Wachtell, Lipton, Rosen & Katz

Nominating and Corporate Governance Committee Guide

2023

About This Guide

This Nominating and Corporate Governance Committee Guide (this "Guide") provides an overview of the key rules applicable to nominating and corporate governance committees of listed U.S. companies and practices that nominating and corporate governance committees should consider in the current environment. This Guide outlines a nominating and corporate governance committee member's responsibilities, reviews the composition and procedures of the nominating and corporate governance committee and considers important legal standards and regulations that govern nominating and corporate governance committees and their members. This Guide also discusses some of the important matters that nominating and corporate governance committees may be called upon to decide or recommend an approach. Although generally geared toward directors who are members of a public company nominating and corporate governance committee, this Guide is also relevant to members of a nominating and corporate governance committee of a private company, especially if the private company may at some point consider accessing the public capital markets.

A few necessary caveats are in order. This Guide is not intended as legal advice, cannot take into account particular facts and circumstances and generally does not address individual state corporation laws. That said, we believe that this Guide will offer directors sound guidance on general rules, practices and considerations relevant to the nominating and corporate governance committee.

The annexes to this Guide include sample committee charters and other policies and procedures. They are included because we believe them potentially useful to the nominating and corporate governance committee in performing its functions. However, it would be a mistake to simply copy published models. The creation of charters, policies and procedures requires experience and careful thought, taking a company's specific circumstances into account. It is not necessary that a company have every guideline and procedure that another company has in order to be "state of the art" in its governance practices. When taken too far, an overly broad committee charter can be counterproductive. For example, if a charter explicitly requires review or other action in specified circumstances, and the nominating and corporate governance committee has not taken that action, that failure to comply with its own charter may be considered evidence of lack of due care. Each company should tailor its nominating and corporate governance committee charter and other written policies and procedures to what is necessary and practical for that particular company.

This Guide was prepared by Trevor S. Norwitz, Sabastian V. Niles, Carmen X.W. Lu, Anna M. D'Ginto and Charles C. See. To the extent this Guide expresses opinions on corporate governance matters, these do not necessarily reflect the views of Wachtell, Lipton, Rosen & Katz or its partners as to any particular situation. We would welcome any feedback readers may have on this Guide, either as to specific items or regarding its general layout and utility so that we can make future editions even more useful. Please pass any comments you may have on to Trevor Norwitz (at tsnorwitz@wlrk.com) or Sabastian V. Niles (at svniles@wlrk.com) or to any other contacts you may have at the firm.

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INTRODUCTION

The nominating and corporate governance committee goes by different names: the Securities and Exchange Commission (the "SEC") refers to the "nominating committee," the New York Stock Exchange (the "NYSE") to the "nominating/corporate governance committee," and Nasdaq to the "nominations committee."[1] Although traditionally known simply as the nominating committee, the increasing incidence of "corporate governance" in the title reflects the wider scope of responsibilities this committee has assumed in recent years. Once focused almost exclusively on identifying and selecting candidates for the board of directors, the nominating and corporate governance committee now typically assumes a leading role in a broad array of corporate governance matters, including the development and implementation of corporate governance guidelines, establishment of director criteria and review of candidates, evaluation of the performance of the board itself and its committees, consideration of shareholder proposals and, in some cases, management succession planning. Sometimes determination of non-employee director compensation is handled by the nominating and corporate governance committee as well, although in other cases this falls within the purview of the compensation committee.

The nominating and corporate governance committee is one of three customary standing committees, along with the audit committee and the compensation committee, required by the NYSE to be composed entirely of independent directors. Until relatively recently, considerable public attention had been paid to the audit committee in the wake of the financial scandals of the early 2000s, and then to the compensation committee in light of the options backdating and other controversies regarding executive compensation. Because it is less regulated and had received less attention than those committees, the nominating and corporate governance committee had sometimes been thought of as the "third" of the three standing committees. But this has changed. With the heightened focus on corporate governance, and a steady push by shareholder rights activists and proxy advisory services to enhance "shareholder rights" and conform to "best practices," the role of the nominating and corporate governance committee has become far more prominent in recent years, and we expect it will play a central role in the years to come.

In recent years, the role of corporations in society, and in particular the degree to which companies should focus on environmental, social and governance ("ESG") factors and the implications of such factors on their businesses has been the subject of dramatically increased attention and debate, particularly in the wake of the Covid-19 pandemic. The growth of ESG has also significantly elevated the importance of the nominating and corporate governance committee, which is of course central to the "G" component of ESG concerns and often plays a

[1] *See, e.g.*, Item 407(c) of Regulation S-K; NYSE Listed Company Manual, Rule 303A.04; Nasdaq Listing Rule 5605-6(e)(B).

leading role in the "E" and "S" components as well, and is increasingly tasked with overseeing ESG at the board level.

In simplest terms, just as the audit committee has primary responsibility to ensure that the company's financial policies and practices are appropriate, and the compensation committee has primary responsibility to ensure that the company's compensation policies and practices are appropriate, so too the nominating and corporate governance committee has primary responsibility to ensure that the company's corporate governance and nominations policies and practices are appropriate for the company.

The standards governing the composition and operations of the nominating and corporate governance committee are in many respects not as specific or as rigorous as those applicable to the audit and the compensation committees. While SEC rules apply to all listed companies, most of the standards relevant to the nominating and corporate governance committee are to be found in the applicable stock exchange listing standards. Listing standards applicable to the nominating and corporate governance committee are different for the NYSE and Nasdaq, subtly or significantly, depending on the issue.

The landscape within which the nominating and corporate governance committee operates is always changing. The panoply of positions taken and policies adopted by the proxy advisory service firms, large institutional investor groups and, to a lesser degree, other shareholder rights activists are constantly evolving and shifting. Members of nominating and corporate governance committees should be familiar with these policies and positions, which, while not binding on companies, have a significant impact on corporate governance practices.

This Guide is organized into three parts. Part I focuses on the "corporate governance" function of the nominating and corporate governance committee; Part II turns to its "nominating" role; and Part III addresses the committee's basic organization and procedures.

PART ONE:

THE "CORPORATE GOVERNANCE" FUNCTION OF THE NOMINATING AND CORPORATE GOVERNANCE COMMITTEE

I. The Purpose of Corporate Governance

The term "corporate governance" encompasses a broad range of legal and non-legal principles and practices that, in combination, establish the rights, powers and obligations of the various stakeholders of a company. Although corporate governance principles and practices most directly regulate the relationships among a company's shareholders, board of directors and management, they also affect all of a company's stakeholders, including employees, customers, suppliers and creditors. Corporate governance can be seen as a means to facilitate the allocation of power and the division of responsibility among the company's stakeholders: the company's shareholders provide capital, elect the Board and approve certain major decisions and transactions; the board of directors is elected by shareholders to oversee management and guide the direction of the company; and senior managers are responsible for the day-to-day operations of the company.

At its core, the proper goal of corporate governance is creating sustainable value. Although the governance landscape has been heavily influenced by shareholder activists, who are sometimes driven by short-term incentives, a "new paradigm" has emerged, which aims to recalibrate the relationship between corporations and investors to resist short-termism and facilitate long-term investment and sustainable value creation. The governance structure and policies that will best achieve this goal are as varied as are companies themselves. A board should tailor its corporate governance decisions to the company it serves, bearing in mind factors such as the unique circumstances of the company and the culture and dynamics among the principal stakeholders. We believe that most decisions regarding corporate governance are ideally determined by a company's directors who have the best information to evaluate these factors, who best understand the company holistically and who are ultimately responsible for the results of these decisions as the only group of stakeholders subject to fiduciary duties.

In this respect, it is important for the nominating and corporate governance committee to resist pressure simply to equate "shareholder-friendly" corporate governance policies with "good" corporate governance policies or to substitute the judgment of proxy advisory firms or activist investors for its own. For many years, institutional investors, hedge funds and activist investors made considerable strides in taking the shareholder-centric model of corporate governance from the fringe to the mainstream, advocating uniform adoption of so-called "best practices." However, such "best practices" may not be best for all companies or shareholders. Shareholders have very different objectives and time horizons. Some shareholders, including many activist investors and hedge funds, are looking to maximize their returns over a short period, while others, such as institutional investors and index funds, generally have longer-term objectives. Others, such as union pension funds, may have special interests not shared by the general body of shareholders. Institutional investors are themselves intermediaries for the ultimate beneficial owners of shares, and the interests of decision-makers at those institutions are often not entirely aligned with the interests of those ultimate beneficiaries. Moreover, it has always been well understood that corporations exist within a complex ecosystem of mutual dependency with many stakeholders, including employees, suppliers, customers, partners and the broader communities in which they operate, making necessary contributions to the success of the enterprise and being dependent on that success in turn. The recent focus on ESG, sharpened by

the Covid-19 pandemic itself, has emphasized the need for corporations to be run for the long-term value creation of all stakeholders, and not only short-term shareholder interests.

Empowering shareholders at the expense of the board will not necessarily lead to better performance and more efficient management of corporations, and the optimal corporate governance structure for one company may not be the optimal corporate governance structure for another company. The nominating and corporate governance committee must therefore remind itself of the fundamental goal of corporate governance and make its own determination as to the proper corporate governance for the company.

Directors must exercise this judgment in a changing corporate governance landscape defined by increasing direct shareholder engagement and frequent implementation by companies of shareholder proposals. Companies and institutional investors now dialogue more regularly on corporate governance and strategic matters than they have ever done before. Many "best practices" long advocated by shareholder groups—including say-on-pay, the dismantling of shareholder defenses, majority voting in director elections and the declassification of boards—have been codified in rules and regulations or voluntarily adopted by a majority of S&P 500 companies. As institutional shareholders and activists advocate new "best practices" and utilize new approaches in engaging companies and in asserting their agendas, directors must strive to continue to act steadfastly in the best interests of the corporation and all of its shareholders. Under the emerging new paradigm for corporate governance, which emphasizes the responsibility and accountability of asset managers to their beneficiaries, many of whom are long-term holders such as individual investors whose retirement and long-term savings are managed by such funds, leading institutional investors have said that they will support long-term investment and value creation by more active engagement and reducing the degree to which they outsource corporate governance decisions to proxy advisory firms like Institutional Shareholder Services Inc. ("ISS") and activist hedge funds. A number of these institutional investors have significantly expanded their governance departments, to facilitate in-house evaluation of governance and strategy.

As this new paradigm has gained acceptance, efforts have increased to crystalize and memorialize its key tenets, resulting in the publication of *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth* published by the World Economic Forum's International Business Council,[2] the *Commonsense Principles of Corporate Governance 2.0* released by a group of 21 executives of leading companies and institutional investors,[3] the

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[2] International Business Council of the World Economic Forum, *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth* (September 2016), http://www.wlrk.com/docs/thenewparadigm.pdf.

[3] *Commonsense Principles of Corporate Governance 2.0* (October 2018), https://www.governanceprinciples.org/wp-content/uploads/2018/10/CommonsensePrinciples2.0.pdf (the 21 executives included: Tim Armour, Capital Group; Mary Barra, General Motors Company; Edward Breen, DowDuPont; Warren Buffett, Berkshire Hathaway Inc.; Jamie Dimon, JPMorgan Chase; Mary Erdoes, J.P. Morgan Asset Management; Larry Fink, BlackRock; Alex Gorsky, Johnson & Johnson; Mark Machin, CCP Investment Board; Lowell McAdam, Verizon; Bill McNabb, Vanguard; Brian Moynihan, Bank of America; Ronald O'Hanley, State Street Global Advisors; James Quincey, Coca-Cola; Brian Rogers, T. Rowe Price; Ginni Rometty, IBM; Charlie Scharf, BNY Mellon; Randall Stephenson, AT&T; David Taylor, Procter & Gamble; Jeff Ubben, ValueAct Capital; and Theresa Whitmarsh, Washington State Investment Board).

Business Roundtable's *Principles of Corporate Governance*,[4] the Investor Stewardship Group's ("ISG") *Stewardship Principles*,[5] the British Academy's *Principles for Purposeful Business*,[6] and the World Economic Forum's *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution*.[7] In August 2019, the Business Roundtable embraced the "new paradigm" in a statement signed by 181 CEOs, including of some of the largest U.S. public companies, in which the signatories disavowed the principles of "shareholder primacy" in favor of a "modern standard for corporate responsibility" under which companies are led for the benefit of all stakeholders—customers, employees, suppliers, communities and shareholders.[8] The new paradigm makes ever more important the role of the nominating and corporate governance committee and, relatedly, a well-functioning board of directors. For example, a cornerstone of the new paradigm is its emphasis on active board participation in strategic planning and companies' transparent articulation of those long-term strategies.[9] Other crucial elements that the nominating and corporate governance committee should help the board to shape and formulate include: directly engaging with management and, where appropriate, directors who do not sit on the nominating and corporate governance committee, on issues and concerns that affect long-term value; developing a thoughtful and well-communicated approach to corporate governance; and, increasingly important, devoting appropriate attention to ESG issues and sustainability.

Large institutional investors have embraced the new paradigm. In a series of letters and publications, Vanguard has emphasized its commitment to bringing a long-term perspective to its

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[4] Business Roundtable, *Principles of Corporate Governance* (August 2016), https://businessroundtable./sites/default/files/Principles-of-Corporate-Governance-2016.pdf.

[5] *The Stewardship Principles*, INVESTOR STEWARDSHIP GROUP (July 2020), https://isgframework.org/wp-content/uploads/2020/07/ISG_Stewardship_Principles.pdf. Investor co-founders and signatories include U.S. Asset Managers (BlackRock; MFS; State Street Global Advisors; TIAA Investments; T. Rowe Price; Vanguard; ValueAct Capital; Wellington Management); U.S. Asset Owners (CalSTRS; Florida State Board of Administration (SBA); Washington State Investment Board); and non-U.S. Asset Owners/Managers (GIC Private Limited (Singapore's Sovereign Wealth Fund); Legal and General Investment Management; MN Netherlands; PGGM; and Royal Bank of Canada (Asset Management)). *See* Wachtell, Lipton, Rosen & Katz, *Promoting Long-Term Value Creation – The Launch of the Investor Stewardship Group (ISG) and ISG's Framework for U.S. Stewardship and Governance* (January 31, 2017), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25508.17.pdf. For a discussion of the various frameworks that have arisen, *see* Wachtell, Lipton, Rosen & Katz, *A Synthesized Paradigm for Corporate Governance, Investor Stewardship, and Engagement* (April 4, 2017), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25546.17.pdf. Other institutions are also involved in combatting short-termism. For example, FCLTGlobal, a not-for-profit organization, advocates for a longer-term focus in business and investment decision-making. *See* "Top Global CEOs Agree to Combat Short-Term Patterns in Business," BUSINESSWIRE (March 2, 2018), https://www.businesswire.com/news/home/20180302005092/en/Top-Global-CEOs-Agree-Combat-Short-Term-Patterns.

[6] The British Academy, *Principles for Purposeful Business* (November 2019), https://www.thebritishacademy.ac.uk/sites/default/files/future-of-the-corporation-principles-purposeful-business.pdf.

[7] World Economic Forum, *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution* (December 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/.

[8] Business Roundtable, *Statement on the Purpose of a Corporation* (August 19, 2019), https://opportunity.businessroundtable.org/wp-content/uploads/2020/03/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf.

[9] A recent governance survey of public companies found that 70 percent of boards list oversight of strategy development as one of their goals for major improvement over the next 12 months. National Association of Corporate Directors, *2023 Governance Outlook* 5 (2022).

investments in public companies.[10] Vanguard's Chairman and CEO has highlighted both the value of engagement and relationship-building with corporate leaders and the four pillars that it will consider in evaluating corporate governance policies: board effectiveness, governance structures, appropriate compensation and risk oversight.[11] Other major institutional investors similarly advocate engaging with public company boards and exercising their voting rights as shareholders to promote the principles advocated by the new paradigm.[12]

The current focus on ESG issues—both by their proponents and the nascent "anti-ESG" movement—reflects a further expansion in discussions in academic, political and business circles about the state and fate of capitalism and the broadening perception of the purpose of the corporation beyond shareholder value.[13] As we have written elsewhere, legislative efforts suggest that capitalism may be at an inflection point and others have suggested that only a "responsible capitalism" can survive current public criticism of corporate behavior and governance.[14] For example, in August 2018, Massachusetts Senator Elizabeth Warren introduced the Accountable Capitalism Act, which would make all corporations with $1 billion or more of annual revenue subject to a federal corporate governance regime. Among other things, this regime would mandate that not less than 40 percent of the directors of a U.S. corporation be elected by employees, and that directors must consider the interests of all corporate stakeholders—including employees, customers, suppliers, investors and the communities in which the corporation operates. While this proposal stalled in Congress, it and later efforts, along with the spotlight on employee working conditions during the Covid-19 pandemic, reflect an ongoing perception that corporations are not serving employees and other stakeholders sufficiently and that changes in board composition could promote better governance and economic outcomes.

In January 2021, the World Economic Forum (the "WEF") announced that 61 of the world's largest companies committed to disclosing against the core ESG metrics developed by the WEF and its International Business Council. The WEF's announcement came on the heels of an announcement in November 2020 by the Sustainability Accounting Standards Board and the International Integrated Reporting Council of their plans to merge into a single organization, called the Value Reporting Foundation, to harmonize their sustainability-focused reporting standards. These accelerating efforts to develop standardized, material and comparable ESG metrics demonstrate a recognition that investors are increasingly assessing company performance

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[10] *See, e.g.*, The Vanguard Group, Inc., *Investment Stewardship 2022 Semiannual Report* (2022), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/investment_stewardship_semiannual_report_2022.pdf.

[11] F. William McNabb III, The Vanguard Group, Inc., *An Open Letter to Directors of Public Companies Worldwide* (August 31, 2017), https://about.vanguard.com/investment-stewardship/governance-letter-to-companies.pdf.

[12] *See, e.g.*, State Street Global Advisors, *Stewardship Report 2021* at 7, 10, 13 and 14 (April 2022), https://www.ssga.com/library-content/pdfs/asset-stewardship/asset-stewardship-report-2021.pdf.; BlackRock, Inc., *BlackRock Investment Stewardship Global Principles* 5 (January 2022), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global.pdf.

[13] *See, e.g.*, Colin Mayer, *Prosperity: Better Business Makes the Greater Good* (2018).

[14] *See* Wachtell, Lipton, Rosen & Katz, *Stakeholder Governance and Purpose of the Corporation* (January 19, 2022), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27935.22.pdf; *see also* Bill George, *Responsible Capitalism Will Be the U.S.'s Saving Grace*, FORTUNE (February 26, 2019), http://fortune.com/2019/02/26/kraft-heinz-stock-responsible-capitalism/.

under the new paradigm—a fact that has come through loud and clear in messages from large institutional investors to their portfolio companies, as discussed further below.

As the landscape continues to evolve, the nominating and corporate governance committee can play an important role in helping the board and management stay ahead of the curve.

II. Sources of Corporate Governance Rules and Policies

The main sources of substantive corporate governance rules are state law and stock exchange listing standards. Within these parameters, a company has a fair amount of flexibility in implementing a corporate governance framework and memorializing that framework in its organizational documents. The SEC's rules generally focus on ensuring adequate disclosure rather than compelling any particular governance practice. Of course, requiring disclosure may in itself nudge corporate governance practices in one direction or another. Additionally, corporate governance decisions are increasingly the result not of black-letter legal requirements, but rather of the substantial influence of proxy advisory firms, policies developed by large institutional investor groups and pressure from shareholder activists.

A. State Law and Governance Documents

The corporate governance framework of each company is principally defined by the laws of its state of incorporation and by its organizational documents. State corporate statutes provide some limits on how companies can structure their affairs, many of which are so ingrained that it is difficult to imagine corporate governance in any other way. For example, under Delaware law, each director of a corporation must be a natural person, regardless of what a corporation's organizational documents might say about the matter.[15] However, a significant portion of state corporate statutes simply provide default rules in the absence of any provision in a corporation's organizational documents to the contrary. Delaware in particular prides itself on its enabling statute, which provides few mandatory elements but allows a high degree of private ordering. A number of provisions in the Delaware General Corporation Law (the "DGCL") are prefaced by "unless the certificate of incorporation provides otherwise" or similar phraseology.[16] This leaves the tailoring of a particular corporate governance regime to each individual company in its organizational documents.

Some corporate governance features, such as (in Delaware) classification of the board, must be effected through the company's certificate of incorporation (also known as its charter). This means that shareholder approval is required to adopt such a provision—or to eliminate or amend such a provision. Other corporate governance matters are commonly fleshed out in a company's bylaws, and boards are commonly granted the authority to make, amend or repeal bylaws without shareholder approval. Shareholders generally have the right to amend, adopt or repeal bylaws as well. Other corporate governance policies, especially those that state the company's current position with respect to a governance issue but preserve flexibility to deviate from it in appropriate circumstances, are often best reserved for a company's corporate governance guidelines. These guidelines are typically adopted, and can be changed, by the board.

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[15] 8 Del. C. § 141(b).

[16] *See, e.g.*, 8 Del. C. §§ 141(b) (number of directors), 141(k)(1) (grounds for removal of directors) and 211(b) (election of directors by written consent).

B. SEC Requirements

The SEC regulates corporate governance principally by imposing disclosure requirements, although it does impose some substantive requirements, such as those defining "independence" for purposes of audit committee membership in the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"),[17] and SEC Rule 10A-3 (*see* Section XI.B.1 for a further discussion of these audit committee requirements). Regulation 14A and the accompanying Schedule 14A, which govern the solicitation of proxies at shareholder meetings, are the SEC's primary mechanisms for requiring corporate governance disclosures. Regulation 14A specifies what information must be presented to shareholders regarding director candidates and other matters to be brought before the shareholders and the format in which it must be presented, and requires disclosure of corporate governance matters, such as board and committee composition, director and committee member independence, attendance at and frequency of board and committee meetings and governance and related-party transaction policies, to name just a few. Rule 14a-8 also provides rules governing the inclusion and presentation of shareholder proposals in a company's proxy materials.[18]

The SEC also requires certain corporate governance disclosures under Sarbanes-Oxley, which set new or enhanced standards for public company boards and management in the aftermath of corporate and accounting scandals, and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[19] the financial regulation passed after the financial crisis of 2008. Notably, the SEC requires shareholders to vote on compensation plans at least every three years[20] under its say-on-pay regime and also to vote on "golden parachute" payments, which are payments to an executive upon an executive's termination in connection with a change in control transaction, such as a merger.[21] Additionally, companies (except for emerging growth companies) must disclose compensation of their named executive officers (the CEO, CFO and the three other highest-paid executive officers) in securities filings.[22]

Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act")[23] also requires all directors, certain executives and shareholders who own 10 percent or more of a company's securities to report transactions in the company's securities, and filings of Schedules 13D and 13G (by shareholders with more than five percent of a company's equity securities) are closely monitored by companies in an effort to anticipate and respond to activism.

