underway, having been initiated in December 2018, when a co-founder and former director of a company nominated (via a trust) a hedge fund manager to the board pursuant to the company's proxy access bylaw.

Source: ISS; SharkRepellent.

Director Elections and Other Voting Issues

(cont'd)

One Share, One Vote

- Along with IPO-company governance more generally, multiple-class stock voting structures—with multiple classes of stock having differential voting rights—are receiving scrutiny from governance industry participants.
    - A number of notable IPOs featuring such structures thrust the topic to the fore.
- In its updates for 2017, ISS changed its policy on unilateral bylaw/charter amendments, adding potential adverse director recommendations at companies completing IPOs with multi-class capital structures in which the classes have unequal voting rights.
    - Along with other factors, ISS will take into consideration the presence of "reasonable" sunset provisions.
- ISG Corporate Governance Framework for U.S. Listed Companies includes the principle that "[s]hareholders should be entitled to voting rights in proportion to their economic interest."
- In the face of mounting pressure from institutional investors following several high-profile multi-class IPOs, which in some cases featured no-vote shares, index providers S&P and FTSE Russell took steps to exclude companies with certain such structures from their indexes.
    - Actions met criticism from BlackRock for potentially limiting "index-based clients' access to the investable universe of public companies and depriv[ing] them of opportunities for returns."
    - SEC Commissioner Robert Jackson also expressed concern with the "blunt tool" of banning dual-class companies from indexes, instead calling on stock exchanges to require sunsets on such structures.
    - MSCI decided instead to launch separate indexes that will "account for unequal voting structures."
- In late 2018, CII petitioned the NYSE and Nasdaq to require companies that go public with multiple-class voting structures to sunset the provisions within seven years (or extend by a shareholder vote).
- Critics are also pushing for enhanced disclosure around insider ownership and voting power.
- Renewed interest in tenured voting and other means for making public markets attractive to founders and innovation, and for resisting short-term pressures.

Director Elections and Other Voting Issues

(cont'd)

Observations

- Further SEC or legislative action is necessary to increase accountability of proxy advisory firms, resolve conflicts of interests and address lack of transparency.
  - Pending definitive action, investors should exercise independent, informed judgments on voting matters and engage constructively with issuers in a case-by-case, pragmatic manner.
- Despite increased pressures, companies should carefully evaluate their own circumstances before adopting one-size-fits-all approaches to proxy access.
  - A company's appropriate framework, if any, should be tailored to complement other corporate governance practices that are already in place and limit potential for abuse or use by those seeking control of the company.
  - Given potential for disruptive effects, care should be taken to ensure that any proxy access regime promotes only the interests of shareholders who have had a meaningful interest in the company for a meaningful period of time, and contains reasonable procedural, eligibility and disclosure safeguards.
- In determining whether a dual-class voting structure is appropriate, a company going public should consider company-specific factors, including the extent to which the structure may be valuable in preserving a "startup culture" and resisting short-term pressures.

Part III: Shareholder Activism

- Shareholder Activism Trends
- Proxy Contests and Settlements
- Rule 14a-8 Shareholder Proposals
- Corporate Social Responsibility

Shareholder Activism Trends

Current State of Play

- The threat of activism remains high, and has become a global phenomenon.
- Activist AUM remain at elevated levels, encouraging continued attacks on large, successful companies in the United States and abroad. In many cases, activists have been taking advantage of recent stock market declines to achieve attractive entry points for new positions. These trends have been highlighted in several recent media reports, including in the WSJ and Bloomberg.
- While the robust M&A environment of much of 2018 has recently subsided, deal-related activism remains prevalent, with activists instigating deal activity, challenging announced transactions (*e.g.*, the "bumpitrage" strategy of pressing for a price increase) and/or pressuring the target into a merger or PE deal with the activist.
- "Short" activists, who seek to profit from a decline in the target's market value, remain highly aggressive in both the equity and corporate debt markets. In debt markets, we have also recently seen a rise in "default activism," where investors purchase debt on the theory that a borrower is already in default and then actively seek to enforce that default in a manner by which they stand to profit.
- Elliott Management was the most active and in many cases aggressive activist of 2018. The WSJ noted that Elliott had publicly targeted 24 companies in 2018, with Icahn and Starboard as runners-up with nine each.
- Enhanced ESG disclosure remains a topic of great interest to institutional investors and the corporate governance community. Activists have sought to enhance their profile among governance professionals, passive institutional investors and ESG-oriented investors (*e.g.*, JANA Partners' "impact investing" fund).
- A new study by Ed deHaan, David Larcker and Charles McClure, "Long-Term Economic Consequences of Hedge Fund Activist Interventions," has found that on a value weighted basis, long-term returns are "insignificantly different from zero."
- The recent *In re PLX Technology Inc.* Delaware Chancery case underscores that activists who join boards must adhere to the same fiduciary duties as other directors and place the interests of the company and all stockholders above any personal, fund-specific or short-sighted interests.

Shareholder Activism Trends

(cont'd)

Targets

- The activism surge continues:
  - Activists publicly targeted 922 companies worldwide in 2018 (856 in 2017), including a record 491 U.S. companies—and significant activist activity takes place privately.
    - Activists launched another 155 short campaigns worldwide (189 in 2017).
  - Activist campaigns targeting non-U.S. companies have become more commonplace, and meet varied success based, in part, upon local regimes and norms (some of which are changing in the face of activism).
    - Outside of the United States, 431 companies publicly targeted in 2018, with significant activity in Europe, Asia, Australia and Canada.
- No company is immune:
  - Performance is not a defense: over one-third of targets had excess returns relative to the market in the year before announcement of an activist attack, according to a January 2015 J.P. Morgan study.
  - Size is not a defense: 20% of targets (13% for shorts) in 2018 had a market capitalization of >$10 billion.
  - Activists targeting controlled companies, financial institutions, REITs and others that may once have seemed relatively immune or difficult to catalyze.
  - Target companies may face successive rounds of activism or multiple activists with competing agendas.

Activists

- The past decade has seen a remarkable increase in the amount of funds managed by activist hedge funds and an uptick in the prevalence and sophistication of their attacks on corporations.
- Institutional investors are working with activists both behind the scenes and by co-sponsoring an attack.
- Next-generation funds, PE funds, founders/former executives and other investors are assuming the activist role; activists, in turn, are expanding into PE, E&S and other bridgeable strategies.

Source: Activist Insight; Financial Times; JPMorgan, "The activist revolution," January 2015; The Deal; Bloomberg.

Shareholder Activism Trends

(cont'd)

Selected Activism Strategies and Tactics

- Key strategies:
  - M&A/deal activism: push for merger/sale/divestiture or after announcement seek appraisal, seek higher price, encourage topping bid, try to influence combined company/integration or try to scuttle deal.
  - Operational activism: call for cost-cutting, strategy change, portfolio review or management turnover—often in partnership with potential replacement CEO and/or slate with deep industry experience.
    - Increasingly prominent attacks seeking to replace (or, on occasion, to retain) a company's CEO.
    - Several major funds have converted to more of a merchant-banking approach of requesting board representation to assist a company in improving operations and long-term strategy.
  - Financial engineering/balance sheet activism: demand capital structure change, buyback, special dividend or tax optimization (tax overhaul plan expected to provide catalysts).
  - Governance (and, more broadly, ESG) activism: ESG issues offer levers for activists to compel events at targets, and governance activism facilitates economic activism (*e.g.*, by eroding takeover defenses).
  - Short activism: short position combined with negative public campaign, white papers, etc.
- Notable activist tactics:
  - Continuing to launch playbook "surprise-wolf-pack"/"shock-and-awe" attacks.
  - Innovating—and pushing boundaries—with approaches (*e.g.*, economic arrangements among funds; partnering with hostile bidder; calling special meetings for "referendum"; hybrid proxy fight/vote-no campaign; hybrid PE/activism; "matched positions" in transactions; net-short debt activism and other default activism by debt investors; holding out activism as option; "white-squire" activism).
  - Experimenting with fundraising strategies (*e.g.*, special purpose fund for investment in a single target).
  - Employing new methods of courting retail voters (*e.g.*, websites, video, social media, webcasts, other technology) and redoubling engagement efforts with institutions and proxy advisors.