Finally, it is worth noting that Form 8-K operates to notify shareholders of certain changes in a corporation's corporate governance, such as material modifications to rights of shareholders, the election and appointment or departure of directors and certain officers, compensatory arrangements with certain officers, changes in control of the company, amendments to the charter or bylaws, amendments to a company's code of ethics or waiver of a

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17 Pub. L. 107-204, 116 Stat. 745.
18 For a discussion of Rule 14a-8, *see* Section IV.A.
19 Pub. L. 111-203, 124 Stat. 1376.
20 17 C.F.R. § 240.14a-21.
21 *Id*.
22 17 C.F.R. § 229.402.
23 15 U.S.C. § 78(a).

provision of a code of ethics, results of shareholder votes and nominations of directors by shareholders.[24]

With respect to board composition, the SEC requires that all members of the audit committee be independent.[25] Under SEC rules, an audit committee member is considered independent if he or she has not: (1) accepted any consulting, advisory or other compensatory fee from the issuer, or (2) been an affiliate of the issuer or any of its subsidiaries.[26] The SEC also provides that national stock exchanges, which must ensure that listed companies have independent audit committee members, must consider the same factors in assessing the independence of compensation committee members as the SEC uses to assess audit committee member independence.[27] Although many of the SEC rules regarding corporate governance are generally "disclosure-based," the substantive rules that the SEC does impose, as well as the potential impact of disclosure-based rules on actual corporate governance practices, appear to be growing over time (although this trend slowed under the previous administration).[28]

The SEC's disclosure and other requirements are affected by the priorities of the incumbent administration. As one example, the SEC under the present administration has signaled a more proactive approach in its oversight of ESG disclosures, particularly as it relates to climate, cybersecurity, board diversity and human capital. In February 2021, the SEC appointed a Senior Policy Advisor for Climate and ESG to advise the agency on ESG matters and advance-related initiatives across the agency's offices and divisions.[29] The acting chair of the SEC issued a statement directing the Division of Corporate Finance to enhance its focus on public company disclosures concerning climate change, including by updating the SEC's 2010 guidance[30] regarding such disclosure to "take into account developments in the last decade."[31]

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[24] Items 3.03, 5.02, 5.01, 5.03, 5.05, 5.07 and 5.08 of Form 8-K. 17 C.F.R. § 249.308.

[25] 17 C.F.R. § 240.10A-3(b).

[26] 17 C.F.R. § 240.10A-3(b)(ii)(A).

[27] 17 C.F.R. §§ 240.10A-3(a)-(b).

[28] Former SEC Commissioner Daniel Gallagher has criticized the trend towards increased federalization of corporate governance matters traditionally left to the states, citing Rule 14a-8 and the Dodd-Frank requirement for a say-on-pay vote as particular incursions: "Some of these requirements unashamedly interfere in corporate governance matters traditionally and appropriately left to the states. Others masquerade as disclosure, but are in reality attempts to affect substantive behavior through disclosure regulation. . . . This stands in stark contrast with the flexibility traditionally achieved through private ordering under more open-ended state legal regimes." Daniel M. Gallagher, former Comm'r, SEC, Remarks at the 26th Annual Corporate Law Institute, Tulane University Law School: Federal Preemption of State Corporate Governance (March 27, 2014), https://www.sec.gov/news/speech/2014-spch032714dmg.html. The impact of the SEC's traditional role in mandating disclosure on substantive corporate governance has also drawn the attention of Congress: In the context of examining the impact of Sarbanes-Oxley on the cost of public company operations, the U.S. House Committee on Financial Services on July 18, 2017 held hearings that, in part, addressed the increased role of the federal government in corporate governance. *See The Cost of Being a Public Company in Light of Sarbanes-Oxley and the Federalization of Corporate Governance: Hearing Before the H. Fin. Servs. Comm.*, 115th Cong. (2017), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402116.

[29] Press Release, SEC, *Satyam Khanna Named Senior Policy Advisor for Climate and ESG* (February 1, 2021), https://www.sec.gov/news/press-release/2021-20.

[30] Commission Guidance Regarding Disclosure Related to Climate Change, 17 C.F.R. Parts 211, 231 and 251 (interpretation, February 2, 2010), https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[31] Public Statement, Allison Herren Lee, Acting Chair, SEC, *Statement on the Review of Climate-Related Disclosure* (February 24, 2021), https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure.

And in March 2021, the SEC announced a new Climate and ESG Task Force within the SEC's Division of Enforcement, which will focus on identifying ESG-related misconduct, including material gaps and misstatements in issuers' disclosure of ESG-related risks under existing SEC rules.[32] The SEC has now moved to change regulations in light of this priority: in March 2022, the SEC proposed extensive amendments to Regulations S-K and S-X to require domestic and foreign issuers to disclose, in registration statements, annual reports on Form 10-K and the audited financial statements filed with the SEC, certain climate-related information encompassing oversight and governance, material risks and opportunities, data regarding greenhouse gas emissions, climate-related financial statement metrics, and information about a company's climate-related targets, goals and transition plans (if any).[33] Larger issuers will be required to provide third-party attestation on their Scope 1 and 2 emissions. The proposed rules will generally be phased in over three years with the final rules expected to be adopted later this year. Proposed rules relating to cybersecurity disclosure, oversight and management were also released in 2022 and are expected to be adopted in 2023. Proposed rules on human capital management and board diversity are also expected to be released in coming months.

Another example of the political vicissitudes affecting SEC rule-making in the governance area is the universal proxy card. Under the Obama administration, the SEC, headed by Chairwoman Mary Jo White, proposed rule amendments that would require proxy cards for director election contests to include the names of all candidates.[34] During the Trump Administration, those rules were not adopted. However, in April 2021, the SEC reopened the comment period, and in November, announced the final rules requiring universal proxy cards in contested elections for shareholder meetings occurring after August 31, 2022.[35]

More recently, the anti-ESG movement has seen several states seek to adopt legislation that would boycott financial firms that limit business activity in certain sectors such as fossil fuels and firearms and legislation that prohibit state pension fiduciaries from making investment decisions based on non-pecuniary factors, including ESG factors. As the anti-ESG movement coalesces into a political platform, proposed and adopted SEC rules will likely face legal and legislative challenges. Already, activist shareholder groups affiliated with the anti-ESG movement have called on companies to roll back certain climate- and DEI-related initiatives and such pressures will likely lead to further scrutiny on board and management decisions in this area.

C. Stock Exchange Requirements

Both the NYSE and Nasdaq have adopted corporate governance standards that, with limited exceptions discussed below, apply to all companies listing common equity securities on

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[32] Press Release, SEC, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues* (March 4, 2021), https://www.sec.gov/news/press-release/2021-42.

[33] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 17 C.F.R. Parts 210, 229, 232, 239, and 249 (proposed rule, March 21, 2022), https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

[34] *See* Gail Weinstein & Philip Richter, *Universal Proxy Unlikely to Be Adopted (and Would Have Little Effect Anyway)*, HARV. L.S. FORUM ON CORP. GOV. & FIN. REG. (December 21, 2016), https://corpgov.law.harvard.edu/2016/12/21/universal-proxy-unlikely-to-be-adopted-and-would-have-little-effect-anyway/.

[35] Universal Proxy, 86 Fed. Reg. 68,330 (December 1, 2021) (to be codified at 17 C.F.R. pt. 240), https://www.govinfo.gov/content/pkg/FR-2021-12-01/pdf/2021-25492.pdf.

the exchanges. These governance standards generally do not apply to companies listing only preferred or debt securities. The discussion in this section provides a brief summary of the corporate governance standards at both exchanges. Please *see* Annex A for a detailed comparison. While the NYSE and Nasdaq (with the exception of the latter's board diversity rule adopted in 2021) have generally refrained from incorporating ESG considerations into their listing standards, both exchanges have introduced voluntary guidelines on ESG disclosure best practices for their listed companies, and both exchanges are members of the Sustainable Stock Exchanges Initiative. In addition, the Long-Term Stock Exchange has emerged as a new U.S. national securities exchange with listing standards designed to promote long-term decision-making among investors and listed companies.

1. Independence

The rules of the exchanges require that a listed company's board comprise a majority of independent directors.[36] The standards of both exchanges for determining director independence are discussed in Section VII.C.1.

2. Diversity

The Nasdaq rules require most listed companies' boards to transition toward including at least two diverse directors. While the rules were approved by the SEC, they remain subject to legal challenges initiated by a number of states and the United States Court of Appeals for the Fifth Circuit is expected to rule on the constitutionality of the rules later this year. The requirements under the Nasdaq rules for diversity on boards is discussed in Section VII.B.

3. Committees

The stock exchanges require listed companies to have an audit committee and a compensation committee, each of which must be composed entirely of independent directors.[37] Each of these committees must have a charter vesting the committee with certain responsibilities and providing for an annual evaluation of the committee.[38] Under NYSE rules, members of the audit and compensation committees must satisfy more stringent independence criteria than other directors. Additionally, the NYSE requires that listed companies have a nominating and corporate governance committee, with a charter, composed entirely of independent directors.[39] Nasdaq does not require listed companies to have a nominations and corporate governance committee, but it does require that listed companies have a formal charter or written resolutions addressing the nominations process and that director nominees be selected by independent directors.[40]

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[36] NYSE Listed Company Manual, Rule 303A.01; Nasdaq Listing Rule 5605(b)(1).

[37] NYSE Listed Company Manual, Rules 303A.05 and 303A.07; Nasdaq Listing Rules 5605(c)(2)(a) and 5605(d)(2)(a).

[38] NYSE Listed Company Manual, Rules 303A.05 and 303A.07; Nasdaq Listing Rules 5605(c) and 5605(d).

[39] NYSE Listed Company Manual, Rule 303A.04.

[40] Nasdaq Listing Rule 5605(e).

4. Corporate Governance Guidelines and Codes of Conduct

Both stock exchanges require listed companies to adopt and disclose a code of business conduct and ethics for directors, officers and employees.[41] The required contents of the codes of conduct for the two exchanges differ somewhat, but they generally must include standards that address honesty and ethical conduct. Companies must promptly disclose any waivers of the code for directors or executive officers. Each code of business conduct must also contain compliance standards or enforcement mechanisms. As discussed in Section XV.B.1, NYSE-listed companies are also required to adopt and disclose corporate governance guidelines that must address director qualification standards, director responsibilities and other director and corporate governance matters. The Nasdaq listing standards do not address corporate governance guidelines.

5. Executive Sessions

The NYSE requires that non-management directors (even if not independent) meet in executive sessions without management directors or other members of management at "regularly scheduled" meetings and that independent directors meet in executive sessions without non-independent directors or members of management at least once a year.[42] Nasdaq requires that independent directors meet in executive sessions without non-independent directors or members of management,[43] with commentary to Nasdaq rules instructing that such executive sessions should occur at least twice a year, and perhaps more frequently, in conjunction with regularly scheduled board meetings.[44]

6. Shareholder Approval of Certain Matters

Both exchanges require shareholder approval in certain instances.

- Share Issuances in Transactions: Both the NYSE and Nasdaq require shareholder approval prior to the issuance of securities in connection with any transaction or series of related transactions if the common stock to be issued is or will be equal to or greater than 20 percent of the voting power or number of shares of common stock outstanding before the issuance (subject to certain exceptions).[45]

- Changes in Control: Shareholder approval is also required under the rules of both exchanges prior to an issuance that will result in a change of control of a listed company.[46]

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41 NYSE Listed Company Manual, Rule 303A.10; Nasdaq Listing Rule 5610.
42 NYSE Listed Company Manual, Rule 303A.03.
43 Nasdaq Listing Rule 5605(b)(2).
44 Nasdaq Listing Rule IM-5605-2.
45 NYSE Listed Company Manual, Rule 312.03(c); Nasdaq Listing Rule 5635(a)(1).
46 NYSE Listed Company Manual, Rule 312.03(d); Nasdaq Listing Rule 5635(b).

- Insider Transactions: Under certain circumstances, shareholder approval is required by both exchanges prior to the issuance of common stock to a director, officer or substantial security holder, or any of their affiliates.[47]

- Equity Compensation: Under the rules of both exchanges, subject to certain exceptions, shareholders must be given the opportunity to vote on the establishment or material amendment of equity-compensation plans.[48]

7. Exemptions for Controlled Companies, Certain Corporate Forms and Private Issuers

Both exchanges provide exemption for relief from their rules to certain companies under certain circumstances. Nasdaq-listed cooperatives, registered management investment companies and controlled companies (defined as a company in which more than 50 percent of the voting power for director elections is held by an individual, group or another company) are not required to have a majority independent board, compensation committee or independent director oversight of nominations.[49] Nasdaq also exempts limited partnerships from its general corporate governance requirements, but imposes certain partnership-specific governance requirements on such entities.[50] Similarly, the NYSE exempts registered management investment companies and certain passive issuers from most of its corporate governance requirements.[51] NYSE-listed limited partnerships, companies in bankruptcy and controlled companies are not required to have majority-independent boards, compensation committees or nominating and corporate governance committees.[52] All of these companies are, however, subject to the remaining corporate governance standards of each exchange.

Generally, foreign private issuers listed on an exchange are permitted to follow home country practice in lieu of the exchange's corporate governance standards, with the exception of the governance standards regarding audit committees, certification of compliance, and, for Nasdaq only, the prohibition on certain alterations to common stock voting rights.[53] Foreign private issuers listed on the NYSE must disclose any significant ways in which their corporate governance practices differ from listing standards, and those listed on the Nasdaq must report each requirement that they do not follow and describe the home country practice they follow in lieu of that requirement.[54] Additionally, a Nasdaq-listed foreign private issuer that follows a

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47 NYSE Listed Company Manual, Rule 312.03(b); Nasdaq Listing Rule 5635(a)(2).

48 NYSE Listed Company Manual, Rule 303A.08; Nasdaq Listing Rule 5635(c).

49 Nasdaq Listing Rules 5615(a)(2), 5615(a)(5) and 5615(c). In 2019, Nasdaq implemented a rule exempting issuers whose only securities listed on Nasdaq are non-voting preferred securities, debt securities or derivative securities from, among other requirements, the majority independent board, compensation committee, independent director oversight of nominations and audit committee requirements (other than, with respect to the audit committee requirements, the applicable requirements of SEC Rule 10A-3). Nasdaq Listing Rule 5615(a)(6),

50 Nasdaq Listing Rule 5615(a)(4). Among other things, a Nasdaq-listed limited partnership must maintain a general partner, have at least three independent directors pursuant to Rule 5605(c)(2)'s audit committee composition requirements, review all related-party transactions on an ongoing basis and review potential material conflict of interest situations, where appropriate, through the use of an audit committee or comparable body of the partnership's board of directors.

51 NYSE Listed Company Manual, Rule 303A.00.

52 *Id.*

53 NYSE Listed Company Manual, Rule 303A.00; Nasdaq Listing Rule 5615(a)(3).

54 NYSE Listed Company Manual, Rule 303A.11; Nasdaq Listing Rule 5615(a)(3)(B).

home country practice in lieu of having an independent compensation committee must disclose the reasons why it elected not to have such an independent committee.[55]

8. Phase-In Exceptions

Both exchanges provide that companies in various categories may phase into corporate governance requirements. For example, both exchanges allow companies listed in conjunction with an Initial Public Offering (an "IPO"), and those ceasing to qualify as controlled companies, up to a year from the listing date or the date on which the company ceased to qualify as a controlled company, as applicable, to establish a majority-independent board.[56] Subject to certain distinctions, both exchanges also allow the companies in these two categories and companies listing upon emergence from bankruptcy to phase in the number of independent directors that serve as members of exchange-required committees: committees must comprise a majority of independent directors within 90 days and all independent directors within one year of listing or status change.[57]

9. Noncompliance

Both exchanges require that a company promptly notify them in writing after the company becomes aware of any noncompliance with the corporate governance standards.[58] The NYSE additionally requires that the CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of the NYSE corporate governance standards, qualifying the certification to the extent necessary.[59]

D. Proxy Advisory Services and Institutional Investors

Large institutional investors commonly hold stock in hundreds of companies and thus are called upon to vote at hundreds of shareholder meetings per year. While institutional investors often have corporate governance and stewardship departments to inform their voting decisions, most institutional investors deal with this volume either by outsourcing voting decisions to proxy advisory services or by using the recommendations of the proxy advisory services to guide their decisions. Proxy advisory services provide voting recommendations on topics including director elections, say-on-pay, shareholder proposals and mergers. In addition to providing company-specific voting recommendations, proxy advisory services publish voting guidelines setting forth their policies on various issues. The two largest proxy advisory firms—ISS and its smaller rival Glass, Lewis & Co. ("Glass Lewis")—enjoy an effective duopoly in the field, with over 90 percent share of the industry.[60]

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[55] Nasdaq Listing Rule 5615(a)(3)(B).
[56] NYSE Listed Company Manual, Rule 303.A00; Nasdaq Listing Rules 5615(b)(1)-(2) and (c)(3).
[57] *Id*.
[58] NYSE Listed Company Manual, Rule 303A.12(b); Nasdaq Listing Rule 5625.
[59] NYSE Listed Company Manual, Rule 303A.12(a).
[60] *See* Staff of H. Comm. on Fin. Servs., 113th Cong., *Memorandum: June 5 Subcommittee on Capital Markets hearing on "Examining the Market Power and Impact of Proxy Advisory Firms"* 3 (May 31, 2013), http://financialservices.house.gov/uploadedfiles/060513_cm_memo.pdf; *see also* National Investor Relations Institute, *The Case for Proxy Advisor Reform* 1 (November 8, 2017), https://www.niri.org/NIRI/media/NIRI-Resources/NIRI-Case-Proxy-Advisor-Reform.pdf; The Editorial Board, *The Proxy Protection Racket*, THE WALL

Both ISS and Glass Lewis are privately owned for-profit enterprises. The U.S. private equity firm Genstar Capital completed its sale of an 80 percent stake in ISS to Deutsche Börse in February 2021.[61] Glass Lewis was acquired by private parties from the Ontario Teachers' Pension Plan Board and the Alberta Investment Management Corporation in 2021.[62]

In the last two decades, the influence of proxy advisory firms increased substantially, and their recommendations became a powerful (and often decisive) force in influencing corporate governance and voting results. This influence is partly the result of the SEC's creation in 2003 of an effective safe harbor from a 1988 Department of Labor determination that institutional investors owed their clients a fiduciary duty when voting their shares. The SEC safe harbor provided that fund managers could insulate themselves from fiduciary duty claims by, in accordance with a predetermined policy, relying upon the proxy voting recommendations of a third party.[63] The SEC staff interpretation letters that created this safe harbor were withdrawn in September 2018.[64] The influence of proxy advisory firms was also greatly increased by the move from plurality to majority voting standards beginning in 2004, as that put "teeth" in their policies of recommending "withhold" votes for directors who did not implement shareholder preferences as reflected in precatory resolutions. It is generally understood that an ISS recommendation has a material impact on the approval rate of a shareholder proposal.[65] A 2018 study by the Manhattan Institute estimated that an ISS recommendation against a proposal is associated with a reduction in the favorable vote count by between 15 to 30 percent.[66] In the last few years, the largest institutional money managers have invested significantly in building out their own stewardship teams, enabling them to make their own decisions taking into account the proxy advisors' recommendations but not simply outsourcing or deferring to them. For this reason, it is believed that the influence of the proxy advisors tapered off slightly in recent years, although it is still very strong and may again increase with the universal proxy card focus on individual directors.

ST. J. (November 10, 2019), https://www.wsj.com/articles/the-proxy-protection-racket-11573417818; https://www.economist.com/business/2022/06/02/why-proxy-advisers-are-losing-their-power.

[61] Press Release, Deutsche Börse Group, Deutsche Börse Successfully Completes Acquisition of ISS, Strengthening the Focus on Sustainable Investing (February 2, 2021), https://deutsche-boerse.com/dbg-en/media/press-releases/Deutsche-B-rse-successfully-completes-acquisition-of-ISS-strengthening-the-focus-on-sustainable-investing-2555110.

[62] Press Release, Glass Lewis, *Peleton Capital Management and Stephen Smith Acquire Glass Lewis* (March 16, 2021), https://www.glasslewis.com/press-release-peloton-capital-management-and-stephen-smith-acquire-glass-lewis/.

[63] Investment Advisers Act of 1940, as amended, 15 U.S.C. § 80b-1-21. *See also* 17 C.F.R. § 275.206(4)-6; Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 17 (November 2010) ("The problem of short-termism is also illustrated by the policies of proxy advisory firms whose growth was fueled by the Labor Department's informed voting requirements for regulated investment funds."), http://www.ecgi.org/tcgd/2011/documents/Strine%20Fundmental%20Corp%20Gov%20Q%202011%20Bus%20L.pdf.

[64] SEC, *Statement Regarding Staff Proxy Advisory Letters* (September 13, 2018), https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters.

[65] James R. Copland *et al*., Manhattan Inst., *Proxy Advisory Firms: Empirical Evidence and the Case for Reform* 13 (2018), https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf.

[66] *Id.*

Both legislators and regulators have questioned the influence of proxy advisory firms and expressed the need to regulate these firms for conflicts of interest and other issues.[67] In response to this mounting pressure from both legislators and companies, in July 2020, the SEC adopted rules to (i) extend proxy solicitation rules to proxy advisors (thus subjecting their vote recommendations to the anti-fraud provisions of Rule 14a-9) and (ii) impose two conditions for proxy advisors to continue relying on Rule 14a-2(b)'s exemptions for proxy advisors from the information and filing requirements of the proxy rules: (1) proxy advisors would need to disclose material conflicts of interests in their proxy voting advice, and (2) proxy advisors would need to adopt and disclose policies and procedures reasonably designed to ensure that their reports be made available to issuers at or prior to the time when such advice is disseminated to clients and that investors have access to issuer responses before voting. The new rules included two non-exclusive safe harbors to ensure compliance with these conditions: first, proxy advisors would need to share their reports with issuers prior to or at the same time as dissemination to investors, and second, proxy advisors would need to notify clients that the issuer has filed or intends to file a response to the report, if so informed by the issuer.[68] However, in July 2022, the SEC adopted amendments that would eliminate the requirements that reports are made available to issuers at or prior to the time when such advice is disseminated to clients and that investors have access to issuer responses before voting, largely rolling back the rules adopted in 2020.[69]

In recent years, money managers themselves increasingly have begun to question the wisdom of reliance on proxy advisory firm recommendations and have asserted an active and independent approach to decision-making on corporate governance issues at portfolio companies.[70] ISS and Glass Lewis have also recently found themselves the targets of the anti-ESG movement, with 21 Republican state attorneys-general issuing a letter to both proxy advisors warning that their recommendations on climate change and other ESG-related matters constituted a breach of their fiduciary duties.[71] A number of leading institutional investors are also building up their own capacities to assess the strategies and governance of the companies in their portfolios, and thus reducing their need to outsource corporate governance activism to

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[67] *See* Staff of H. Comm. on Fin. Servs., 113th Cong., *Memorandum: June 5 Subcommittee on Capital Markets Hearing on "Examining the Market Power and Impact of Proxy Advisory Firms*," 3 (May 31, 2013), http://financialservices.house.gov/uploadedfiles/060513_cm_memo.pdf; *see also Examining the Market Power and Impact of Proxy Advisory Firms: Hearing Before the Subcomm. on Capital Markets and Gov. Sponsored Enters. of the H. Comm. on Fin. Servs.*, 113th Cong. 1 (June 5, 2013), http:/financial services.house.gov//113-27.pdf; Daniel M. Gallagher, Comm'r, SEC, Remarks at Society of Corporate Secretaries and Governance Professionals (July 11, 2013), http://www.sec.gov/News/Speech/Detail/Speech/.

[68] Exemptions from the Proxy Rules for Proxy Voting Advice, 85 Fed. Reg. 55,082 (September 3, 2020) (codified at 17 C.F.R. pt. 240); *see also* Wachtell, Lipton, Rosen & Katz, *ISS and Glass Lewis: SEC Adopts Proxy Advisor Reform—Initial Perspectives and Implications* (July 22, 2020), https://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.27043.20.pdf.

[69] Press Release, SEC, *SEC Adopts Amendments to Proxy Rules Governing Proxy Voting Advice* (July 13, 2022), https://www.sec.gov/news/press-release/2022-120.

[70] *See* BlackRock, *The Investment Stewardship Ecosystem* 5-6 (2018), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf; Kristen Grind & Joann S. Lublin, *Vanguard and BlackRock Plan to Get More Assertive with Their Investments*, THE WALL ST. J. (March 4, 2015), http://www.wsj.com/articles/vanguard-and-blackrock-plan-to-get-more-assertive-with-their-investments1425445200.

[71] Letter from the Attorneys General of Utah and Texas to Institutional Shareholder Services, Inc. and Glass, Lewis & Co. (January 17, 2023), https://attorneygeneral.utah.gov/wp-content/uploads/2023/01/2023-01-17-Utah-Texas-Letter-to-Glass-Lewis-ISS.pdf.

proxy advisory firms and activist hedge funds. In any case, in the current corporate governance environment companies must remain cognizant of the positions of both major institutional shareholders and the proxy advisory firms and their likely reactions to corporate governance initiatives.

1. Voting Guidelines

Proxy advisory firms convey their recommendations through voting guidelines and position papers. Although these positions are generally described by the proxy advisors as "best practices" to create shareholder value, they are often grounded in an ideology that the discretion and judgment of the board must be limited, that relationships between boards and management must be curtailed and that restraints on shareholder decision-making in the company's business are counterproductive. While proxy advisory guidelines, especially those published by ISS, historically have tended to provide a generalized recommendation for each type of proposal without regard to companies' specific circumstances, recent updates to ISS policies on a number of issues represent a welcome, measured, company-specific approach to corporate governance practices, reflecting a move, however limited, away from one-size-fits-all policies and recommendations. For ISS, the shift to a "case-by-case" approach was most apparent with respect to circumstances in which ISS would make "withhold" or "against" recommendations with respect to individual directors, committee members or the entire board, as appropriate, when the board has failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year.[72] Where a board does not adopt a majority-supported shareholder proposal, ISS will consider: disclosed outreach efforts by the board to shareholders in the wake of the vote; rationale provided in the proxy statement for the level of implementation; the subject matter of the proposal; the level of support for and opposition to the proposal in past meetings; actions taken by the board in response to the majority vote and its engagement with shareholders; the continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and other appropriate factors.[73]

Despite these recent positive shifts towards a "case-by-case" approach, proxy advisory firms continue to articulate rigid, generalized views on various important and nuanced governance matters. ISS and Glass Lewis have historically advanced a shareholder-centric position that potentially punishes a board that amends the bylaws of a company without seeking shareholder approval, even though the board has the authority to do so. Both proxy advisors warn that they may use the significant power of their withhold or adverse vote recommendations for directors in response to a unilateral bylaw amendment that, in their view, materially diminishes or removes shareholders' rights or that could adversely impact the rights of shareholders.[74] Additionally, ISS has extended its voting guidelines on unilateral bylaw and charter amendments to apply to newly public companies as well. Thus, ISS will make withhold or adverse voting recommendations for directors at the first shareholder meeting of a newly listed public company if that company has bylaw or charter provisions that it considers "adverse to shareholder rights" (including supermajority vote requirements to amend the bylaws or

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[72] *See, e.g.*, ISS, *2023 U.S. Proxy Voting Guidelines* 9 (December 13, 2022).
[73] *Id.*
[74] *See* ISS, *2023 U.S. Proxy Voting Guidelines* 15 (December 13, 2022); Glass Lewis, *2023 Policy Guidelines* 27 (November 17, 2022).

charter, a classified board structure, or other similar provisions).[75] And, unless the adverse provision is reversed or submitted to a vote of public shareholders, ISS will vote case-by-case on director nominees in subsequent years.[76] When updating bylaws, companies should consider explaining the board's rationale for doing so via appropriate disclosure to ensure that proxy advisory firms and shareholders understand why particular changes are deemed appropriate and to facilitate discussion with investors.

Even when applying a "case-by-case" approach, proxy advisory firm methodologies tend towards "scoreboards," checklists, formulae and tabulations, which, by their nature, cannot do justice to the complexities of corporate governance at individual companies. For example, ISS's "Equity Plan Scorecard" bases recommendations with respect to equity plan proposals on a combination of factors in an analysis where positive factors may counterbalance negative factors, and vice versa.[77] While this more nuanced approach is preferable to the rigid test it replaced, any evaluations using scorecards run the risk of becoming mechanical and do not permit the appropriate exercise of judgment and flexibility to consider the situation of each particular company in this complex area.

Thus, proxy advisors' gradual shifts away from the one-size-fits-all approach towards a "case-by-case" or "holistic" approach is a welcome admission that generalized advice does not serve the best interests of companies or their shareholders. Yet, these shifts fall short of stemming the tide of ideological generalizations advanced by proxy advisory firms and shareholder rights activists that have eroded governance provisions that have traditionally facilitated long-term growth at many companies. Nominating and corporate governance committees should be cognizant of the views of proxy advisory firms, but must exercise their own judgment when confronted with corporate governance matters and resist the temptation to passively defer to the judgment of proxy advisory services. Indeed, the emergence of the new corporate governance paradigm perhaps suggests that a well-articulated rationale for corporate governance policies and decisions may, in fact, go further with key investors than a rudimentary stamp of approval from proxy advisory firms.

2. QualityScore

One feature of the corporate governance landscape about which members of nominating and corporate governance committees need to be aware is the governance grades or ratings generated by certain members of the governance industry. The most prominent of these is the ESG Governance QualityScore product produced by ISS, and another is GMI Ratings. ISS's QualityScore is the latest iteration of ISS's corporate governance-scoring product, which was preceded by Governance Risk Indicators and then Governance QuickScore (which itself underwent a few transformations).[78] QualityScore uses an algorithm similar to QuickScore to score companies in four topical classifications—Board Structure, Compensation, Shareholder Rights and Audit & Risk Oversight—and to provide an overall governance rating, taking into

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[75] ISS, *2022 U.S. Proxy Voting Guidelines* 15 (December 13, 2021).
[76] *Id*.
[77] *Id*. at 44-47.
[78] ISS, *ISS Governance QuickScore 2.0, Overview and Updates* (January 2014), http://issgovernance.com/files/ISSGovernanceQuickScore2.0.pdf. https://www.issgovernance.com/esg/ratings/governance-qualityscore/#download_methodology_highlights.

account over 280 "factors," including director tenure, director approval rates, compensation of outside directors, alignment on pay and total shareholder return and say-on-pay support.[79] In recent years, QualityScore has added a number of factors related to ESG topics—examples include the number of women serving in leadership roles on the board, the number of women who are named executive officers and the standard deviation of director age and tenure,[80] the level of disclosure on environmental and social performance for executive incentive plans and the greatest percentage of vote support for environmental or social shareholder resolutions at the most recent annual meeting.[81] In 2022, ISS added 23 new governance factors—a high-water mark for recent years—spanning board diversity, anti-pledging policies for directors and executives, various new compensation disclosures, new audit and risk oversight factors, along with expanded coverage of board structure category factors such as board committee independence and director overboarding.[82]

Scores are presented on a 1 to 10 scale and rely upon "decile" comparisons of a company's raw scores against those of others in the same index or region.[83] Through this ranking, ISS aims to "provide an at-a-glance view of each company's governance risk."[84] ISS asserts that QualityScore "focuses on quantitative and qualitative aspects of regional governance best practices as well as the analysis undergirding ISS voting policies and voting recommendations."[85] However, a number of the factors are qualitative by nature, and the specific weightings and balancing between quantitative and qualitative factors remain undisclosed. Given an inherent amount of subjectivity in the analysis and the opaqueness of the weighting system, the soundness of these purported correlations cannot be tested, and companies are not able to calculate scores on their own. Additionally, because the category scores and overall scores are relative, based on a comparison of other companies in the same index or region, a company's scores can change solely as a result of changes at other companies.

While we welcome ISS's ongoing efforts to update its QualityScore methodology to reflect the growing importance of ESG issues to companies, investors and other stakeholders, and the increasing efforts by other providers to provide governance and broader ESG ratings, we remain skeptical of the notion that a board's effectiveness can be quantified and correlated to one-size-fits-all best practices. But even leaving aside the dubiousness of these correlations, QualityScore is problematic in a number of respects. Ranking companies can be misleading and counterproductive, as half of all companies, by definition, will be below the median. Given the success of best-practices advocates in imposing uniformity of corporate governance structures, it is likely that minor differences will separate the deciles, particularly in the Board Structure and Shareholder Rights areas. As a result, many companies, even those with no serious governance concerns, face the unwarranted taint of a below-average score.

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[79] *See* ISS, *Governance QualityScore: Methodology Fundamentals* 4, 12-14 (November 2022), https://www.issgovernance.com//file/products/methodology-fundamentals-governance-qualityscore.pdf.
[80] *See* ISS, *QualityScore, Overview and Updates* 9-10 (December 19, 2018).
[81] *See* ISS, *Governance QualityScore: Methodology Guide* 9-10 (October 2019).
[82] *See* ISS, *Governance QualityScore: Q4 2022 Methodology Highlights* (October 31, 2023).
[83] *See* ISS, *Governance QualityScore: Methodology Guide* 10-12 (January 2021).
[84] *Id.* at 5.
[85] *Id.* at 12.

Because of ISS's outsized influence, nominating and corporate governance committees cannot disregard QualityScore, notwithstanding its shortcomings. However, while directors should understand the QualityScore implications of different governance structures, they must also remember that a high score should not be an end in itself. Rather, directors have a fiduciary duty to exercise their informed business judgment to adopt the policies they believe will best serve their company. No single metric or bundle of metrics can substitute for the informed business judgment of an engaged and well-advised board as to what is necessary and appropriate in dynamic, real-world circumstances.

3. Shareholder Activism

Shareholder activism continues to be a key area of concern for most companies. In the 2020 proxy season, the Covid-19 pandemic caused a momentary pause with a significant decline in companies publicly subjected to activist demands for the year.[86] However, the number of public campaigns in 2022 saw a return to the pace of activism activity prior to the pandemic. A total of 196 U.S. companies with a market capitalization in excess of $500 million at the time of the campaign announcement were targeted by activists via approximately 241 campaigns, a 39 percent increase in the number of campaigns compared to the 158 companies targeted in 2021 via 173 campaigns. Activity increased consistently across each quarter (when compared to the same quarter the previous year) and the fourth quarter of 2022 being the most active on record.[87]

Shareholder activism can be broadly separated into two categories. The first is corporate governance-related activism, which focuses on issues such as board structure, executive compensation, takeover defenses and social concerns. The second is economically motivated activism, which seeks to alter the strategic direction of the company—typically with the intent of causing a near-term event, such as prompting a sale of part or all of the company or the return of capital to shareholders. In addition, there continue to be a significant number of short activism attacks, by which an activist attempts to profit by taking a short position in a company (that is, betting that its stock price will fall) and then actively trying to drive its stock price down by publicizing perceived flaws in the company, often accounting questions or allegations of fraudulent behavior.[88] Short activist attacks are typically conducted by firms specializing in short activism, but large activist funds have also made short attacks.[89] Activists may also leverage concerns regarding environmental and social matters to drive a wedge between the company and its institutional investors.

Although they are very different, the two types of activism are mutually supportive and sometimes used in tandem. Corporate governance shifts serve as leverage to force economic or strategic changes, and a battle with economic activists may leave a company more vulnerable to

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[86] Insightia *et al*., *The Activist Investing Annual Review* 6 (2022).

[87] FactSet. As of March 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.

[88] We have noted the rise of "debt default activism," by which investors purchase debt of a company on the theory that the borrower is already in default, and then actively seek to enforce that default in a manner by which they stand to profit (sometimes by buying "credit default swaps," which will pay out if the borrower struggles financially). Wachtell, Lipton, Rosen & Katz, *Default Activism in the Debt Markets* (November 16, 2018), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26271.18.pdf.

[89] Probably the most famous "short attack" was Pershing Square's $1 billion short on Herbalife and ultimately unsuccessful efforts to have it declared an illegal pyramid scheme.

corporate governance activism. Additionally, economic activists often cloak themselves with a corporate governance platform in hopes of gaining the support of proxy advisory services and institutional investors. Further, economic activists will often advocate for the replacement of directors or senior managers, both as leverage to settle proxy contests in favor of their economic agendas and as a strategy to influence board decisions through board representation after a proxy fight is completed. Over the last few years, companies have been under increased pressure from activist investors to return "excess" capital to shareholders, put into place new capital allocation plans, sell or spin off assets, increase merger consideration, replace managers or directors and reform compensation structures, among other actions. However, the liquidity crisis triggered by the Covid-19 pandemic led to substantial criticism of past capital allocation decisions, including buybacks and special dividends, that favored short-term shareholder returns over long-term sustainability considerations.[90]

Recent activism trends included the continued expansion of activism campaigns in global markets (in particular, in Europe and Japan), the sustained popularity of campaigns tied to mergers and acquisitions (including on the buy-side to block transactions), an increase in campaigns targeting large-cap companies, and the continued willingness of targets to settle. The number of campaigns launched against European companies increased in 2022 to 87 campaigns launched against companies with a market capitalization in excess of $500 million (compared to 50 campaigns in 2021).[91] The United Kingdom accounted for 53 percent of all activist campaigns in Europe, up from 42 percent in 2021 and continuing an upward trend in activism activity in recent years driven by leading large-cap activists.[92] In Asia, activist activity declined slightly in 2022 to 40 campaigns launched against companies with a market capitalization in excess of $500 million compared to 54 campaigns in 2021 and 50 campaigns in 2020.[93] Consistent with prior years, Japan continues to drive a significant portion of overall activism activity in Asia (approximately 65 percent of total campaigns in Asia in 2022, the same percentage as in 2021).[94]

ESG-related issues have continued to weave their way into activist theses in 2022, with activists looking to capitalize on emerging market opportunities created by regulatory changes and continued investor demand in green investments. For example, Sachem Head last year acquired a position in Denbury, a company which specializes in carbon capture and storage. Following the passage of the Inflation Reduction Act, Sachem Head deemed the company to be an attractive takeover target for a larger legacy energy company looking to capitalize on the new tax incentives to build out Denbury's capabilities. Third Point called on Shell to separate its refining and renewables operations to allow for more aggressive investment in de-carbonization and to optimize the company's ability to address the different strategic priorities of its various stakeholders. Similarly, Engine No. 1 called on Coca-Cola to commit to a partnership with Republic Services, a plastics recycler in which Engine No. 1 owns a stake, as part of the

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[90] *See, e.g.*, Emily Flitter & Peter Eavis, *Some Companies Seeking Bailouts Had Piles of Cash, Then Spent It*, N.Y. TIMES (April 24, 2020), https://www.nytimes.com/2020/04/24/business/coronavirus-bailouts-buybacks-cash.html.

[91] FactSet. As of March 2023. Includes 87 European activist campaigns from 2022 against companies with a market capitalization in excess of $500 million in FactSet's database.

[92] *Id*.

[93] FactSet. As of March 2023. Includes 47 Asian activist campaigns from 2022 against companies with a market capitalization in excess of $500 million in FactSet's database.

[94] *Id*.

company's efforts to phase out single-use plastics. Meanwhile, activists have continued to use ESG issues to drive a wedge between the company and its institutional investors. Legion, for example, ran a high-profile campaign against Guess, calling for the removal of the company's co-founders in the wake of sexual misconduct allegations.

Not all ESG-oriented campaigns in 2022 had an economic thesis. Carl Icahn's campaigns at Kroger and McDonald's focused on the companies' treatment of pigs (a cause of interest to his daughter) and was not the first time activists have sought to draw attention to broader social issues: in 2018, JANA Partners teamed up with CalSTRS on a platform of encouraging Apple to provide more disclosures regarding parental controls and tools for managing use of technology by children, teenagers and young adults. Notwithstanding these campaigns, much of the ESG-related shareholder activism continues to be centered around shareholder proposals. The past year continued to see record numbers of ESG-related shareholder proposals, although the passage rate declined compared to previous years as institutional investors scaled back support for more prescriptive proposals relating to greenhouse gas emissions reduction targets. Approximately 941 ESG-related shareholder proposals were submitted in 2022, up from 837 in 2021.

Towards the second half of 2022, the growing anti-ESG movement saw several household companies being targeted by Strive Asset Management, a newly formed asset manager that opposes ESG-oriented investing. Strive publicly sought engagement with companies including Exxon, Chevron, Disney and Home Depot, asking the companies to reconsider certain sustainability and social commitments, including those which have previously received shareholder support. Strive has also partnered with conservative think tank the National Center for Public Policy Research, which has independently filed several shareholder proposals calling on companies to revoke their ESG-related commitments.

During the 2021 proxy season, a newly-formed ESG activist fund, Engine No. 1, with the support of CalSTRS, launched the first proxy contest based in part on ESG demands at ExxonMobil – and later succeeded in gaining shareholder support to place three nominees on the board. The astounding degree of electoral leverage Engine No. 1 was able to achieve with a minuscule economic stake – 2,500 votes for every share it owned – showed how smart activists can, at relatively low cost, leverage the extraordinary concentration of voting power in a small number of large institutional investors, and is likely to be emulated. As we have written elsewhere, activists have also embraced a new two-front "pincer attack" strategy: from ESG activists, on the one side, and economic activists, on the other.[95] This new twist on "wolf-pack" activism provides new opportunities for activists to drive a wedge between a company and its key stakeholders. The risks of these pincer attacks are complicated by the proliferation of ESG metrics and inconsistent reporting expectations (despite current promising convergence and rationalization efforts) alongside evolving investor-side voting policies, all of which leave companies vulnerable to attack. Increasingly, activists will leverage ESG issues to rally the support of key institutional shareholders in favor of broader strategic changes, including M&A.

[95] *See* Wachtell, Lipton, Rosen & Katz, *The ESG/TSR Activist "Pincer Attack"* (Jan. 21, 2021), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.27304.21.pdf.

Recent examples include Third Point's campaigns to break up Royal Dutch Shell and Elliott Management's efforts to separate SSE.[96]

A significant number of activist campaigns continue to settle before going to a vote. Most campaigns in 2022 ended with announced settlements with activist hedge funds, and only a handful "went the distance" all the way to the annual meeting. Of the 135 board seats won by activists in 2022, 23 were won via a proxy contest and 112 board seats were won via settlement, consistent with trends over recent years.[97]

Activists have also grown increasingly sophisticated and aggressive in their tactics. One example of this has been the increased cooperation (sometimes tacit, sometimes overt) between traditional long-only investment funds and activists. In the case of Whole Foods, for example, long-only investor Neuberger Berman had been engaging actively with the company and when that did not yield the results it wanted, enlisted activist JANA Partners to target the company. They pressed the same agenda with conscious parallelism and accumulated stock at the same time, although they did not file as a 13D group. These aggressive actions proved enormously profitable for both companies when Whole Foods was acquired shortly afterwards by Amazon. Similar examples of cooperation between traditional long-only active managers and activists include T. Rowe Price supporting Pershing Square in the Allergan situation, Capital Group supporting Starboard in its campaign against Darden and CalSTRS supporting various activists in campaigns involving ExxonMobil, PepsiCo, Ingersoll Rand, Perry Ellis and Timken.