Source: news articles.

Proxy Contests and Settlements

Proxy Contest Trends

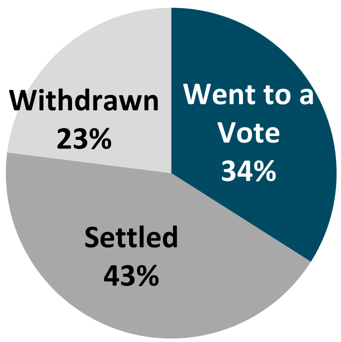
- Insights from recent proxy fights include:
  - Engagement efforts can help build credibility for the board and management and enable them to hear what long-term shareholders want.
  - Failure to have successfully engaged with major investors and understand their opinion of the company's operations and strategy has resulted in proxy fights that were lost or won by such a narrow margin that management change quickly followed.
  - An activist with a multibillion-dollar investment is unlikely to sell the positon after a close proxy fight and will continue to pressure the company on issues raised in the fight. Moreover, an activist that has narrowly "lost" a proxy fight will likely contest preliminary results.
  - An activist with a track record of success in urging change in long-term strategy rather than financial engineering can gain support from proxy advisors and major institutional investors.
  - A large retail shareholder base does not guarantee company success in a proxy fight.
  - Massive sums are being spent by both companies and activists in waging proxy battles.
  - Activists can make substantial inroads/attain board seats with relatively small percentage stakes, so long as they have institutional support.
  - Activist overreach, including through demands for board control, may backfire with proxy advisors and shareholders and fuel target pushback. Activists ultimately may pare back slate/settle in anticipation.
  - M&A deals are more likely to be successfully received in the face of an activist challenge when companies can contextualize them within a longer-term plan to create value.
  - Accommodating activist demands through settlement may not always be what the board considers to be in the best interests of all shareholders; companies must carefully make this determination.
    - Hedge fund representatives as director nominees may present particular obstacles to settlement.

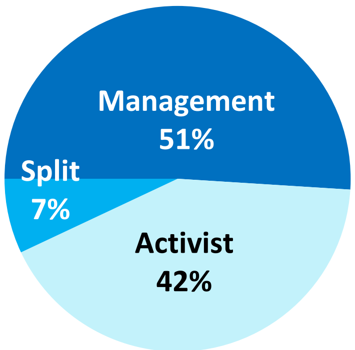
Proxy Contests and Settlements

(cont'd)

Proxy Contest Outcomes

Proxy Campaigns (2010–2014)	Winner After Vote

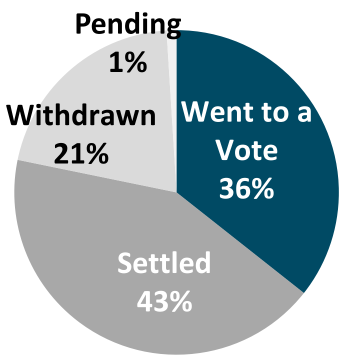




Total: 453 Proxy Fights

Total: 152 Votes (77 Management Wins, 64 Activist Wins, 11 Splits)

Proxy Campaigns (2015–2018)	Winner After Vote



Total: 396 Proxy Fights

Total: 141 Votes (79 Management Wins, 57 Activist Wins, 5 Splits)

Source: SharkRepellent accessed January 30, 2019. 2018 data separately counts proxy fights/wins by one dissident against a single fund family. Includes all proxy fight types. Percentages may not total 100% due to rounding.