Another example of the aggressive tactics used by activists is in the manner they enlist and compensate experts and Board nominees. Efforts a few years ago by, among others, Elliott Partners in their proxy fight with Hess and JANA in the Agrium situation, to incentivize their director nominees to sell the target company within a short period (so-called "golden leash" arrangements), were disfavored by many institutional investors. Another innovation (evident in JANA's Whole Foods campaign) is for the activist to allow its director nominees to buy stock before announcement of their campaign, thereby almost guaranteeing a near-term profit for them when the stock price rises in announcement. This does generally require that the parties buying stock together on the basis of this shared knowledge of their plans file a 13D as a group when they reach the five percent threshold.

The high-water mark of sophisticated and aggressive tactics may have been the unprecedented partnership between activist hedge fund Pershing Square and Valeant Pharmaceuticals in their effort to buy Allergan, Inc. In 2014, the two parties formed a joint bidding entity and quietly amassed a 9.7 percent "beachhead" investment in Allergan stock and options. They publicly disclosed their interest on the same day that Valeant launched a $45 billion unsolicited bid for Allergan.[98] Though the bid was ultimately unsuccessful and

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[96] *See* Cara Lombardo & Sarah McFarlane, *Third Point Has Big Shell Stake, Urges Energy Giant to Break Up,* The THE WALL STREET J. (Oct. 27, 2021), https://www.wsj.com/articles/third-point-has-big-shell-stake-urges-energy-giant-to-break-up-11635349151; Jaime Taboada, *Elliott Renews Pressure on SSE Leadership Over Strategy – Update*, MARKETWATCH (Dec. 7, 2011), https://www.marketwatch.com/story/elliott-renews-pressure-on-sse-leadership-over-strategy-update-271638867672.

[97] FactSet. As of April 2023.

[98] In a variation on the strategic acquiror-activist cooperation, activist Mantle Ridge cooperated with Hunter Harrison, a former railroad CEO with long experience in the railroad business, to target CSX Corp., eventually

Pershing Square's involvement with Valeant proved disastrous for them, the parties initially made a sizeable profit when Allergan struck a much higher deal with Actavis plc. Pershing Square initially reaped a profit of over $2 billion and Valeant received 15 percent of that from the transaction.[99] This partnership between activist hedge funds and strategic corporate acquirors has been subject to litigation that threatens the approach in the future. After litigation alleging that these profits were derived from illegal insider trading, a federal district court tentatively concluded that Pershing Square had accumulated Allergan shares while knowingly in possession of material nonpublic information in violation of Rule 14e-3.[100] Immediately prior to the finalizing of the district court's decision, Pershing Square and Valeant settled the litigation, with Pershing Square and Valeant together deciding to pay almost $300 million to settle the claims.[101] The ruling suggests that the "co-offering persons" model is "not a sustainable blueprint for deal-making and is subject to attack as insider trading."[102]

Another recent development that is worth paying attention to is the blurring of the historically clear line between activist funds and private equity investors. Some activist funds are seeking to pursue more long-term private equity investing. To cite one example, in 2019, Elliott's private equity affiliate, Evergreen Coast Capital, partnered with Francisco Partners to take LogMeIn private, two years after Elliott had exited the stock. There have also been a number of instances where companies under pressure have turned to an activist to take a stake in the company and take seats on the board as a way of protecting themselves from other activists or threats. The Starboard investment in Papa John's Pizza would be an example of this phenomenon, which may become more common. On the other hand, there are early signs that some private equity investors have been willing to adopt more aggressive tactics historically reserved for activists and strategic acquirers—examples include KKR securing board representation at restaurant chain Dave & Buster's after disclosing that it had acquired over 10 percent of the company's stock and would be seeking changes to the business and Cerberus publicly demanding changes at Commerzbank, including board representation for itself.

More broadly, the extent to which activist pressures will continue to influence companies is likely to depend, to some extent, on macroeconomic market trends. In recent years, some of the largest and most important institutional investors have encouraged companies to resist short-term activism and instead to focus on engagement with their long-term shareholders to enlist

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forcing the company to hire Mr. Harrison as CEO. *See* Josh Funk, *Former CP CEO Teaming with Investor to Target CSX Railroad*, SEATTLE TIMES (January 19, 2017), https://www.seattletimes.com/business/former-cp-ceo-teaming-with-investor-to-target-csx-railroad/; Michelle Celarier, *Mantle Ridge Up to Nearly $2 Billion on CSX Play*, INST. INVESTOR (April 23, 2017), https://www.institutionalinvestor.com/article/b1505q2v83gm50/mantle-ridge-up-to-nearly-$2-billion-on-csx-play; *see also* Svea Herbst-Bayliss, *Ackman Plays Big Role in Laying Out Canadian Pacific Rail Deal*, REUTERS CANADA (December 8, 2015), http://ca.reuters.com/article/businessNews/idCAKBN0TR2QN20151208. Mr. Harrison passed away in late 2017. *See* David Voreacos & Thomas Black, *Death of CSX's New CEO Renews Debate on Health Disclosures*, CHICAGO TRIBUNE (December 19, 2017), http://www.chicagotribune.com/business/ct-biz-csx-hunter-harrison-dead-health-dislosure-20171219-story.html.

[99] *See Allergan, Inc.* v. *Valeant Pharm. Int'l, Inc.*, C.A. No. 14-cv-1214 DOC, 2014 WL 5604539 (C.D. Cal. November 4, 2014).

[100] Wachtell, Lipton, Rosen & Katz, *Activist-Driven Dealmaking Falls Flat* (January 17, 2018), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25861.18.pdf.

[101] *Id.*

[102] *Id.*

their support for the company's long-term strategy because, as one investor noted, "index investors are the ultimate long-term investors."[103] It is likely, however, that activists will remain a key force driving both the governance "best practices" and the economic strategies of public companies. Sections IV and V discuss two of activists' most important tools, the shareholder proposal and the proxy fight, in greater detail.

[103] Larry Fink, Chairman and CEO of BlackRock Inc., *Letter to CEOs: A Sense of Purpose* (January 12, 2018), https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter.

III. Key Corporate Governance Topics

Whether periodically reviewing corporate governance policies or considering the appropriate response to a particular shareholder proposal, a nominating and corporate governance committee will benefit from a solid understanding of the fundamental building blocks of corporate governance and an ongoing effort to keep apprised of legal, economic and social changes that steer the ever-evolving thinking on corporate governance matters. By better appreciating the considerations underlying a decision to adopt—or not to adopt—a particular corporate governance feature, a nominating and corporate governance committee will be better equipped to develop and defend sound, cohesive and comprehensive corporate governance policies and procedures that enable directors and management to best perform their duties, do not unduly dampen or encourage risk-taking, promote long-term value creation and are conducive to good corporate citizenship and social responsibility.

A. Sustainability and Social Topics

Environmental and social topics, including climate risk, continue to be at the forefront of investor engagement with public companies. While often grouped by investors, companies and analysts along with board diversity, governance and other initiatives,[104] environmental and social topics, which we also refer to generally as "ESG" topics, concern a company's approach to addressing environmental and social risks that will or could impact its performance. Given that these topics have become major, mainstream investor priorities, directors, especially members of the nominating and corporate governance committee, should be knowledgeable about such topics.

Institutional investors especially have increasingly emphasized board attention to ESG topics. The U.S. Department of Labor in 2021 proposed new rules expressly enabling Employee Retirement Income Security Act ("ERISA") fiduciaries to consider ESG factors in investment decisions and to engage in proxy voting without the perception that fiduciaries need a special justification for the ordinary exercise of shareholder rights on ESG matters.[105] This proposed rulemaking will reaffirm consideration of environmental factors by pension funds, particularly after Trump-era rulemaking requiring retirement plan fiduciaries to focus on "pecuniary" factors in the investment process, casting doubt on the ability to incorporate ESG factors, and requiring fiduciaries to consider only economic interests of the plan when deciding whether to vote proxies.[106] The Office of the New York City Comptroller, which directs the investment of pension funds for the city's employees, has been transforming its Boardroom Accountability Project from a proxy access advocacy institution to one that "seeks to make boards more diverse,

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[104] For accuracy, this discussion uses the labels utilized by the cited sources wherever appropriate, though these labels may differ from the "environmental and social" topic heading used here.

[105] Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57,272 (proposed October 14, 2021) (to be codified at 29 C.F.R. pt. 2550), https://www.govinfo.gov/content/pkg/FR-2021-10-14/pdf/2021-22263.pdf.

[106] Financial Factors in Selecting Plan Investment, 85 Fed. Reg. 72,846 (November 13, 2020) (to be codified at 29 C.F.R. pts. 2509 & 2550), https://www.govinfo.gov/content/pkg/FR-2020-11-13/pdf/2020-24515.pdf.

independent, and climate competent."[107] Earlier this year, the New York State Comptroller Thomas DiNapoli announced a series of shareholder proposals and other initiatives as part of the New York State Common Retirement Fund's ongoing efforts to increase corporate accountability for progress on diversity, equity and inclusion ("DEI") issues.[108]

Reflecting a growing consensus by major institutional investors that ESG issues have a growing impact on long-term value creation and risk, institutional investors have adjusted their internal voting guidelines for director nominees and shareholder proposals to consider environmental and social topics. In 2019, the United Nations Principles for Responsible Investment ("PRI"), the largest investor network focused on sustainable investing, which already requested voluntary reporting on key climate risks, mandated its 2,250 signatories to, starting in 2020, report risk indicators on both climate-related governance and strategy.[109] BlackRock and other institutional investors now expect companies to issue reports aligned with the recommendations of the Task Force on Climate-related Financial Disclosures and the standards put forward by the Sustainability Accounting Standards Board,[110] and have supported shareholder proposals asking companies to produce incremental disclosures consistent with such recommendations and standards.[111] Other institutional investors have similar environmental and social guidance.[112]

Institutional investor engagement, however, extends beyond voting guidelines, as leading investors have become increasingly outspoken on sustainability and the impact of corporations on society more broadly. BlackRock Chairman and CEO Larry Fink, in his 2022 letter to CEOs of companies in which the fund invests, stated, "We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients. That requires understanding how companies are adjusting their businesses for the massive changes the economy is undergoing. As part of that focus, we are asking companies to set short-, medium-, and long-term targets for greenhouse gas reductions. These targets, and the quality of plans to meet them, are critical to the long-term economic interests of your shareholders."[113] Institutional investors have also taken concrete steps to further their ESG-related goals—for example, BlackRock implements a "heightened scrutiny" model to manage climate-related risk in its

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[107] Office of the New York City Comptroller, *Comptroller Stringer Launches Boardroom Accountability Project 3.0, a First-in-the-Nation Initiative to Bring Diversity to Board and CEO Recruitment* (October 11, 2019), https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/boardroom-accountability-project-3-0/.

[108] Office of the New York City Comptroller, *DiNapoli Seeks Increased Diversity at Pension Fund's Portfolio Companies* (February 15, 2023), https://www.osc.state.ny.us/press/releases/2023/02/dinapoli-seeks-increased-diversity-pension-funds-portfolio-companies.

[109] UN PRI, *TCFD-Based Reporting to Become Mandatory for PRI Signatories in 2020* (February 18, 2019), https://www.unpri.org/news-and-press/tcfd-based-reporting-to-become-mandatory-for-pri-signatories-in-2020/4116.article.

[110] BlackRock Investment Stewardship, *Proxy Voting Guidelines for U.S. Securities* 18 (January 2023), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

[111] *See* BlackRock Investment Stewardship, *Investment Stewardship; Global Principles* 12 (January 2023), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global.pdf.

[112] *See, e.g.*, State Street Global Advisors, *Stewardship Report 2021*, at 57 (April 2022), https://www.ssga.com/library-content/pdfs/asset-stewardship/asset-stewardship-report-2021.pdf.; ISS, *United States Climate Proxy Voting Guidelines: 2022 Policy Recommendations* (January 2022).

[113] Larry Fink, Chairman and CEO of BlackRock Inc., *Larry Fink's 2022 Letter to CEOs* (2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

active portfolios, and will flag holdings in companies that pose significant climate-related risk for potential exit.[114] However, in his 2022 letter, Larry Fink clarified the limits to this approach: "Divesting from entire sectors—or simply passing carbon-intensive assets from public markets to private markets—will not get the world to net zero. And BlackRock does not pursue divestment from oil and gas companies as a policy."[115]

In 2021, institutional investors responded to the ongoing movement against racial injustice by engaging on DEI. BlackRock's 2021 Stewardship Expectations noted the belief that "an inclusive, diverse, and engaged workforce contributes to business continuity, innovation, and long-term value creation."[116] In addition to its ongoing engagement on board diversity, BlackRock has asked companies to disclose workforce demographics in line with EEO-1 data, as well as steps taken to support DEI and an engaged workforce. Similarly, State Street has increased its expectations for boards and companies, including requiring disclosure of board diversity and EEO-1 data.[117] That ESG topics have come to the forefront for institutional investors has in some cases come at the expense of shareholder activists that have pursued short-term objectives perceived as conflicting with ESG considerations. For example, in March 2020, the University of California's investment office reportedly moved to divest itself from Elliott Management due to pressure from the Communication Workers of America Union and the Private Equity Stakeholder Project, which represents workers and other stakeholders at private-equity owned companies, due in part to Elliott's push for significant job cuts and stock buybacks at AT&T.[118]

Nominating and corporate governance committee members must become much more familiar with ESG issues and prepare to engage on such issues with stakeholders, including in shareholder proposals, direct engagement and in new director nominee selection. Evidence suggests, however, that boards may still be playing catch-up when developing expertise and experience on these issues. In one recent survey, less than two-third of directors felt their board understood the internal processes and controls around climate risk and strategy and just 56 percent felt they understood the company's carbon emissions, although the same report also found that 86 percent of directors said their board understood the company's ESG strategy and 82 percent understood the company's ESG risks.[119] The gaps in understanding may be undergirded by a lack of relevant expertise, particularly around more technical issues—another recent study found that only 29 percent of Fortune 100 board directors have relevant ESG

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[114] BlackRock, Inc., *Net Zero: A Fiduciary Approach* (2021), https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter.

[115] Larry Fink, Chairman and CEO of BlackRock Inc., *Larry Fink's 2022 Letter to CEOs* (2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[116] BlackRock Investment Stewardship, *Our 2021 Stewardship Expectations: Global Principles and Market-Level Voting Guidelines* 8 (2020), https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf.

[117] State Street Global Advisors, *Guidance on Diversity Disclosures and Practices* (January 2022), https://www.ssga.com/library-content/pdfs/asset-stewardship/racial-diversity-guidance-article.pdf.

[118] Alicia McElhaney, *The University of California is "Phasing Out" Elliott Management*, INST. INVESTOR (March 31, 2020), https://www.institutionalinvestor.com/article/b1l02zs9ckg3x5/The-University-of-California-Is-Phasing-Out-Elliott-Management.

[119] PricewaterhouseCoopers LLC, *Charting the course through a changing governance landscape: PwC's 2022 Annual Corporate Directors Survey* (2022), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2022-annual-corporate-directors-survey.pdf.

credentials and that such credentials are largely concentrated on the "S" element of ESG (while 21 percent of board members have relevant "S" experience, the figure was six percent each for the "E" and "G" elements).[120] However, evidence points to a turning tide. In another recent survey, while only 18 percent of director respondents considered climate change as a "top five" trend that could impact business performance, 44 percent of respondents considered it important or very important that their board improve oversight of ESG matters in 2021, up from 43 percent in the prior year and 28 percent two years prior.[121] Given the speed at which institutional investors have come to embrace ESG principles in recent years, we think board focus on ESG issues will, and should, intensify in the near-term.

B. Director Tenure and Board Refreshment

As discussed in further detail in Section X.B, the related topics of director tenure and board refreshment have remained top-of-mind among investors in recent years. A significant number of institutional investors have expressed concern about prolonged director tenure—in a 2016 survey, more than two-thirds of the investor respondents identified a high proportion of long-tenured directors on their boards as problematic, a sentiment that continues to be shared today, albeit tempered somewhat by the Covid-19 pandemic which demonstrated the importance of having a balance of deep institutional knowledge alongside newer perspectives on the board.[122] According to ISS, such concerns stem primarily from investors' perception that a stale board risks becoming complacent and is more likely to suffer from a lack of independence, new perspectives and diversity.[123]

While we believe that the composition of a board of directors should reflect a range of tenures, we do not think that a one-size-fits-all approach to board refreshment is appropriate. Rather, in deciding whether to implement measures such as a mandatory retirement age or term limits, directors should recognize that age and experience can bring wisdom, judgment, knowledge and—in some cases—greater independence from management. Substantive director evaluation and re-nomination decisions tailored to the unique circumstances of the company will serve better than arbitrary policies.

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[120] Tensie Whelan, *U.S. Corporate Boards Suffer from Inadequate Expertise in Financially Material ESG Matters*, NYU STERN SCH. OF BUS. 3 (forthcoming) (last updated March 1, 2021), https://ssrn.com/abstract=3758584. The "G" categories included in the study were: accounting oversight/expertise, regulatory body (SEC, FC), cyber/telecom security, risk, ethics/corruption/corporate responsibility, fiduciary/director responsibility and governance. *Id.*

[121] National Association of Corporate Directors, *2020-2021 NACD Trends and Priorities of the American Boardroom* 16, 19 (February 2021); National Association of Corporate Directors, *2019-2020 NACD Public Company Governance Survey* 12, 35 (December 2019); National Association of Corporate Directors, *2018–2019 NACD Public Company Governance Survey* 18 (December 2018).

[122] ISS, *2016-2017 ISS Global Policy Survey: Summary of Results*, 5-6 (September 29, 2016), https://www.iss.com/file/policy/2016-2017-iss-policy-survey-results-report.pdf; *see also* Wachtell, Lipton, Rosen & Katz, *ISS 2017 Policy Survey Results* (October 4, 2016), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25402.16.pdf; David A. Katz & Laura A. McIntosh, *Corporate Governance Update: Director Tenure Remains a Focus of Investors and Activists*, N.Y.L.J. (July 28, 2016), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25356.16.pdf.

[123] ISS, *Board Refreshment: Finding the Right Balance* (2018), https://www.issgovernance.com/library/board-refreshment-finding-the-right-balance/.

C. Classified Boards

Until recently, shareholder proposals to remove classified boards were among the most prevalent and hard-fought governance issues. The pressure over the last decade-and-a-half to declassify boards has achieved significant results. The percentage of S&P 500 companies with a classified board has plummeted from roughly 36 percent in 2007 to just over 11 percent as of February 2023.[124] As a result of this success, shareholder proposals with regard to declassifying boards have declined sharply in recent years.

Under a classified, or staggered, board, directors are divided into classes, typically three, with only one class up for election at each annual meeting. Thus, directors on a classified board are essentially elected to three-year terms. In addition to promoting board stability and enabling directors to think on a longer time frame, a classified board provides an important structural defense against hostile takeovers. Whereas a hostile acquiror can seize control of a company board that is annually elected through a single successful proxy contest, obtaining a majority of a classified board typically requires two elections. Classified boards attract particularly great scrutiny due to the convergence of the interests of governance activists and economic activists: governance activists see classified boards as a barrier to board responsiveness, while economic activists see them as an impediment to forcing a sale or other short-term event.

Although shareholder activists see board declassification as "improving" governance arrangements, there is no persuasive evidence that declassifying boards enhances shareholder value over the long term, and the absence of a classified board makes it more difficult for a public company to fend off an inadequate, opportunistic takeover bid or to focus on long-term value creation. Supporting this proposition, a study by Citigroup Global Markets found that between 2001 and 2009 initial takeover bids were 28.7 percent higher for firms with a classified board in place and that classified boards contributed an additional 13.5 percent in premium in subsequent negotiations, resulting in an aggregate 42.2 percent increase in takeover premiums.[125] One example illustrates the point clearly. In late 2015, Airgas, which had successfully resisted an opportunistic hostile takeover bid from Air Products about six years earlier, agreed to be sold to Air Liquide for more than double the final Air Products offer, even before considering substantial dividends paid in the intervening years, vindicating the Airgas board's judgment. Airgas would not have been able to defend itself without a classified board, which would have cost its shareholders billions of dollars in upside value.[126]

The benefits and drawbacks of classified boards are hotly contested. A number of academic studies have shown that classified boards are associated with an increase in firm value (as measured by Tobin's Q or, roughly, the ratio of market value of assets to book value of

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[124] FactSet. As of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.

[125] Carsten Stendevad *et al.*, Citigroup Global Markets Inc., *M&A: Hostility on the Horizon* 12-13 (September 2009).

[126] *See* Leo E. Strine, Jr., *Can We Do Better by Ordinary Shareholders? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 454 n.16 (2014) ("As it turns out, they were right and, within a few months, the stock was trading well above Air Products' final bid of $70.00 and has continued to trade above that threshold ever since."). On November 18, 2015, Airgas agreed to be sold to Air Liquide at a price of $143 per share, in cash, nearly 2.4 times Air Products' original $60 offer and more than double its final $70 offer, in each case before considering the more than $9 per share of dividends received by Airgas shareholders in the intervening years.

assets), while declassified boards are associated with a decrease.[127] The authors concluded that there is "no support" for the view that entrenched boards decrease firm value,[128] and recommended policy changes to increase the hurdles required for a public company to effect board declassification.[129] Though there has been some pushback against these significant findings from those holding the view that classification reduces firm value by entrenching boards,[130] the proponents have critiqued such pushback for relying on statistically flawed and economically insignificant results.[131]

Unfortunately, this debate is now largely academic, at least for large companies, most of which now have declassified boards. Unlike a rights plan, which the board can implement quickly as the need arises, a declassified board is a defense that, once removed, cannot be reinstated whenever a takeover threat materializes. Companies that still have classified boards are likely to continue facing pressure to remove them. Nominating and governance committees faced with this issue will have to react on a case-by-case basis, but should be wary of implementing changes with far-reaching implications that cannot be easily reversed.

D. Majority Voting

The corporate law of most states, including Delaware, provides that directors are to be elected by plurality voting, unless otherwise provided in the company's certificate of incorporation or bylaws.[132] Under this default, if the nominees endorsed in the company's proxy statement run unopposed, they are assured of election regardless of the number of votes "against" or "withheld." Under a majority voting standard, however, a director is not elected unless he or she receives at least a majority of the votes cast.

Historically, directors of virtually all companies were elected under a plurality standard. Beginning in 2004, activists began calling for majority voting. Some form of majority voting is now used by around 91 percent of S&P 500 companies and is well on its way to becoming

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[127] *See* K.J. Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, *Staggered Boards and Long-Term Firm Value, Revisited*, 126 J. FIN. ECON. 422 (2017); K.J. Martijn Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 STAN. L. REV. 67, 71 n.17 (2016) (explaining Tobin's Q valuation).

[128] K.J. Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, *Staggered Boards and Long-Term Firm Value, Revisited*, 126 J. FIN. ECON. 422, 443 (2017). For the entrenchment view, *see* Lucian A. Bebchuk, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409 (2005). Our firm has criticized the Harvard Law School Shareholder Rights Project headed by Professor Lucian Bebchuk, a leading advocate for the position that classification entrenches boards and reduces firm value, for engaging in advocacy advancing a narrow and controversial agenda that would exacerbate the short-term pressures under which U.S. companies are forced to operate. *See* Wachtell, Lipton, Rosen & Katz, *Harvard's Shareholder Rights Project is Wrong* (March 21, 2012), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.21664.12.pdf; Wachtell, Lipton, Rosen & Katz, *Harvard's Shareholder Rights Project is Still Wrong* (November 28, 2012), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos//WLRK.22209.12.pdf.

[129] *See* K.J. Martijn Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 STAN. L. REV. 67, 138-40 (2016).

[130] *See* Lucian A. Bebchuk & Alma Cohen, *Recent Board Declassifications: A Response to Cremers and Sepe* (May 1, 2017), https://ssrn.com/abstract=2970629.

[131] *See* K.J. Martijn Cremers & Simone M. Sepe, *Board Declassification Activism: Why Run Away from the Evidence?* (June 2017), https://ssrn.com/abstract=2991854.

[132] *See, e.g.*, 8 Del. C. § 215(c)(3).

universal among large companies.[133] ISS and Glass Lewis generally advise shareholders to vote to adopt the majority vote standard.[134]

Under state laws designed to ensure that there are always directors in place, a director who receives less than a majority of the votes cast in a majority voting election would not be elected but would continue to serve as a "holdover" director until his or her successor is elected and qualified. Many companies with majority voting address the matter of holdover directors by establishing a resignation policy for directors receiving less than a majority vote. In some cases, these policies call for directors to deliver resignation letters in advance, which are triggered automatically if a director receives less than a majority vote (thereby avoiding the need to attempt to compel a sitting director to tender a resignation after failing to receive the requisite vote). An example of such a resignation policy is attached as Annex B. The unconflicted members of the board (or perhaps of the nominating and corporate governance committee) would then deliberate over whether or not to accept the director's resignation. Delaware courts have confirmed that a board of directors is not required to accept the resignation of a director for failure to obtain majority support.[135] However, nominating and corporate governance committee members should understand that shareholders likely would not appreciate having a director they had rejected reinstated, absent special circumstances. (Indeed, activists have coined a colorful but unflattering description of such holdover directors, who are sometimes called "zombie directors.")

A company that adopts majority voting should draft its bylaws carefully (so that abstentions do not count as votes "against" the incumbent director) and, where possible, provide that once the determination is made that an election is "contested," the plurality standard remains in place, even if there is no competing slate at the time of the shareholders' meeting. The perils of not doing so were demonstrated in a proxy contest in 2008, in which a dissident dropped its proxy contest and contended that the vote standard therefore reverted to majority, enabling a "withhold" vote campaign intended to result in directors failing to be elected.[136]

E. Shareholder Rights Plans

Shareholder rights plans, popularly known as "poison pills," became highly relevant again in 2020, due to the dramatic declines in stock prices across the board as a result of the Covid-19 pandemic. More rights plans were adopted in March and the first two weeks of April

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[133] FactSet. As of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.
[134] ISS, *2023 U.S. Proxy Voting Guidelines* 22 (December 13, 2022); Glass Lewis, *2023 Policy Guidelines* 43 (November 17, 2022).
[135] *See City of Westland Police & Fire Ret. Sys.* v. *Axcelis Techs., Inc.*, 1 A.3d 281 (Del. 2010). *But cf. Louisiana Mun. Police Employees Ret. Sys.* v. *Morgan Stanley & Co. Inc.*, C.A. No. 5682-VCL, 2011 WL 773316, at *6 (Del. Ch. March 4, 2011) (citing *Axcelis*, 1 A.3d at 290, 291) (noting that a board may be subject to a stockholder books-and-records request for the purpose of evaluating whether the board's decision not to accept resignations tendered by directors failing to obtain the requisite support was in the best interests of the corporation).
[136] *Levitt Corp.* v. *Office Depot, Inc.*, C.A. No. 3622-VCN, 2008 WL 1724244, at *3, *15-16 (Del. Ch. April 14, 2008).

2020 than in the whole of 2019 or 2018.[137] However, the trend has since reversed, with the adoption of poison pills declining from 100 in 2020 to 49 in 2021 and 35 in 2022.[138]

In 2022, the adoption by Twitter of a poison pill in response to a proposed takeover by Elon Musk received significant press attention that was more explanatory than critical. For years before that, poison pills had not been as prominent a feature of the corporate governance debate as they had been in years past, because the controversy around them had abated with the general acceptance that they are extremely valuable and important tools that a board of directors can use on short notice to protect the corporation against threats, but also that shareholders are only willing to accept them on a short-term basis. Because the shareholder rights plan is a critical piece of any board's defensive arsenal, members of nominating and corporate governance committees should be familiar with how they work and what they can and cannot do.

A shareholder rights plan is a mechanism that can be employed by board action that, while in place, effectively deters individuals or groups from acquiring more than a specified percentage of the company's stock. Rights plans do not interfere with negotiated transactions and do not preclude unsolicited takeover offers. Instead, they combat abusive takeover tactics by preventing an acquiror from gaining a controlling stake in a company without negotiating with the company's board to provide an adequate bid. Also, if a tender or exchange offer is launched, the rights plan will give the board and the shareholders time to properly evaluate the bid and potentially to pursue more attractive options that might not otherwise be available under the time pressure of a tender offer. Despite these salutary effects, shareholder rights plans have been the subject of intense debate since they were first used in the 1980s. Critics contend that shareholder rights plans discourage deal activity and entrench boards by limiting shareholders' ability to approve the sale of the company.

Because a rights plan (especially when coupled with a classified board) is the single most effective defense against a hostile takeover bid, until about 15 years ago most large companies had standing rights plans in place, typically with 10-year terms. In response to sustained criticism from activists that rights plans discourage deal activity and entrench boards by limiting shareholders' ability to approve a sale, most companies have allowed their rights plans to expire, preferring to hold in reserve the ability to adopt a rights plan in response to a takeover bid if one is made (referred to as having a rights plan "on the shelf"). Indeed, the percentage of S&P 500 companies with a rights plan in place has decreased from about 50 percent in 2005 to roughly one percent as of February 2023.[139] Proxy advisory voting policies have been a major driving force behind this change. Even the proxy advisors acknowledge the significant beneficial effects of a rights plan in providing time for the board and shareholders to respond to an actual threat, such as an inadequate hostile takeover bid, but they view it as a short-term delaying device, not as a "show-stopper." ISS recommends an "against" or "withhold" vote for board members (except new nominees, who are assessed on a case-by-case basis) where the board adopts an initial rights plan with a term of more than 12 months or renews any existing rights plan (regardless of its term) without shareholder approval, although a commitment to put a newly adopted rights plan of less than 12 months' duration to a binding shareholder vote may result in a

[137] FactSet. As of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.
[138] FactSet. As of April 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.
[139] FactSet. As of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.

case-by-case vote recommendation.[140] ISS also considers adoption of a rights plan without shareholder approval to be a problematic provision that, if aggregated with other such provisions in a director performance evaluation, could cause ISS to vote "against" or "withhold" votes from a board.[141] ISS and Glass Lewis also generally recommend, with limited exceptions, voting "for" shareholder proposals requesting that a company submit its rights plan to a shareholder vote.[142]

Under pressure from activists, some companies have agreed not to implement a rights plan absent shareholder approval or ratification within some period of time, most commonly one year. Activist institutional investors, such as TIAA-CREF, have sponsored precatory shareholder proposals to adopt a policy requiring that rights plans be submitted for shareholder approval. Due, in part, to proxy advisory voting guidelines, such proposals routinely garner wide support, even at companies that do not have a rights plan in place. For those companies that have not adopted a policy that restricts the board's ability to adopt a rights plan, they retain the ability to maintain an "on-the-shelf" rights plan that can be adopted quickly by the board should a specific threat arise. Unlike some other takeover defenses that, once removed, cannot practically be regained, such as a classified board, a "shadow" rights plan provides a company the flexibility to respond to changing circumstances. A board may therefore conclude that it would be prudent to avoid the scrutiny that accompanies adopting a rights plan by waiting until it is needed to fend off a particular threat. A board should be wary, however, of policies or situations that would curtail its ability to employ this crucial component of effective takeover defense.

The threats to companies posed by the Covid-19 pandemic and the significant declines in their stock prices during the pandemic's onset illustrated the importance of retaining this flexibility through the maintenance of a rights plan that is "on the shelf and ready to go." Some companies saw fit to adopt rights plans with unusually aggressive terms during the pandemic, leading to criticism of the board.[143] Needless to say, the decision to adopt a rights plan and its specific terms and features should be based on a thoughtful consideration of the factual circumstances, and supported by expert advice.

F. Advance Notice Bylaw

The advance notice bylaw is an important corporate housekeeping tool with the primary purpose of helping to ensure orderly business at shareholder meetings. It requires a shareholder to submit "advance notice" of his or her intention to introduce business at a shareholder meeting, such as the nomination of director candidates or the introduction of a shareholder proposal. An

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[140] ISS, *2023 U.S. Proxy Voting Guidelines* 14 (December 13, 2022).

[141] *Id.* at 13-15.

[142] ISS, *2023 U.S. Proxy Voting Guidelines* 29 (December 13, 2022); Glass Lewis, *2023 Policy Guidelines* 69 (November 17, 2022).

[143] ISS recommended a withhold vote for the chairman of The Williams Companies after the company adopted a rights plan that ISS viewed as "highly restrictive." *See* Corrie Driebusch & Rebecca Elliott, *Pipeline Operator Williams Comes Under Fire*, THE WALL ST. J. (April 7, 2020), https://www.wsj.com/articles/pipeline-operator-williams-comes-under-fire-11586286169. The Delaware Court of Chancery issued a decision in February 2021 finding that the rights plan could not withstand scrutiny under *Unocal*. *The Williams Cos. Stockholder Litig.*, C.A. No. 2020-0707-KSJM, 2021 WL 754593 (Del. Ch. February 26, 2021), *aff'd*, *The Williams Cos.* v. *Wolosky*, 264 A.3d 641 (Del. 2021) (TABLE). This holding was affirmed by the Supreme Court of Delaware in November 2021.

advance notice bylaw serves three significant functions: first, to inform a company of shareholder business to be brought at the meeting an adequate time in advance of the meeting; second, to provide an opportunity for all shareholders to be fully informed of such matters an adequate time in advance of the meeting; and third, to enable a company's board to make informed recommendations or present alternatives to shareholders regarding such matters. As a result, such advance notice bylaws typically require not only notice of shareholder business but also the information necessary to determine that a shareholder-nominated director candidate is qualified to be elected, as well as other important information, such as records demonstrating that the person introducing business is actually a shareholder of the company. A common formulation of the time frame in which proposals or nominations must be submitted is no later than 90 days and no earlier than 120 days prior to the anniversary of the prior year's annual meeting. However, some companies provide for different windows. For example, a number of companies have reconciled their advance notice bylaw with the SEC's timing requirements for Rule 14a-8 proposals (described in Section IV.A), which call for any proposal to be submitted at least 120 calendar days before the date on which the company released its proxy statement for the previous year's annual meeting.

Although the validity of advance notice bylaws has been established in many court decisions, such provisions are not immune from legal challenge. In 2012, for example, the Delaware Court of Chancery granted a motion to expedite a claim brought by Carl Icahn alleging that the board of Amylin Pharmaceuticals had breached its fiduciary duties by enforcing the company's advance notice bylaw provision and refusing to grant Mr. Icahn a waiver so he could make a nomination after the advance notice deadline and following the company's rejection of a third-party proposal.[144] In December 2014, however, the Delaware Court of Chancery alleviated some of the concerns raised by that decision, clarifying that to enjoin enforcement of an advance notice provision, a plaintiff would have to allege "compelling facts" (such as the board taking an action that resulted in a "radical" change between the advance notice deadline and the annual meeting) indicating that enforcement of the advance notice provision was inequitable.[145] Subsequently, in *BlackRock Credit Allocation Income Trust* v. *Saba Capital Master Fund, Ltd.*, the Supreme Court of Delaware held that, absent "manipulative conduct" by the board, a stockholder that had failed to meet a deadline under an advance notice bylaw to respond to the board's information request regarding its proposed nominees had no grounds to challenge the resulting invalidity of its nomination.[146] Although the Chancery Court in the *Saba* case had criticized the company for seeking information on the insurgents' nominees that went beyond what was specifically called for in the bylaws and then insisting on an unreasonable timeline, the Supreme Court's decision is a strong endorsement of the utility and importance of advance notice bylaws. In other cases in Delaware, judges have ruled in favor of activist shareholders based on ambiguities in the companies' advance notice bylaw provisions.[147] These decisions provided a sobering reminder of the importance of clear and careful drafting. As a result of

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[144] *Icahn Partners LP* v. *Amylin Pharm., Inc*., C.A. No. 7404-VCN, 2012 WL 1526814 (Del. Ch. April 20, 2012).
[145] *AB Value Partners, LP* v. *Kreisler Mfg. Corp.*, C.A. No. 10434-VCP, 2014 WL 7150465, at *5-6 (Del. Ch. December 16, 2014).
[146] *BlackRock Credit Allocation Income Tr.* v. *Saba Capital Master Fund, Ltd*., 224 A.3d 964, 981 (Del. 2020), *reh'g denied* (January 29, 2020).
[147] *Jana Master Fund, Ltd.* v. *CNet Networks, Inc.*, 954 A.2d 335 (Del. Ch. 2008); *Levitt Corp.* v. *Office Depot, Inc.*, C.A. No. 3622-VCN, 2008 WL 1724244 (Del. Ch. April 14, 2008); *Sherwood* v. *Chan Tsz Ngon*, C.A. No. 7106-VCP, 2011 WL 6355209 (Del. Ch. December 20, 2011).

decisions such as these, advance notice bylaws continue to evolve. A model advance notice bylaw is attached as Annex C.

Innovative activist tactics can also impact how public companies review, draft or amend advance notice bylaws in the future. In mid-2016, activist Corvex Management LP proposed to replace the entire 10-member board of The Williams Companies, Inc. immediately before Williams's advance notice notification deadline.[148] Faced with the notification deadline, Corvex identified 10 of its own employees as placeholders, allegedly satisfying the notification deadline, and proposed to identify and disclose to Williams stockholders the actual director candidates prior to the vote.[149] The placeholder Corvex nominees could then, if elected, appoint the actual directors to the Williams board and then immediately resign.[150] While it is questionable that such a tactic would survive judicial review, since the Corvex-Williams dispute, other public companies have amended their bylaws to restrict or prevent placeholder notifications of the type proposed by Corvex.[151]

More recently, following the disclosure of an approximately 9 percent stake in Masimo Corporation by Politan Capital Management in August 2022,[152] Masimo adopted advance notice bylaws which required nominating shareholders to disclose information about their own investors, other investors with whom they have spoken, as well as other companies for which they are also nominating directors.[153] The amendments—which among other things required disclosures as to the identity and holdings of Politan's limited partners (which investment funds customarily keep strictly confidential) and information regarding planned nominations and proposals at other companies within the next 12 months—attracted criticism from the investment community, who regarded the disclosure requirements as serving primarily to frustrate a dissident's ability to run a proxy contest. The amendments were withdrawn following litigation brought by Politan in the Delaware Court of Chancery.[154]

Nominating and corporate governance committee members should understand and assess whether their companies' advance notice bylaws properly address the risk posed by the nominee placeholder tactic, while also making sure that such bylaws are sensibly tailored and do not impose overly onerous requirements on shareholder nominees or impede the stockholder franchise. Well-drafted advance notice bylaws ensure that the board has all of the information it needs to make an informed recommendation to stockholders, and that investors are apprised of

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[148] *See* Leslie Picker, *Former Director Unveils Disputed Plan for Williams Board*, N.Y. TIMES (August 24, 2016), https://www.nytimes.com/2016/08/25/business/dealbook/former-director-unveils-disputed-plan-for-williams-board.html.

[149] *See* Press Release, Corvex Management LP, *Letter to Stockholders of The Williams Companies Inc.* (August 24, 2016), https://www.prnewswire.com/news-releases/corvex-issues-open-letter-to-williams-stockholders-regarding-notice-to-replace-entire-williams-board-of-directors-300317583.html.

[150] *Id.*

[151] *See, e.g.*, Amended and Restated Bylaws of Coeur Mining, Inc., effective as of March 8, 2019.

[152] *See* Cara Lombardo, *Activist Politan Capital Has 9% Stake in Masimo*, THE WALL ST. J. (August 15, 2022), https://www.wsj.com/articles/activist-politan-capital-has-9-stake-in-masimo-11660600800.

[153] *See* Scott Deveau, *Masimo Investor Politan Sues to Block Activist Rule Changes*, BLOOMBERG (October 21, 2022), https://www.bloomberg.com/news/articles/2022-10-21/masimo-investor-politan-sues-to-block-rules-hindering-activists?leadSource=uverify%20wall.

[154] *See* Svea Herbst-Bayliss, *Masimo reverses bylaws requiring detailed activist information*, REUTERS (February 6, 2023), https://www.reuters.com/business/healthcare-pharmaceuticals/masimo-backs-off-bylaw-amendments-requiring-detailed-information-activists-2023-02-06/.

the eligibility and suitability of dissident candidates, benefiting the company and all shareholders.

G. Separation of Chairman and CEO Roles

As in many other corporate governance areas, the prevalence of the same individual serving as both Chairman and CEO has seen a dramatic change in the last decade. A recent survey found that nearly 60 percent of S&P 500 boards now separate the Chairman and CEO roles, compared with only 40 percent in 2010.[155] This trend has been driven, in large part, by corporate governance activists who consider separation of the roles to be "best practice." In this vein, a survey of companies that had recently separated their Chairman and CEO roles found that, in 2016, 20 percent of respondents considered separation of the roles to represent the best governance model, a significant drop from the prior year, when 43 percent of respondents expressed this belief.[156] Much more important than the form of board structure, however, is whether it works in practice for a particular company.

The traditional model of a combined Chairman and CEO generally offers a number of advantages. The CEO's thorough familiarity with the company, expertise in the industry and leadership skills may uniquely position him or her to have the credibility with constituencies that is essential to effectively chair the board. The CEO's leadership as Chairman may also help avoid the balkanization that may arise if directors split between those aligning with the CEO and those aligning with the Chairman. Further, combining the roles of CEO and Chairman avoids confusion over the scope of the Chairman's and CEO's respective responsibilities, thus potentially enhancing CEO accountability. A CEO's service as Chairman may also foster effective communication between management and the board.

Advocates for separation of the Chairman and CEO positions typically contend that separation strengthens the board's independence and ability to oversee and evaluate management—the CEO in particular—by reducing the CEO's control over the board agenda. Another common rationale is that separating the roles will allow for greater focus and an effective division of labor, with the CEO concentrating on running the company's business and the Chairman on leading the board. However, the validity of these arguments will vary depending on a company's specific circumstances and the dynamic of its leadership structure. Although the SEC requires a company to disclose its board leadership structure and, if the CEO and Chairman roles are combined, whether the company has a lead independent director and his or her specific role,[157] it should be noted that these are simply disclosure requirements. They are not a mandate for separation of the CEO and Chairman roles, and they are not an endorsement by the SEC of activists' view that separation of the roles is in all cases a "best practice."

A company choosing to separate the Chairman and CEO positions should ensure that the respective roles of the two positions are clearly delineated to avoid duplication or neglect of

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[155] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 36 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

[156] Spencer Stuart, *Spencer Stuart Board Index 2016*, at 23 (2016), https://www.spencerstuart.com/research-and-insight/spencer-stuart-board-index-2016; Spencer Stuart, *Spencer Stuart Board Index 2015*, at 20 (2015), https://www.spencerstuart.com/and-insight/spencer-stuart-us-board-index-2015.

[157] Item 407(h) of Regulation S-K. 17 C.F.R. § 229.407(h).

certain responsibilities or damage to the cohesion of the board. Because of the risks to board cohesion arising from separating the positions if they are currently held by the same person, succession is a common way for a Chairman/CEO split to be implemented. A 2019 survey found that over half of all companies facing a succession event for a CEO choose to make other changes to management and the board.[158] A split may be desirable if the incoming CEO is less familiar with the board and the company than was his or her predecessor. It is not uncommon for companies that separate the Chairman and CEO role during a CEO transitional period to later recombine the roles once the CEO has gained experience with the company. Some companies that separated the roles of Chairman and CEO found the separation suboptimal and later chose to recombine the positions.[159]

A company with a combined Chairman and CEO should have a lead director (also sometimes called a presiding director). From a board-effectiveness perspective, it is not necessary to separate the roles of Chairman and CEO so long as there is an effective lead director with robust responsibilities in place. As one position paper succinctly put it, after a review of the academic literature, "[n]o structural attribute of boards has ever been linked consistently to company financial performance."[160] Indeed, a combined Chairman and CEO teamed with a capable independent lead director may enable the board to enjoy the benefits of both the CEO's expertise and a strong independent voice.