Proxy Contests and Settlements

(cont'd)

Settlements with Activists

- Many companies choose to settle with an activist, if it can be done on acceptable terms, to avoid a public fight and an uncertain outcome.
  - The question of whether to settle will depend on a number of factors, including:
    - The activist's agenda.
    - The company's likelihood of success if the fight is taken to a stockholder vote.
    - Whether there is common ground that could form the basis of a settlement.
    - Whether the activist is willing to be reasonable and seek a compromise.
- Topics typically addressed in a proxy fight settlement include:
  - Board representation: activist nominees may be affiliated with activist, independent or a combination.
    - Agreement may cover committee representation or formation of new board committees.
  - Standstill: activist agrees to drop the proxy fight and be bound by a standstill for a period of time.
  - Voting/support commitments: *e.g.*, activist commitment to vote in favor of board slate that includes activist nominees.
  - Situation-specific business or policy commitments: *e.g.*, commitments on capital allocation, exploration of strategic alternatives or implementation of cost-cutting measures.
  - Confidentiality and use of information given to activist's board nominees.
  - Non-disparagement: typically mutual agreement that neither party will publicly criticize/disparage the other.
  - Any reimbursement of activist expenses.
- In the recent *Sarissa* case, the Delaware Chancery Court ordered specific performance of an oral activist settlement agreement that included the addition of two dissident directors to the company's board.

Rule 14a-8 Shareholder Proposals

- Increasing calls for modernization of Rule 14a-8 shareholder proposal process (*e.g.*, Business Roundtable; Chamber of Commerce; Financial CHOICE Act of 2017; H.R. 5756).
  - Provisions under spotlight include eligibility, resubmission and disclosure requirements.
  - Also focus on SEC no-action process for exclusion of proposals from proxies.
  - Opponents to reform, such as CII in an August 2017 letter to the SEC, cite "improvements to corporate governance and corporate disclosure that have resulted from the current rule."
- In November 2017, the SEC Division of Corporate Finance provided guidance on excluding certain Rule 14a-8 shareholder proposals (Staff Legal Bulletin No. 14I).
  - *"Ordinary Business" Exclusion*: noting that often involves difficult judgment calls, SLB 14I expresses that these judgments are better made by the company's directors and states the expectation that no-action requests submitted under Rule 14a-8(i)(7) will include discussion of the board's analysis of the issues.
  - *"Economic Relevance" Exclusion*: going forward, the SEC Staff will give more weight to the 5% test in evaluating a proposal's significance to the company's business, but, as with the above, expect that no-action requests under Rule 14a-8(i)(5) will include a discussion of the board's analysis.
  - SLB 14I also sets forth documentary requirements for shareholder proposals submitted by third-party representatives and provides guidance as to when graphs and images may be excluded under Rule 14a-8.
- The Corporate Finance Staff offered further guidance on SLB No. 14I, including on enhancing the utility of its contemplated board analysis and the scope of the exclusions, in the October 2018 SLB No. 14J.
- Following the 2018 proxy process roundtable, SEC Chair Clayton commented that he "believe[s] it is clear that we should consider reviewing the ownership and resubmission thresholds for shareholder proposals," and consider other factors demonstrating that the proponent's interests are aligned with long-term investors'.
- In its updates for 2019, ISS added policies intended to quell the burgeoning practice of companies requesting that shareholders ratify existing charter or bylaw provisions, often to the exclusion of a shareholder proposal on the same topic (*e.g.*, to lower the threshold for shareholders' ability to call a special meeting).

Corporate Social Responsibility

Overview

- Corporate social responsibility is a major concern for companies and boards, as well as for investors.
  - Growing prominence of environmental and social (“E&S”) matters with institutional investors.
    - *E.g.*, BlackRock CEO Larry Fink’s 2018 governance letter stating that “[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society,” which theme is further developed in his 2019 letter “Purpose & Profit.”
    - Impact of DOL Field Assistance Bulletin No. 2018-01, which clarifies previous guidance for ERISA-covered private-sector employee benefit plans regarding proxy voting, shareholder engagement and economically targeted investments in the context of ESG initiatives, remains to be seen.
  - Rise of E&S-oriented funds and strategies, including assumption of E&S mantle by activist hedge funds.
  - ISS marketing a new “E&S QualityScore” product for rating public companies.
  - Calls for broader E&S disclosure, including focus on sustainability measurement and diversity.
    - *E.g.*, multiple large companies adopting Sustainability Accounting Standards Board standards.
    - In October 2018, two business law professors, supported by entities with over $5 trillion in AUM, filed a petition for rulemaking calling for the SEC to “develop a comprehensive framework requiring issuers to disclose identified [ESG] aspects of each public-reporting company’s operations.”
    - An early 2019 CDI offers guidance on diversity disclosure in the context of director qualifications.
    - Introduction of the Improving Corporate Governance Through Diversity Act of 2019.
  - Expectations rising for companies/CEOs to articulate public positions on and respond to E&S issues (*e.g.*, Fink 2019 letter to CEOs: “the world needs your leadership”).
  - Market participants reexamining the concept of corporate “purpose” (*e.g.*, Fink 2018 and 2019 letters, UK Corporate Governance Code) and questioning shareholder-value maximization as the sole corporate goal.
  - Enactment of benefit corporation laws by Delaware and some 30 other states.