All but four boards of S&P 500 companies have either an independent Chairman or an independent lead/presiding director.[161] In 2017, the full board selected the lead/presiding director according to approximately 71 percent of respondents from S&P 500 companies then surveyed, while 14 percent of respondents said that a lead/presiding director was selected by the nominating and corporate governance committee (down from 26 percent in 2016) and 16 percent said that independent directors select the lead/presiding director.[162] The responsibilities of a lead director should be clearly delineated and will include many of the responsibilities assumed by an independent Chairman. The traditional responsibilities of the lead director include presiding at, and having the authority to call, executive sessions, setting meeting agendas for executive sessions, and being available for consultation and direct communication with major shareholders where appropriate. In recent years, there has been an increasing focus on the role of the lead director, which has, in many cases, expanded to include leading the board's annual self-assessment process, cooperating with the CEO in setting the agenda for full board meetings and sometimes also approving materials for full board meetings. The lead director's role should be

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[158] The Conference Board, *CEO Succession Practices* 33 (2019), https://www.conference-board.org/publications/publicationdetail.cfm?publicationid=8791.

[159] Examples include Caterpillar Inc., Time Warner Inc., General Motors and Duke Energy Corporation. *See also* Korn Ferry International and National Association of Corporate Directors, *Annual Survey of Board Leadership 2017 Edition* 13, 33 (2017), https://www.kornferry.com/institute/korn-ferry-board-leadership-survey-2017.

[160] Richard Leblanc & Katharina Pick, The Conference Board, *Director Notes, Separation of Chair and CEO Roles* 3 (August 2011); *see also* Phillip C. James, *Understanding the Impact of Board Structure on Firm Performance: A Comprehensive Literature Review*, 10 INT'L J. BUS. & SOC. RSCH., No. 1, 2020, at 7 (noting that "there remains no general consensus on the question of whether board structure/composition positively or negatively affect firm performance").

[161] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 36 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

[162] Spencer Stuart, *Spencer Stuart Board Index 2017*, at 6 (2017), https://www.spencerstuart.com/research-and-insight/ssbi-2017.

tailored to the company's needs, which depend on a number of factors, such as the company's history and the personalities of those serving on the board.

While the nominating and corporate governance committee should make an independent judgment as to the appropriate leadership structure, it should remain mindful of the powerful influence of proxy advisory firms. ISS will generally recommend a vote in favor of a shareholder proposal to require that the Chairman's position be filled by an independent director, taking into consideration various factors, such as the scope of the proposal, the company's current board leadership structure, governance structure and practices and company performance.[163] In the past, ISS has conceded, however, that "attempts to correlate the separation of position with market performance have been inconclusive."[164] Glass Lewis will typically encourage support of proposals to separate the roles of Chairman and CEO on the grounds that a CEO as Chairman makes it difficult for a board to fulfill its role as overseer and policy setter, but it does not recommend that shareholders vote against CEOs who chair the board.[165]

H. Ability of Shareholders to Act by Written Consent

Under Delaware law, unless a corporation's charter provides otherwise, any action that may be taken by shareholders at a meeting may instead be taken by written consent at the same approval threshold as would be required to take such action at a meeting of shareholders.[166] Approximately 70 percent of S&P 500 companies have charter provisions prohibiting action by written consent, while other companies permit action by written consent only if such consent is unanimous (which, for broadly held public companies, is effectively equivalent to a prohibition).[167]

Permitting shareholder action by written consent is considered by some institutional and activist groups to be an important shareholder right. Having largely achieved their initial goals of eliminating standing shareholder rights plans and classified boards, and facilitating shareholder-called special meetings in between annual meetings (at ever decreasing thresholds), action by written consent is one of the next targets of activist groups. Because the prohibition on action by written consent must be included in the charter (in Delaware at least), shareholder activists have in recent years proposed precatory resolutions calling on the board to permit such action. Institutional investors often support these proposals. ISS recommends voting for shareholder proposals that provide shareholders with the ability to act by written consent, but will recommend voting on a case-by-case basis for such shareholder proposals if the company (1) allows special meetings to be called by 10 percent of its shareholders with no restrictions on grouping to reach that threshold and agenda at the meeting; (2) has a majority vote standard in

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[163] ISS, *2023 U.S. Proxy Voting Guidelines* 21 (December 13, 2022). *See also* ISS, *2015 U.S. Independent Chair Policy: Frequently Asked Questions* (2015) (noting that, in determining whether to recommend for or against the shareholder proposal, ISS will also consider the presence of an executive or non-independent chair in addition to the CEO, a recent recombination of the role of CEO and chair and/or departure from a structure with an independent chair, as well as any recent transitions in board leadership and the effect such transactions may have on independent board leadership as well as the designation of a lead director role).

[164] ISS, *2015 U.S. Proxy Voting Manual: 2015 Benchmark Policy Recommendations* 52 (April 30, 2015).

[165] Glass Lewis, *2023 Policy Guidelines* 16 (November 17, 2022).

[166] 8 Del. C. § 228(a).

[167] FactSet. Data as of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.

uncontested elections; (3) has no non-shareholder-approved poison pill; and (4) has an annually elected board.[168] Companies generally resist these proposals, pointing out that action by written consent is more appropriate for a closely held corporation with a small number of shareholders than for a widely held public company. Action by shareholder meeting provides many benefits not available in a written consent context, including: the meeting and the shareholder vote taking place in a transparent manner on a specified date that is publicly announced well in advance, giving all interested shareholders a chance to express their views and cast their votes; a forum for open discussion and full consideration of the proposed action; advance distribution of detailed information by both sides about the proposed action; and the ability of the board to analyze and provide a recommendation with respect to proposed actions. Action by written consent, by contrast, effectively disenfranchises all of those shareholders who do not have the opportunity to participate in the consent.

For a company that allows shareholders to call special meetings in between annual meetings, action by written consent offers no benefit. What it does do is render a company particularly vulnerable to a hostile takeover bid. A raider's ability to conduct a consent solicitation and effectively "ambush" a target with little or no warning may limit a target company's ability to mount an effective defense or fully explore alternative transactions. Naturally, the smaller the market capitalization of the company, the greater the threat becomes.

Unfortunately for companies today, it is unlikely that shareholders would support a charter amendment to prohibit action by written consent, and many companies are being pressured by their shareholders and the proxy advisors to give up that protection if they have it. A company with a charter provision permitting shareholders to act by written consent may limit its vulnerability by adopting a bylaw that enables the board to set the record date for a shareholder's solicitation of written consents.[169] The form of bylaw adopted generally adheres to the standards that have been upheld by the Delaware Court of Chancery, sometimes referred to as the "10 + 10" bylaw, which requires the board to take action to set a record date for the written consent solicitation within 10 days of receiving notice from a shareholder seeking to solicit consents, and requiring the board to then set a record date within 10 days of taking action. This means that the record date for the consent solicitation cannot be more than 20 days after the shareholder requests that the board set a record date, effectively giving the board a three-week "heads-up" before a hostile party can solicit consents.[170] To best position itself if this approach is challenged, a company adopting such a bylaw should build as strong a record as possible as to why the restriction is necessary and appropriate.

I. Ability of Shareholders to Call a Special Meeting

The right to call special shareholder meetings in between annual meetings is another activist investor hot button issue. From the company's perspective, it is better to have a predictable window of vulnerability around the annual meeting. The right to call special meetings—particularly when combined with a declassified board—has the potential to seriously

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[168] *See* ISS, *2023 U.S. Proxy Voting Guidelines* 31 (December 13, 2022).

[169] *See Edelman* v. *Authorized Distrib. Network, Inc.*, C.A. No. 11104, 1989 WL 133625 (Del. Ch. November 3, 1989); *see also Nomad Acquisition Corp.* v. *Damon Corp.*, C.A. No. 10173, 1988 WL 383667 (Del. Ch. September 20, 1988).

[170] *See Edelman* v. *Ackerman*, C.A. No. 11104, 1989 WL 133625 (Del. Ch. November 3, 1989).

inhibit the ability of a board to defend against an opportunistic takeover bid that undervalues the company. Shareholder rights activists, however, consider the right to call special meetings an important element of "shareholder democracy" because, if shareholders are permitted to call a special meeting, they do not have to wait for an annual meeting to seek to effect change, but instead can act throughout the year, including to submit shareholder proposals or seek removal of directors. ISS recommends voting against proposals that restrict or prohibit shareholders' ability to call special meetings.[171] In our view, there is no reason to consider "California-style" recall elections a better model of democracy than the traditional "republican" model, in which voters elect representatives periodically, entrust them to do the job and can remove them from office at the end of their term if they are dissatisfied. However, activist pressure (powered by shareholder resolutions and ISS withhold recommendations) is extremely hard to resist.

Under activist pressure, roughly 70 percent of S&P 500 companies now permit shareholders to call special meetings in between annual meetings.[172] Among the companies that permit shareholders to call special meetings, the minimum threshold required to call a special meeting varies. Many shareholder rights activists consider 10 percent the gold standard and will initiate shareholder proposals even at companies that already permit shareholders to call special meetings at higher percentages.

J. Removal of Directors

As a general rule, directors may be removed, with or without cause, by the holders of at least a majority of the shares entitled to vote.[173] As a notable exception, Delaware corporate law provides that, unless the charter provides otherwise, directors of a corporation with a classified board may be removed only for cause.[174] Following a 2015 Delaware case confirming that corporations without classified boards or cumulative voting could not restrict stockholders' ability to remove directors without cause,[175] the Delaware Court of Chancery ruled that bylaws requiring supermajority stockholder approval for the removal of directors are invalid.[176] Neither case, however, spoke directly to the question of supermajority removal provisions in charters, which have a much stronger basis under the Delaware statute.

Indeed, some companies' charters still have supermajority vote requirements to remove directors without cause. However, these supermajority provisions are generally disfavored by shareholder activists and other institutional investor groups. Supermajority vote requirements have themselves often been the subject of precatory proposals and tend to receive substantial

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[171] ISS, *2023 U.S. Proxy Voting Guidelines* 32 (December 2022).
[172] FactSet. As of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.
[173] Notably, in a transcript ruling, the Delaware Court of Chancery invalidated charter and bylaw provisions providing that directors of a company without a staggered board and cumulative voting could only be removed for cause. The stockholder plaintiffs argued—and the court agreed—that under § 141(k) of the DGCL, stockholders have the right to remove directors without cause unless the company has a staggered board or cumulative voting. Companies with unclassified boards whose charters allow director removal only "for cause" should consult with counsel, as these charter provisions may be unenforceable and plaintiffs' firms will be seeking to compel companies to amend their charters to eliminate them, in order to earn a fee. Ruling Tr., *In re Vaalco Energy S'holder Litig.*, C.A. No. 11775-VCL (Del. Ch. December 21, 2015).
[174] 8 Del. C. § 141(k)(1).
[175] Ruling Tr., *In re Vaalco Energy S'holder Litig.*, C.A. No. 11775-VCL (Del. Ch. December 21, 2015).
[176] *Frechter* v. *Zier*, C.A. No. 12038-VCG, 2017 WL 345142 (Del. Ch. January 24, 2017).

shareholder support, leading to their elimination to avoid a vote against recommendation by ISS for a director nominee, given ISS's definition of any supermajority vote requirement as a "problematic provision" when evaluating board accountability and oversight.[177] As the number of companies with classified boards and supermajority vote requirements decreases, directors become more vulnerable to removal at any time, and companies become more vulnerable to takeovers.

K. Exclusive Forum Provisions in Organizational Documents

The volume of duplicative, costly and often frivolous shareholder litigation that was being brought simultaneously in multiple courts in multiple states led many companies to adopt an "exclusive forum" provision. These provisions, which can be included either in a company's charter or bylaws, typically designate specific courts in the state of incorporation (Delaware for many public companies) to serve as the exclusive venues for particular types of shareholder and intra-corporate litigation, most commonly: (1) derivative lawsuits; (2) actions asserting breaches of fiduciary duty; (3) actions arising pursuant to any provision of the corporate statute of the state of jurisdiction (the DGCL for many public companies); and (4) actions asserting claims governed by the internal affairs doctrine. These provisions serve multiple objectives, including preventing the waste that inevitably occurs when duplicative lawsuits asserting the same claims on behalf of the same constituencies seeking the same relief are commenced at the same time by multiple shareholders in multiple courts and ensuring that fiduciary duty and internal affairs claims are adjudicated by the courts most familiar with the underlying corporate law and capable of authoritatively interpreting the law. These provisions also allow companies to better plan and manage the litigation landscape by imposing order and consistency before litigation begins.

Exclusive forum provisions contained in bylaws and adopted unilaterally by the board have been legally tested and upheld. Although a 2011 case in California federal district court initially refused to enforce a company's board-adopted exclusive forum bylaw where it was put in place after alleged board-level malfeasance,[178] the Court of Chancery ultimately upheld forum selection bylaws as a matter of Delaware law in an important June 2013 decision involving a bylaw adopted by Chevron Corporation,[179] and reaffirmed the validity of the bylaws in December of 2014, noting that such bylaws reflect a company's legitimate interest in rationalizing shareholder litigation.[180] In December 2018, the California Court of Appeal became the second appellate court outside of Delaware to recognize the enforceability of forum-selection bylaws adopted by a Delaware corporation designating the Delaware Court of Chancery as the exclusive forum for litigating intracorporate and fiduciary disputes.[181]

The number of companies adopting exclusive forum provisions has risen dramatically in recent years. Exclusive forum provisions in certificates of incorporation or corporate bylaws

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[177] ISS, *2023 U.S. Proxy Voting Guidelines* 34 (December 2022).
[178] *Galaviz* v. *Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011).
[179] *Boilermakers Local 154 Ret. Fund* v. *Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).
[180] *United Techs. Corp.* v. *Treppel*, 109 A.3d 553 (Del. 2014).
[181] *Drulias* v. *1st Century Bancshares, Inc.*, 241 Cal. Rptr. 3d 843, 846 (Cal. Ct. App. 2018); *see also* Wachtell, Lipton, Rosen & Katz, *California Appeals Court Confirms Enforceability of Delaware Forum-Selection Bylaws* (April 8, 2016), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26303.18.pdf.

were first proposed in 2007[182] and began to be adopted more broadly in 2010, following the Delaware Court of Chancery's mention of the provision as a possible solution to the multi-forum duplicative litigation problem.[183] Before the *Chevron* opinion, approximately 250 publicly traded corporations had adopted an exclusive forum provision in some form; the overwhelming majority (approximately 175) in the form of a charter provision adopted in circumstances where public shareholder approval was not required (*e.g.*, in connection with an IPO, a spin-off or bankruptcy reorganization). Today, over 2,781 public companies have adopted an exclusive forum provision, with roughly 44 percent in the form of a board-adopted bylaw.[184] In 2015, the Delaware General Assembly gave statutory backing to forum selection bylaws by adopting a new provision of the DGCL, which allows a company, in its certificate of incorporation or bylaws, to provide that "any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State."[185] Notably, the new provision also provides that a forum selection bylaw may not divest stockholders of the right to bring suit in Delaware, overturning prior Delaware case law.[186] Jurisdictions outside Delaware are increasingly enforcing forum selection bylaws that provide that shareholder litigation must be conducted in Delaware.[187] The Court of Chancery, however, has consistently stated that it is reluctant to grant an anti-suit injunction against proceedings in a sister jurisdiction to uphold these bylaws, and instead still requires litigation filed outside of the contractually selected forum to be challenged in that jurisdiction.[188] Currently, roughly 52 percent of S&P 500 companies have an exclusive forum provision in their bylaws or charter.[189]

While the DGCL authorizes corporations to select an exclusive venue for litigating internal corporate claims, it does not expressly address federal securities claims. Recently, in response to a proliferation of federal claims under the Securities Act of 1933 (the "Securities Act") brought by shareholder plaintiffs in state court, companies conducting initial public offerings began to include bylaws or charter provisions designating federal courts as the exclusive forum for litigating Securities Act claims. Although a Delaware Vice-Chancellor had held such federal forum selection provisions invalid in 2019, in March 2020, the Delaware Supreme Court ruled in *Salzberg* v. *Sciabacucchi* that such provisions are permissible under

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[182] Theodore N. Mirvis, *Anywhere But Chancery*, THE M&A JOURNAL 17 (May 2007).
[183] *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 959-61 (Del. Ch. 2010).
[184] FactSet. As of February 2023. Includes the 4,497 United States-incorporated public companies accounted for in the universe of FactSet's corporate governance screening.
[185] 8 Del. C. § 115.
[186] Previously, the Court of Chancery had ruled that a company could validly adopt a bylaw providing that all litigation must be brought in its non-Delaware headquarters state. *See City of Providence* v. *First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014).
[187] *E.g.*, *In re CytRX Corp. S'holder Derivative Litig.*, No. CV-14-6414, 2015 WL 9871275 (C.D. Cal. October 30, 2015); Order, *Brewerton* v. *Oplink Commc'ns, Inc.*, No. RG14-750111 (Cal. Super. Ct. December 14, 2014); *Groen* v. *Safeway Inc.*, No. RG14-716641, 2014 WL 3405752 (Cal. Super. Ct. May 14, 2014); *Miller* v. *Beam Inc.*, No. 2014 CH 00932, 2014 WL 2727089 (Ill. Cir. Ct. March 5, 2014); *Genoud* v. *Edgen Grp., Inc.*, No. 625,244, 2014 WL 2782221 (La. Dist. Ct. January 17, 2014); *Collins* v. *Santoro*, No. 154140/2014, 2014 WL 5872604 (N.Y. Sup. Ct. November 10, 2014); *HEMG Inc.* v. *Aspen Univ.*, C.A. No. 650457/13, 2013 WL 5958388 (N.Y. Sup. Ct. November 14, 2013); *North* v. *McNamara*, 47 F. Supp. 3d 635 (S.D. Ohio 2014); *Roberts* v. *TriQuint Semiconductor, Inc.*, 358 Or. 413, 415 (2015); *see also City of Providence* v. *First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014) (enforcing a North Carolina forum-selection bylaw).
[188] Order, *Centene Corp.* v. *Elstein*, C.A. No. 11589-VCL (Del. Ch. October 8, 2015); Rulings Tr., *Edgen Grp. Inc.* v. *Genoud*, C.A. No. 9055-VCL (Del. Ch. November 5, 2013).
[189] FactSet. As of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.

Delaware law.[190] In doing so, the Delaware Supreme Court reaffirmed the "immense freedom" Delaware entities enjoy "to adopt the most appropriate terms for the organization, finance, and governance of their enterprise."[191] It continues to be the case that forum selection provisions need to be well crafted and that the record of reasons for their adoption by the board should be adequately reflected.

Although exclusive forum provisions are becoming very mainstream and their legal validity with respect to both selection of appropriate state courts for internal corporate claims and federal courts for federal securities law claims is now beyond question, they have been unpopular with some shareholder activists who consider them an infringement of shareholder rights. Historically, proxy advisors have similarly disfavored exclusive forum provisions, although this has started to change recently. In 2021, ISS shifted from its prior case-by-case approach to recommendations on all exclusive forum provisions to a policy of generally voting in favor of federal forum selection provisions designating the district courts of the United States as the exclusive forum for federal securities law matters and state forum selection provisions designating Delaware as the exclusive forum for corporate law matters for Delaware corporations, in each case unless there are "serious concerns about corporate governance or board responsiveness to shareholders," while taking a case-by-case approach to state exclusive forum provisions for states other than Delaware.[192] By contrast, Glass Lewis will generally recommend against any exclusive forum provision but may change that recommendation if a company puts forth a compelling argument as to how the provision would benefit shareholders, provides evidence of abusive litigation in other jurisdictions, narrowly tailors such provision to the risks involved and has strong corporate governance practices generally.[193] Furthermore, Glass Lewis will generally recommend "against" the chairperson of the company's nominating and corporate governance committee if, during the past year, a company's board adopted an exclusive forum provision without shareholder approval or if the board is currently seeking shareholder approval of such provision pursuant to a bundled bylaw amendment rather than as a separate proposal.[194] Additionally, the AFL-CIO and the CII have each expressed their opposition to exclusive forum provisions.[195]

Despite historical proxy advisor opposition and despite activists' best efforts to the contrary, shareholders appear to approve of exclusive forum provisions. In 2016, 24 companies sought ratification of an existing exclusive forum bylaw or put adoption of such a provision to a shareholder vote and only two proposals failed to pass despite ISS recommending "against" nearly all of the proposals.[196] And only 5 of the 71 such proposals submitted from 2017 to 2022

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[190] 227 A. 3d 102 (Del. 2020).
[191] *Id.* at 116.
[192] ISS, *2031 U.S. Proxy Voting Guidelines* 28 (December 2022).
[193] Glass Lewis, *2023 Policy Guidelines* 73 (November 17, 2022).
[194] *Id*. at 27.
[195] AFL-CIO, *Proxy Voting Guidelines*, Section D.16, at 20 (2012), www.aflcio.org/content/download//154821/proxy_voting_2012.pdf; Council of Institutional Investors, *Corporate Governance Policies*, Section 1.9, at 5 (September 2020), https://www.cii.org/files/policies/09_22_20_corp_gov_policies.pdf.
[196] Shirley Wescott, *2016 Proxy Season Review*, THE ADVISOR 9 (July 2015), http://allianceadvisorsllc.com/wp-content/uploads/2016/07/Alliance-Advisors-Newsletter-July-2016-2016-Proxy-Season-Review.pdf. In 2016, the only exclusive forum bylaw proposals that failed to garner the requisite support were at Progressive and Dean Foods, where they required 67 percent approval.

failed to pass despite ISS recommending "against" or "do not vote" for approximately 80 percent of them.[197]

Shareholders have therefore demonstrated their support for exclusive forum provisions, siding with the management proposals against proxy advisor and activist pressure.

L. Dissident Director Compensation Bylaws

In recent years, activist hedge funds engaged in proxy contests have increasingly offered special compensation to their dissident director nominees. In about one-quarter of proxy fights over the past few years, dissident nominees have been paid a relatively modest flat fee (typically around $25,000 to $40,000) for agreeing to stand as candidates. In a few high-profile cases, these arrangements provide for large payouts, in the millions of dollars, contingent on the nominee being elected and the activist's goals being met within specified near-term deadlines. Prominent examples included the proxy contests at Hess Corp. and Agrium.[198]

These contingent compensation schemes (which have been referred to as "golden leash" arrangements) are troublesome in a number of respects. They create incentives to maximize short-term returns, whether or not doing so would be in the best interests of all shareholders. They can also lead to a multi-tiered and dysfunctional board in which a subset of directors is compensated and motivated significantly differently from other directors. Leading commentators share these concerns. For example, Columbia School of Law Professor John C. Coffee, Jr. has written that "third-party bonuses create the wrong incentives, fragment the board and imply a shift toward both the short-term and higher risk,"[199] and Professor Stephen Bainbridge of UCLA School of Law has concurred, saying "[i]f this nonsense is not illegal, it ought to be."[200] The CII has also noted that these arrangements "blatantly contradict" its policies on director compensation[201] and has called on the SEC to consider interpretive guidance or an amendment to the proxy rules to require disclosure of compensation arrangements between nominating shareholders and their director candidates.[202] We support CII's call and, moreover, advocate that companies include robust disclosure requirements in their advance notice bylaws to support transparency in dissident nominations. A company and its shareholders should have a clear understanding of economic arrangements between dissidents and their activist backers.

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[197] *ISS Corporate Solutions: Voting Analytics*, https://login.isscorporatesolutions.com/newmain.php.

[198] *See* Matthew D. Cain *et al.*, *How Corporate Governance Is Made: The Case of the Golden Leash*, Faculty Scholarship Paper 1571, at 666-70 (2016), http://scholarship.law.upenn.edu/faculty_scholarship/1571.

[199] John C. Coffee, Jr., *Shareholder Activism and Ethics: Are Shareholder Bonuses Incentives or Bribes?*, The CLS Blue Sky Blog (April 29, 2013), http://clsbluesky.law.columbia.edu/2013/04/29/shareholder-activism-and-ethics-are-shareholder-bonuses-incentives or-bribes/.

[200] Stephen Bainbridge, *Can Corporate Directors Take Third Party Pay from Hedge Funds?*, PROFESSORBAINBRIDGE.COM (April 8, 2013), http://www.professorbainbridge.com/professorbainbridgecom/2013/04/can-corporate-directors-take-third-party-pay-from-hedge-funds.html.

[201] Council of Institutional Investors, *CII Governance Alert, Special Pay Plans for Hedge Fund Nominees Spark Controversy*, Vol. 18, No. 18 (May 16, 2013).

[202] Letter from Jeff Mahoney, Gen. Counsel, Council of Institutional Investors, to Keith F. Higgins, Dir., Division of Corp. Finance, SEC (May 31, 2014), http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_31_14_CII_letter_to_SEC.pdf.

When the "golden leash" threat emerged, we issued a memorandum recommending that companies might consider implementing a bylaw that establishes a default standard (amendable by shareholder resolution, as are all bylaws) that would disqualify from service as a director any person party to such an arrangement (with exceptions for indemnification, expense reimbursement and preexisting employment relationships not entered into in contemplation of director candidacy). In the months following publication of the memorandum, dozens of companies adopted a similar bylaw to address the threats posed by these arrangements. ISS however released an FAQ warning that it "may" recommend a withhold vote against director nominees if a board adopts "restrictive director qualification bylaws" designed to prohibit "golden leashes" without submitting them to a shareholder vote.[203] Predictably, ISS's threat has had a chilling effect, with very few companies adopting, and most that had adopted repealing, such bylaws to avoid a confrontation with ISS, despite the risks posed by "golden leash" schemes. As we noted at that time, although we continue to believe that such a bylaw is not only legal but consistent with good corporate governance, it is entirely rational for companies not to incur the disfavor of ISS over a theoretical issue by adopting the bylaw to discourage "golden leash" arrangements.[204] Any dissident who implemented a golden leash compensation scheme would likely weaken its proxy contest, and so it makes sense to contest this issue on a case-by-case basis.

At a minimum, all companies should require full disclosure of any third-party arrangements that director candidates may have, which has long been a common practice and does not (at least given ISS's current position) raise the risk of an ISS withhold recommendation. Additionally, in 2016, Nasdaq adopted a rule requiring Nasdaq-listed U.S. companies to publicly disclose any arrangements or agreements relating to compensation provided by a third party in connection with their candidacy or board service.[205]

An important lesson from the "golden leash" bylaw affair is that ISS and other members of the shareholder activist community are becoming increasingly resistant to board-adopted bylaws on anything other than pure housekeeping matters. Their primary objection to the bylaw was not with its substance—they generally agreed that "golden leash" arrangements are inconsistent with good corporate governance—but rather the fact that boards implemented these bylaws without shareholder approval or engagement. This is a significant development. The adoption of bylaws that the board considers to be in the best interests of the company has traditionally been within the board's prerogative. Boards should still do what they think is right, but they must be aware of the increasingly strident call for shareholder engagement regarding all things that may affect shareholder rights and interests and engage with key shareholders on any change that may be controversial.

Another mechanism used by activist investors (and other "blockholders" planning to file Schedule 13Ds to disclose their position in a target company) to compensate their director nominees has been to "tip" them about the upcoming 13D filing or other announcement of their

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[203] ISS, *Director Qualification/Compensation Bylaw FAQs* (January 13, 2014), http://www.iss.com/files/directorqualificationcompensationbylaws.pdf; *see also* ISS Proxy Advisory Services, *Report on Provident Financial Holdings, Inc.* (November 12, 2013).

[204] Wachtell, Lipton, Rosen & Katz, *ISS Publishes Guidance on Director Compensation (and Other Qualification) Bylaws* (January 16, 2016), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.23042.14.pdf.

[205] Nasdaq Listing Rule 5250(b)(3).

activist campaign and allow them to invest in the target at the pre-announcement price, thereby benefiting (sometimes very substantially) from the increase in the target's stock price that typically follows such an announcement. Some activists have included these directors in their SEC filings under Regulation 13D as members of their "group" but others more aggressively have not. The SEC Staff recently issued a release in which they noted the "self-evident" "advantages inherent to this mutually beneficial relationship between the tipper and the tippee" which "creates the potential for reciprocal behavior."[206] The Staff further noted that in their view, "the tipping arrangement described above falls within the scope of activity Congress sought to regulate when it enacted Section 13(d)(3)" and the new regulations will clarify that all individuals compensated in that manner, including director nominees, should be considered part of the 13D "group." Hopefully this regulatory development will reduce the incidences of this particular form of golden leash arrangement.

M. The Universal Proxy and Proxy Access

In November 2021, the SEC adopted rules (first proposed in 2016) requiring "universal" proxy cards in contested director elections for shareholder meetings taking place after August 31, 2022.[207] Voting shareholders will receive a single "universal" proxy card presenting both the company's and the dissident's nominees, thereby enabling shareholders to "mix and match" from the two (or possibly more) slates, in contrast to the current proxy rules, under which shareholders almost always receive separate sets of proxy cards.[208] The effect of this rule change may vary, but will likely strengthen the hand of activists in pushing for board representation via settlement, as companies will seek to avoid adverse consequences from "mix and match" voting, and may increase investor scrutiny on individual directors in proxy contests, as dissidents will have an easier path to target a particular director or directors for replacement. One immediate trend observed in the wake of effectiveness of the new rules was that many companies, large and small and across industries, amended their corporate bylaws to account for the new rules (with some taking the opportunity to make additional changes as well). In a few cases (*e.g.*, Masimo Corporation's dispute with Politan Capital Management), companies have enacted more aggressive advance notice bylaw amendments that have been met with resistance.

This development will likely reduce the relevance of "proxy access" which is the term (or rather the slogan) that has come to stand for the right of shareholders to put their own director candidates on the company's proxy card and in the company's proxy statement, rather than having to use their own proxy card and statement. In light of the new universal proxy rules, proxy access bylaws' main remaining advantage is to enable the proponent to avoid proxy-related expenses, as the proponent does not need to file a proxy statement nor engage in any holder solicitation.

Over the past two decades, proxy access was a fertile area for activism, discussion, rule-making and litigation.[209] These events culminated in a U.S. Court of Appeals vacating the

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[206] SEC Release Nos. 33-11030; 34-94211; File No. S7-06-22 Modernization of Beneficial Ownership Reporting.
[207] 17 C.F.R. Part 240 (final rule, January 31, 2022), https://www.sec.gov/rules/final/2021/34-93596.pdf.
[208] Wachtell, Lipton, Rosen & Katz, *SEC Announces Proposed Rules to Require Universal Ballots in Proxy Fights* (October 26, 2016), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25415.16.pdf.
[209] The SEC proposed a proxy access rule in 2003 and in 2007, approving a final rule in 2010.

SEC's promulgated mandatory proxy access rule, called Rule 14a-11.[210] The SEC did, however, amend Rule 14a-8 (which had previously regarded proxy access proposals as excludable because they related to an election contest) to allow shareholders to submit proxy access proposals to companies. As a result of this change, proxy access proposals accounted for 22 percent of shareholder contacts and became the most frequent issue formally raised by shareholders in 2015,[211] the first year in which proxy access bylaw proposals were allowed.

In subsequent years, pressure to adopt proxy access has prompted many companies to adopt the practice voluntarily or after some outside pressure, notably from the Office of the New York City Comptroller's Boardroom Accountability Project. As of February 2023, approximately 84 percent of S&P 500 companies had some form of proxy access bylaw.[212]

Over the same period, largely as a result of the support of many of the country's largest asset managers,[213] a consensus as to the headline terms of such proposals has emerged. The current consensus as to headline terms of such proxy access proposals (and unilateral proxy access adoptions predating the new SEC rule) continues to be that shareholders holding at least three percent of a company's shares continuously for three years should be able to nominate candidates for up to the greater of 20 percent of the company's board or two directors, with up to 20 or so shareholders permitted to group and aggregate continuously held shares in order to meet the three percent threshold.[214] These consensus terms are similar to the SEC's now-vacated Rule 14a-11, which had proposed to adopt a proxy access model allowing shareholders holding at least three percent of a company's shares continuously for three years to nominate candidates for up to 25 percent of the company's board.[215]

Looking ahead, the proxy access bylaw will likely remain relatively unused in practice, as the universal proxy has created a duplicate path for ensuring that shareholders may vote for dissident nominees on the company's proxy card and the most prolific activists are sufficiently well-capitalized to bear the expenses of filing their own proxy and soliciting holders. In the next

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[210] *See Bus. Roundtable* v. *S.E.C.*, 647 F.3d 1144 (D.C. Cir. 2011).

[211] Spencer Stuart, *Spencer Stuart Board Index 2015*, at 22 (2015), https://www.spencerstuart.com/research-and-insight/spencer-stuart-us-board-index-2015.

[212] FactSet. As of February 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.

[213] In early 2015, for instance, both BlackRock and Vanguard made statements generally in favor of proxy access. BlackRock evaluates proxy access proposals on a case-by-case basis but generally has been supportive of standard "three percent" proposals, and generally opposes proposals requesting non-standard thresholds where a standardized provision exists. BlackRock Investment Stewardship, *Proxy Voting Guidelines for U.S. Securities* 21 (January 2022), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf. Vanguard also evaluates proxy access proposals on a case-by-case basis, and since February 2016, its proxy voting guidelines have indicated that it would generally support proposals at the three percent ownership threshold (rather than the five percent ownership threshold Vanguard had previously required for its likely support) for three years, allowing nominating shareholder(s) to nominate up to 20 percent of board seats. Vanguard, *Proxy Voting Policy for U.S. Portofilio Companies* (March 1, 2022), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/US_Proxy_Voting.pdf (March 1, 2022). Similarly, CalPERS and CalSTRS are generally supportive of proxy access bylaws. *See* CalPERS, *CalPERS Proxy Voting Priorities* 8 (April 2022), https://www.calpers.ca.gov/docs/proxy-voting-guidelines.pdf; CalSTRS, *Corporate Governance Principles* 14 (January 27, 2021), https://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf.

[214] *See* Alexandra Higgins & Peter Kimball, *Beyond the Basics: An In-Depth Review of the Secondary Features of Proxy Access Bylaws* 6-7, ISS (April 2017).

[215] Rules 14a-11(b)-(c). 17 C.F.R. §§ 240.14a-11(b)-(c) (vacated).

year, threatened or executed proxy battles will demonstrate to what extent the landscape has changed with these new rules.

IV. Shareholder Proposals

Given its corporate governance expertise and familiarity with the company's corporate governance rules and policies, the nominating and corporate governance committee is often called upon to consider the appropriate responses to shareholder proposals. In fulfilling this function, the nominating and corporate governance committee must not only understand the substance of the specific proposal but also the procedural and technical requirements applicable to shareholder proposals, the consequences of proxy advisory voting policies and the prevailing trends in shareholder sentiment.

A. Shareholder Proposals under Federal Law

Under SEC Rule 14a-8, shareholder proposals must be included in a company's proxy statement and submitted to a shareholder vote unless they fail to meet eligibility and procedural requirements of Rule 14a-8 or the proposal falls within one of 13 subject matter exclusions under the rule. If a company intends to exclude a shareholder proposal under Rule 14a-8, the company must submit its reasons for doing so to the SEC. In general, a company will not exclude a shareholder proposal unless the SEC accepts the company's position that the proposal may be excluded.

The degree to which shareholder proposals are to be available for broader social activism, as opposed to being limited to true shareholder issues, is inherently political and impacted by political currents. We are currently in an expansive environment. For many years, there was substantial criticism that the low eligibility requirements had led to an epidemic of shareholder proposals that are not only wasteful and distracting for companies but are a major drain on the SEC Staff's resources.[216] In 2014, then-SEC Commissioner Daniel Gallagher stated that "[a]ctivist investors and corporate gadflies have used these loose rules [under Rule 14a-8] to hijack the shareholder proposal system."[217] In response to an essay by a leading shareholder rights advocate, former Delaware Chief Justice Leo Strine (now Of Counsel at our firm) wrote that "[i]t simply raises the cost of capital to require corporations to spend money to address annually an unmanageable number of ballot measures that the electorate cannot responsibly consider and most investors do not consider worthy of consideration."[218] Commissioner Gallagher, the SEC's former Chairman, Jay Clayton, and former Chief Justice Strine proposed

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[216] *See also* David A. Katz & Laura A. McIntosh, *Shareholder Proposals in an Era of Reform*, N.Y.L.J. (November 29, 2017).

[217] Daniel M. Gallagher, Comm'r, SEC, Remarks at the 26th Annual Corporate Law Institute, Tulane University Law School: Federal Preemption of State Corporate Governance (March 27, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370541315952#.VQfYE9J0xMw. *See also* Daniel M. Gallagher, Comm'r, SEC, Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College (June 23, 2015), https://www.sec.gov/news/speech/activism-short-termism-and-the-sec.html#_ednref6. Similarly, the Business Roundtable has been outspoken about its belief that Rule 14a-8 is outdated and in need of modernization, noting, among other issues, that the $2,000 ownership threshold shareholders must meet to submit a Rule 14a-8 proposal is too low. Business Roundtable, *Responsible Shareholder Engagement and Long-Term Value Creation: Modernizing the Shareholder Proposal Process* (October 31, 2016), http://businessroundtable.org/resources/responsible-shareholder-engagement-long-term-value-creation.

[218] Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 483 (2014).

various reforms to Rule 14a-8 requirements, as discussed further under Section IV.D. In response to these calls for change, in September 2020, the SEC adopted amendments to change the eligibility requirements under Rule 14a-8(b), which amendments became effective on January 4, 2021 and apply to proposals submitted for meetings held on or after January 1, 2022.[219] These amendments are discussed below.

1. Eligibility and Procedural Requirements

To be eligible to submit a proposal, a shareholder must have continuously held at least $2,000 in market value, or one percent of the company's securities entitled to vote (under pre-amendment Rule 14a-8) for at least one year at the time of the proposal and must continue to hold those securities through the meeting date. A proposal must not exceed 500 words, and each shareholder may submit only one proposal per meeting. Also, a proposal may be excluded if in the past two calendar years the shareholder submitted a proposal but failed to appear and present such proposal at a meeting or failed to maintain the required stock ownership through the date of a meeting.

The SEC's amendments to Rule 14a-8(b) adopted in September 2020 eliminated the one-percent threshold option and created a tiered system under which a shareholder can satisfy any of three alternative thresholds to be eligible to submit a proposal: (i) continuous ownership of at least $2,000 of the company's securities for at least three years, (ii) continuous ownership of at least $15,000 of the company's securities for at least two years, or (iii) continuous ownership of at least $25,000 of the company's securities for at least one year.[220] While many had been hoping for more substantial changes to the 14a-8 eligibility requirements to eliminate the prodigious use of Rule 14a-8 by political and social gadflies with minuscule economic investments in companies, the SEC had to balance business considerations against the political importance of allowing small shareholders a voice in corporate affairs. The longer holding periods were intended to reduce some of the historical waste of time and resources associated with responding to marginal 14a-8 proposals.

Rule 14a-8 also imposes notice requirements. For a regularly scheduled annual meeting, a proposal must be submitted at least 120 calendar days before the date on which the company released its proxy statement for the previous year's annual meeting. However, if the company did not hold an annual meeting the previous year, or if the date of this year's annual meeting has been changed by more than 30 days from the date of the previous year's meeting, then the deadline is a reasonable time before the company begins to print and send its proxy materials. Likewise, for a meeting other than a regularly scheduled annual meeting, the deadline is a

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[219] Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, 85 Fed. Reg. 70,240 (November 4, 2020, adopted September 23, 2020) (codified at 17 C.F.R. 240, 14a-8), https://www.govinfo.gov/content/pkg/FR-2020-11-04/pdf/2020-21580.pdf.

[220] *Id.* The amendments also included other changes that require shareholders relying on representatives to submit their proposals to provide authorizing documentation, impose requirements on shareholders to provide their availability to meet with the company after submitting a proposal, amend the one-proposal limit to apply to "each person" rather than "each shareholder" and increase the threshold levels of shareholder support that a proposal must receive to be eligible for resubmission at the same company's future shareholder meetings. *Id.*

reasonable time before the company begins to print and send its proxy materials. Very little guidance or precedent is available to clarify the meaning of "reasonable time" in this context.

2. Substantive Requirements

In addition to eligibility and procedural requirements, Rule 14a-8 provides 13 substantive bases for exclusion:

(1) *Improper under state law*: If the proposal is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization;

(2) *Violation of law*: If the proposal would, if implemented, cause the company to violate any state, federal or foreign law to which it is subject;

(3) *Violation of proxy rules*: If the proposal or supporting statement is contrary to any of the SEC's proxy rules, including the rule prohibiting materially false or misleading statements in proxy soliciting materials;

(4) *Personal grievance; special interest*: If the proposal relates to the redress of a personal claim or grievance against the company or any other person, or if it is designed to result in a benefit to the submitting shareholder, or to further a personal interest, which is not shared by the other shareholders at large;

(5) *Relevance*: If the proposal relates to operations that account for less than five percent of the company's total assets at the end of its most recent fiscal year, and for less than five percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business;

(6) *Absence of power/authority*: If the company would lack the power or authority to implement the proposal;

(7) *Management functions*: If the proposal deals with a matter relating to the company's ordinary business operations;

(8) *Director elections*: If the proposal: (i) would disqualify a nominee who is standing for election; (ii) would remove a director from office before his or her term expired; (iii) questions the competence, business judgment or character of one or more nominees or directors; (iv) seeks to include a specific individual in the company's proxy materials for election to the board of directors; or (v) otherwise could affect the outcome of the upcoming election of directors;

(9) *Conflicts with company's proposal*: If the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the

same meeting (although as discussed below, the SEC is currently reviewing its position on this basis for exclusion);

(10) *Substantially implemented*: If the company has already substantially implemented the proposal;

(11) *Duplication*: If the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting;

(12) *Resubmissions*: If the proposal deals with substantially the same subject matter as another proposal or proposals that has or have been previously included in the company's proxy materials within the preceding five calendar years, a company may exclude it from its proxy materials for any meeting held within three calendar years of the last time it was included if the proposal received: (i) less than five percent of the vote if proposed once within the preceding five calendar years; (ii) less than 15 percent of the vote on its last submission to shareholders if proposed twice previously within the preceding five calendar years; or (iii) less than 25 percent of the vote on its last submission to shareholders if proposed three times or more previously within the preceding five calendar years;[221] and

(13) *Specific amount of dividends*: If the proposal relates to specific amounts of cash or stock dividends.

Of these bases for exclusion, three substantive bases for exclusion have dominated no-action requests in recent years: "violation of proxy rules" because the proposal includes materially false or misleading statements, "management functions" because the proposal deals with ordinary business operations and "substantial implementation" by the company. These specific grounds for exclusion are discussed in more detail below (along with the "economic relevance" exception).

(a) Rule 14a-8(i)(3): Violation of Proxy Rules Because Proposal Includes Materially False or Misleading Statements

The SEC has required companies that seek to exclude proposals on the grounds that they violate proxy rules to demonstrate that the statements in question are objectively materially false and misleading, and the SEC has articulated a preference that companies address these statements in their "statements of opposition" included in proxy materials rather than excluding the proposal from the proxy statement altogether.[222] The policy implications of this position are difficult to ignore—misstatements in a shareholder proposal may influence how other shareholders vote, even if a company refutes them in its response; they may also spread misinformation if they are distributed through channels that the company cannot police.

[221] These thresholds were increased from three percent, six percent and 10 percent, respectively, as a result of the 2020 amendments to Rule 14a-8.

[222] SEC Staff Legal Bulletin No. 14B, *Shareholder Proposals* (September 15, 2004), http://www.sec.gov/interps/legal/cfslb14b.htm.