Source: WSJ.

Corporate Social Responsibility

(cont'd)

E&S Shareholder Proposals

- Through late October 2018, 481 E&S Rule 14a-8 shareholder proposals filed, including:
  - Environment/climate change (121) and sustainability (29);
  - Political issues (95);
  - Human rights (40), labor (40) and workplace diversity (32);
  - Board diversity (29); and
  - E&S link to executive pay (22).
- The withdrawal rate for full-year 2018 (48%) represents a substantial increase over that for 2017 (37%), and average support for proposals on the ballot hit a record high (25%), while abstentions continued to drop (3%).
  - Settled proposals addressing diversity/parity and sustainability/climate change bolstered withdrawal rate.
  - Twelve E&S shareholder proposals received majority support (11 passed).
- Heightened activism around climate change, particularly in the context of the late-2015 Paris Climate Accord and the Trump administration's deregulatory stance.
  - Eight environment/climate/sustainability proposals received majority support in 2018 (seven passed).
- Despite recent decreases in proposals, continued focus on lobbying and political-spending disclosure following the 2016 Presidential election and 2018 midterms (as well as Supreme Court's 2010 *Citizens United* decision).
- Board diversity remains in the spotlight despite a decline in proposals from full-year 2017, with institutional investors using engagement and voting power to express dissent.
- Headline-capturing social issues are also resonating with shareholders, with two gun safety proposals and two opioid-crisis proposals having received majority support in 2018.
- Look for proponents' testing of various strategies in support of ESG proposals (*e.g.*, individual use of exempt solicitations on Form PX14A6G to communicate views; litigation to enjoin mailing of proxy excluding proposal).

Source: ISS.

Corporate Social Responsibility

(cont'd)

ESG and Sustainability: The Board's Role

- Be aware that ESG and sustainability have become major, mainstream governance topics that encompass a wide range of issues, and consider how the company presents itself with respect to these matters.
- Recognize that the role of the board in these areas is generally one of partnership with management and appropriate oversight, rather than unilateral board-level mandates.
- Work with management to identify which ESG issues are most pertinent to the company's business and key stakeholders and to oversee implementation of appropriate policies and processes for assessing, monitoring and managing material ESG risks and opportunities.
- May want to receive regular briefings on relevant ESG matters and the company's approach to handling them.
- Appreciate that in some industries and sectors, sustainability and other ESG initiatives may have clear (and positive) impacts on a company's bottom line and may provide business benefits and competitive advantages over peers; in other businesses and contexts, the impact may not be immediately clear, certain or measurable.
- As the public conversation on the role of companies in addressing ESG issues continues to evolve, consider how the board's risk oversight role specifically applies to various ESG-related risks.
- Be informed about the company's approach to dealing with investor requests for ESG-related engagement, external disclosure and reporting of the company's approach, response and progress on these matters.
- If faced with an activist investor sounding ESG-linked themes, leverage prior preparedness and apply best practices to respond. If faced with a shareholder proposal addressing these matters, have an appropriate governance process for considering the proposal, its business implications and the company's options.
- Not every director or member of senior management can be an "ESG expert," but directors and appropriate company personnel should educate themselves on the key ESG issues facing the company and be able to converse comfortably on those issues that matter or present significant risks.