Notably, in February 2014, a federal court recognized this difficulty when it ruled in favor of a company seeking to exclude a shareholder proposal on the basis that the proposal included material, factual misstatements about the amount of executive compensation paid by the company, the voting standard adopted by the company, the existence of a clawback policy and the number of negative votes received by a director.[223] Despite this court ruling, in 2021, the SEC continued to be reluctant to permit exclusions on this basis: only four "materially false and misleading" arguments were accepted by the SEC, compared to one in each of the prior three years. The trend continued in 2022, with no company successfully excluding a shareholder proposal on the grounds that it was unduly false or misleading. Given that the SEC has been a difficult forum in which to succeed in excluding proposals on this basis, an increasing number of companies may decide to turn to federal courts when faced with misleading proposals.

(b) Rule 14a-8(i)(5): If the Proposal Relates to Operations which Account for Less than Five Percent of the Company's Total Assets, Net Earnings and Gross Sales, and Not Otherwise Significantly Related to the Company's Business

The *de minimis* economic relevance rationale for exclusion of a shareholder proposal in Rule 14a-8(i)(5) has generally been used infrequently. Historically, the SEC Staff did not consider a proposal's significance to the company's business but rather evaluated the significance of the *topic of the proposal* if such proposal was of broad social or ethical concern.

However, in November 2017, the SEC's Division of Corporation Finance issued now-rescinded additional guidance that appeared to make the economic exclusion more significant.[224] The 2017 guidance classified the previous method of analyzing requests for exclusion under Rule 14a-8(i)(5) as "unduly limited." Under the 2017 guidance, the analysis focused "on a proposal's significance to the company's business when it otherwise relates to operations that account for less than five percent of total assets, net earnings and gross sales," an analysis that depended on the "particular circumstances" of the company.[225] The Division of Corporation Finance stated that the availability of a Rule 14a-8(i)(5) exclusion would be a wholly separate analysis from that assessing the availability of a Rule 14a-8(i)(7) exclusion, reversing the historical practice of analyzing these exclusions using the same analytical framework.[226]

In November 2021, the SEC issued Staff Legal Bulletin No. 14L ("SLB 14L"), rescinding the 2017 guidance on the economic relevance exclusion in Rule 14a-8(i)(5) (among other changes), stating that shareholder proposals that raise issues of broad social or ethical concern related to a company's business may not be excluded, even if the relevant business falls below the economic thresholds in Rule 14a-8(i)(5).[227] The SEC framed this guidance as

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[223] *See Express Scripts Holding Co.* v. *Chevedden*, No. 4:13-cv-2520-JAR, 2014 WL 631538 (E.D. Mo. February 18, 2014).

[224] *See* SEC Staff Legal Bulletin No. 14I, *Shareholder Proposals* (November 1, 2017), https://www.sec.gov/interps/legal/cfslb14i.htm.

[225] The guidance notes, however, that some issues, such as corporate governance, would most likely be considered significant to all companies. *See id.*

[226] *See id*.

[227] *See* SEC Staff Legal Bulletin No. 14I, Shareholder Proposals 4 (November 3, 2021), https://www.sec.gov/corpfin/staff-legal-bulletin-14l-shareholder-proposals.

"returning to [its] longstanding approach."[228] Companies apparently took notice, as the 2022 proxy season saw an overall decline in the number of no-action requests arguing economic relevance under Rule 14a-8(i)(5). The new guidance also facilitated a record uptick in proposals regarding environmental and social topics (particularly in tandem with the guidance update applicable to the ordinary course exception, discussed next). Companies should watch developments in this area to understand how to respond to the increasingly common proposals that may have an attenuated economic impact to the individual company.

(c) Rule 14a-8(i)(7): Management Functions Because the Proposal Deals with Ordinary Business Operations

In past years, companies often relied on the ordinary business operations exclusion in seeking no-action relief from shareholder proposals relating to social risks, such as health, financial, human rights and environmental risks. However, as with the economic relevance exception, SLB 14L significantly reduced Rule 14a-8(i)(7)'s applicability to proposals related to social policy issues.[229] While the SEC had previously focused on the significance of a social policy issue to a *particular* issuer in determining whether a proposal was of social policy significance and could be excluded, the SEC will now focus on the proposal's "broad societal impact," and no longer focuses on "determining the nexus between a policy issue and the company." In so doing, SLB 14L nullified recent Rule 14a-8 precedents, including shareholder proposals previously deemed excludable under Rule 14a-8(i)(7) because the shareholder proponent failed to demonstrate that the issue was significant to the company.[230]

With respect to the micromanagement exclusion (which comes under Rule 14a-8(i)(7)), the SEC indicated it would "take a measured approach," stating that proposals seeking detail, suggesting targets or seeking to impose time frames for methods are not *per se* excludable, so long as such proposals provide discretion to management as to how to achieve the desired goals.[231] As one example, proposals such as those related to setting emission reduction targets, but "not impos[ing] a specific method for doing so," will be unlikely to face exclusion based on claimed micromanagement.[232]

In the immediate aftermath of SLB 14L, we (and other commentators) predicted that the changes to the ordinary business (and, as discussed earlier, economic relevance) would facilitate a larger number of shareholder proposals—in particular, ESG proposals—coming to a shareholder vote.[233] This proved to be correct, on multiple dimensions. The 2022 proxy season saw a surge in shareholder proposals. Social and environmental proposals represented over half of all proposals submitted in 2022, up from 44 percent in 2021, with anti-discrimination/diversity representing the most popular category of social proposal, and climate change the most popular category of environmental proposal. At the same time, no-action success rates plummeted to 38 percent, from 71 percent in 2021 and 70 percent in 2020—by far the lowest level in the past

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[228] *Id*.
[229] *Id*.
[230] *Id*.
[231] *Id*.
[232] *Id*.
[233] *See, e.g.*, Wachtell, Lipton, Rosen & Katz, *SEC Staff Limits Exclusion of "Social Policy" Shareholder Proposals* (November 4, 2021), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27894.21.pdf.

decade. The ordinary business exception was particularly hard-hit, with success rates falling to a mere 24 percent, from 65 percent in 2021. Looking ahead to the 2023 proxy season, early observations suggest that shareholder proponents will continue to focus on environmental and social proposals, and companies will face a skeptical audience in the SEC if and when they seek to exclude them.[234]

(d) Rule 14a-8(i)(10): Substantially Implemented

Often, companies also seek to exclude proposals on the basis that they were substantially implemented by the company. A no-action request on this basis must not only demonstrate that the relevant action by the company compares favorably with the proposal at issue but also address each element of the proposal.[235] However, the relevant action need not be taken by management or the board, and effects of court decisions, business developments, corporate events and third-party requirements may render the proposal moot.[236] Trends vary across proposals, and while the SEC's past actions regarding proxy access proposals suggest there may be some increased willingness to grant no-action relief on the substantially implemented basis, the SEC has generally made it increasingly difficult to exclude a proposal on the basis of substantial implementation. For example, while the SEC historically granted requests that argued that special meeting proposals were substantially implemented even where a company's provision imposed additional conditions on calling a special meeting so long as these conditions were not restrictive, the SEC within the past few years denied no-action requests where a proposal called for an amendment to the bylaws that would allow 10 percent of the stockholders to call a special meeting and the bylaws included a 25 percent standard.[237]

In July 2022, the SEC proposed amendments to Rule 14a-8(i)(10) that would likely narrow the possible bases for exclusion under the substantial implementation exception (as well as the duplication and resubmission exceptions). In the release, the SEC explained that it is "concerned that [Rule 14a-8(i)(10)] may be difficult to apply in a consistent and predictable manner," and further, that "the language of the current rule is insufficiently focused on the specific actions requested by a proposal—*i.e.*, its elements—and, thus, it may not serve the original purpose of the exclusion to avoid the consideration of proposals on which a company already has 'favorably acted.'"[238] The proposed amendments would provide that a proposal may be excluded as substantially implemented if "the company has already implemented the essential elements of the proposal." The SEC explained that the focus of its analysis would be on the "specific elements of the proposal"—a "determination of which elements of the proposal are the 'essential elements' and an analysis of whether those elements have been addressed."[239] To exclude a proposal as substantially implemented, the company would have to show it had already implemented "all" essential elements[240]—likely making it more challenging for issuers to exclude proposals, and consistent with the SEC's recent approach in the 2022 proxy season.

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[234] *ISS Corporate Solutions: Voting Analytics*, https://login.isscorporatesolutions.com/newmain.php.
[235] Amy Goodman *et al.*, A Practical Guide to SEC Proxy and Compensation Rules § 12.08 (6th ed. 2020 Supp.).
[236] *Id.*
[237] *Id.*
[238] 17 C.F.R. Part 240 at 13 (proposed rule, July 13, 2022), https://www.sec.gov/rules/proposed/2022/34-95267.pdf.
[239] *Id*. at 14.
[240] *Id*. at 15.

3. Curable and Non-Curable Deficiencies

A deficiency may either be curable or non-curable. For example, an untimely submission is not curable because the deadline has passed, whereas an overly wordy proposal is curable through revision and resubmission. Similarly, a proposal that is improper under state law because it mandates a particular action may be cured by reformulating it as a precatory proposal. If a deficiency is curable, a company is required to notify the proponent within 14 calendar days of receiving the proposal of any procedural or eligibility deficiencies, as well as of the time frame for responding. The proponent's response must be postmarked no later than 14 days from the date of receipt of the company's notification. If a deficiency is non-curable, a company need not provide the proponent notice.

4. No-Action Requests

If a company wishes to exclude a proposal from its proxy materials, it must seek a no-action letter by filing its reasons with the SEC no later than 80 calendar days before it files its definitive proxy statement and form of proxy, although this requirement may be waived for good cause. No-action letters issued by the SEC in response to these requests provide useful guidance both to shareholders submitting proposals and to nominating and corporate governance committees in determining their response to shareholder proposals.

In September 2019, the SEC discontinued its longstanding practice of providing a written response to each shareholder proposal no action request, stating that it would issue written responses "where it believe[d] doing so w[ould] provide value such as more broadly applicable guidance about complying with Rule 14a-8."[241] In lieu of written responses, for the 2020 and 2021 proxy seasons, the SEC communicated its decisions through a chart tallying the SEC's oral and written responses to no-action requests.[242] While the chart provided the regulatory bases asserted by the company to exclude the proposal, and the SEC's response, it did not provide any insight regarding the reasoning underpinning the SEC's decision, limiting visibility into how and why the SEC made certain decisions for both companies and shareholder proponents. Formal letters were issued only in limited instances (in the 2021 proxy season, only five percent of the time).

In December 2021, however, the SEC announced that it had reconsidered its approach and would immediately return to its prior practice of issuing a response letter for each no-action request, to give shareholder proponents and companies more transparency and certainty regarding the SEC's decision-making.[243] Following this announcement, the SEC ceased using the online chart, and began issuing responses to each no-action request and posting them on its website. The chart is updated at the end of each proxy season.[244]

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[241] SEC, *Announcement Regarding Rule 14a-8 No-Action Requests* (September 6, 2019), https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests.
[242] *See* SEC, *Shareholder Proposal No-Action Responses*, https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/shareholder-proposal-no-action-responses.htm.
[243] SEC, *Announcement Regarding Rule 14a-8 No-Action Requests* (December 13, 2021), https://www.sec.gov/corpfin/announcement/announcement-14a-8-no-action-requests-20211213.
[244] *See, e.g.*, SEC, *2021-2022 Shareholder Proposal No-Action Responses*, https://www.sec.gov/file/2021-22-shareholder-prop-no-action-responses-chart.pdf.

We view this as a welcome development, particularly in light of the significant changes brought by SLB 14L.

5. Including Proposal in Proxy Materials

A company may include in its proxy materials a statement of reasons why it believes that shareholders should vote against a proposal. The company's response or "opposition statement" is not subject to the 500-word limit for shareholder proposals. The company must provide a copy of this statement to the proponent no later than 30 calendar days before it files definitive copies of its proxy statement and form of proxy, or, if the SEC's no-action response requires the proponent to make revisions to the proposal as a condition of its inclusion, the company must provide the proponent with a copy of its opposition statements no later than five calendar days after the company receives a copy of the revised proposal.

6. Precatory and Mandatory Proposals

The corporate law of most states, including Delaware, provides that the business and affairs of a company are to be managed under the direction of the board.[245] Under this structure, with the exception of a few specific items provided for by statute (such as the content of the company's bylaws and approval of mergers and sales of all or substantially all of the company's assets), running the company is left to the company's directors and the management team appointed by those directors, rather than to shareholders. The avenue for shareholders to directly affect the company's operations is primarily confined to replacing the board or amending the company's bylaws. A shareholder proposal mandating that the board take a particular action would run afoul of this fundamental division of power. Thus, shareholder proposals calling for a specific action (other than seeking to amend the company's bylaws) must, in general, be submitted as precatory suggestions to the board. The board can then decide whether or not to implement a resolution adopted by the shareholders. As a practical matter, however, boards may face significant pressure to implement precatory proposals supported by shareholders.[246] In Delaware and most other states, the board of directors must submit to the shareholders any changes in the charter, and the shareholders may not amend the charter without board approval. Accordingly, any shareholder efforts to amend the charter (for example, to eliminate a classified board or allow action by written consent) must be brought by precatory resolution.

B. Shareholder Proposals under State Law

In addition to having a proposal included in the issuer's proxy statement under Rule 14a-8, shareholders may submit proposals under state law. A key distinction between the two is that, whereas a qualifying Rule 14a-8 proposal must be included in the company's proxy statement, a shareholder submitting a proposal under state law must ordinarily do so in his or her own proxy statement. Thus, making a proposal under state law requires a shareholder to bear the expense of printing and mailing proxy materials. As a result, such proposals are most common in the context of a hostile takeover bid or a proxy fight where the stockholder seeks a fundamental change in corporate direction, including by proposing a competing slate of director nominees for election. State law is particularly important for director nominations because, as

[245] *See* 8 Del. C. § 141(a).
[246] *See* Section IV.C.

noted above, director nominations are generally excludable from proxy access under Rule 14a-8, leaving state law as the only avenue.

Director nominations and other shareholder proposals must comply with a company's advance notice bylaws governing the deadline for submission of such proposals. In addition to submission deadlines, bylaws typically require that the proponent be a shareholder as of the record date of the meeting and call for a number of disclosures by the proponent. Examples of these disclosures include background information about the proponent, the amount of the proponent and its affiliates' beneficial ownership (including derivative instruments) and any voting agreement with other stockholders. If a proposal nominates a director candidate, bylaws often require that the proposal include a questionnaire and all information about the nominee that would be required for election of directors in a contested election pursuant to federal securities laws. Increasingly, bylaws also require that the nomination disclose any material arrangements or relationships between the proponent and the nominee. For submissions other than nominations, bylaws typically require the text of the proposal and a brief description of the matter desired to be brought, including any material interest of the stockholder in the matter.

C. Responding to Shareholder Proposals

The appropriate response to receipt of a proposal will vary depending on the facts and circumstances. If a Rule 14a-8 shareholder proposal does not comply with certain procedural and substantive requirements, it may be excludable under SEC rules. If a state law (that is, a non-Rule 14a-8) proposal does not comply with the company's bylaws, then it generally may be excluded under the bylaws from being raised at the meeting. In other cases, the company may engage in a dialogue with the shareholder to find a mutually acceptable compromise. In still other cases, it may make sense to implement the proposal, or to formulate an alternative proposal that will achieve largely the same effect. In responding to voted-upon shareholder proposals, boards should be cognizant that their actions will likely be closely monitored by proxy advisory services and activist investors. A board that declines to implement a broadly supported shareholder proposal may find itself subject to scrutiny and perhaps even election challenges or withhold-the-vote campaigns. Increasingly in these situations, proxy advisory services are recommending "no" votes for members of the nominating and corporate governance committee. While directors cannot be dismissive of the influence of proxy advisory services and large shareholders, directors also should not blindly succumb to their mandates. Care should be taken to consider shareholder concerns and articulate the board's reasoning, but ultimately corporate governance is a core function of the board, and directors must bear in mind that they are best positioned to select the most appropriate policies for the company.

1. Deciding whether to Implement a Precatory Shareholder Proposal

Neither federal nor state law imposes any legal obligation on the board to act upon precatory shareholder proposals that receive majority support. To the contrary, it is the board's responsibility to carefully evaluate such proposals and implement them only if it believes doing so is in the best interests of the company. Provided that the board has deliberated with care and acted to further the company's best interests, any determination should be protected by the deferential business judgment rule.

Although the board's decision not to implement a shareholder proposal will not be vulnerable to legal challenge, there may be other consequences. A board that declines to implement a shareholder proposal that garnered substantial support may find itself subject to criticism and perhaps even election challenges or withhold-the-vote campaigns from proxy advisory services or institutional investors. This can be particularly significant if the company's directors are elected by majority voting (as most directors now are).

2. Proxy Advisory Policies Regarding Response to Shareholder Proposals

ISS recommends voting on a case-by-case basis on individual directors, committee members or the entire board if the board failed to act on a shareholder proposal that received the support of a majority of votes cast the previous year.[247] Among the factors ISS will consider are the subject matter and level of support of the proposal, the actions taken by the board in response and its disclosed engagement with shareholders after the vote and the rationale provided in the company's proxy statement for the level of implementation.[248] Glass Lewis takes a more aggressive position, stating that any time a shareholder proposal receives at least 20 percent support, the board should, depending on the issue, "engage with shareholders on the issue and demonstrate some level of responsiveness," which will be evaluated on a case-by-case basis.[249] Glass Lewis also indicates that "clear action is warranted" when a shareholder proposal receives support from a majority of votes cast (excluding abstentions and broker non-votes).[250] This may include "fully implementing the request of the shareholder proposal and/or engaging with shareholders on the issue and providing sufficient disclosures to address shareholder concerns."[251] These ISS and Glass Lewis positions are more moderate than ISS's former position that it would automatically recommend that shareholders withhold votes from directors who declined to implement expressed shareholder desires. ISS's withhold policy, coupled with the shift to majority voting, were strong contributors to the erosion of takeover protections, such as shareholder rights plans and classified boards, over the past decade.

3. Responding to Pressure from Shareholders and/or Proxy Advisory Services

Despite the changing dynamics between the board and shareholders, the board must remember that it has the responsibility to exercise its own business judgment in determining what course will best serve the company. A board need not, and should not, accede to every corporate governance "best practice" promulgated by proxy advisory services and other governance activists. That said, without abdicating its responsibilities, the board should be mindful of governance policies and shareholder concerns and consider the potentially disruptive impact of scrutiny from shareholders and proxy advisory services as one factor in determining the company's best interests. When the board chooses to depart from the approach called for by corporate governance activists, it must be prepared to articulate clear and thoughtful explanations for its decisions. This approach will build the board's credibility with shareholders and also help it formulate policies that may be acceptable to all parties. In the current corporate governance environment, the challenge for directors is to base their decisions on what they believe will best

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[247] ISS, *2023 U.S. Proxy Voting Guidelines* 13 (December 13, 2022).
[248] *Id*.
[249] Glass Lewis, *2023 Policy Guidelines* 18 (November 17, 2022).
[250] *Id*.
[251] *Id*.

serve the company while at the same time maintaining sufficient awareness and sensitivity of shareholder concerns to avoid an attack that could undermine the board's ability to serve the company's best interests.

D. Effect of Shareholder Proposals

Corporate governance has undergone a dramatic transformation over the last two decades, in no small part due to activists who brought shareholder proposal after shareholder proposal until nearly every company had succumbed; in short, the putative aspirational "best practices" of a decade ago have been so widely adopted or codified that there is now a period of relative stasis in corporate governance. Among S&P 500 companies in 2022: only 11 percent had classified boards, compared to nearly 50 percent in 2005;[252] the CEO was the only non-independent director on 65 percent of boards, compared to 40 percent in 2005 and 12 percent in 2000;[253] over 90 percent had some form of majority voting for director elections, compared to virtually none in 2004 (when activists began to call for majority voting);[254] and less than one percent had a poison pill in place, compared to nearly 50 percent in 2005.[255] Nevertheless, pressure from corporate governance activists remains acute, partly due to increased scrutiny of the remaining holdouts and partly as a result of ever-evolving standards propagated by those who make their living in the corporate governance industry.

S&P 500 companies received 581 shareholder proposals in 2022, as compared to 570 in 2021, 505 in 2020, 480 in 2019, 524 in 2018, 607 in 2017, 579 in 2016 and 550 in 2006; the figures for the Russell 3000 were 754 in 2022, 740 in 2021, 710 in 2020, 689 in 2019, 692 in 2018, 790 in 2017, 811 in 2016 and 643 in 2006.[256] In 2022, approximately eight percent of the shareholder proposals submitted to S&P 500 companies and voted on passed, compared to 11 percent in 2021, seven percent in 2020, about five percent in 2019 and 2018, six percent in 2017, seven percent in 2016 and 17 percent in 2006.[257] The lower success rate of shareholder proposals in recent years is attributable, in large part, to a shrinking proportion of the core corporate governance-related proposals that typically receive strong support, as companies have conformed to "best practices" mandates, and an increase in socially oriented proposals that typically receive less support.

Even when unsuccessful in changing a company's corporate governance, shareholder proposals are not without impact. As former Delaware Chief Justice Strine observed, shareholder proposals can distract managers from running companies and impose unnecessary costs on companies, with virtually no cost to the shareholder proponents.[258] Indeed, many of

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[252] FactSet. Data as of March 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.
[253] Spencer Stuart, *Spencer Stuart Board Index 2022* 14 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.
[254] FactSet. Data as of March 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.
[255] FactSet. Data as of March 2023. Includes 486 companies in the S&P 500 Index in FactSet's database.
[256] FactSet. Data as of March 2023. Includes all shareholder proposals received for inclusion at annual and special meeting and for written consents for companies in the applicable index at the time of the meeting, including non-U.S. companies.
[257] *Id.* Includes all shareholder proposals received for inclusion at annual and special meeting, and for written consents for companies in the S&P 500 Index at the time of the meeting, including non-U.S. companies.
[258] Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 475 (2014).

these proposals are brought by "professional" governance gadflies, who have virtually no economic interest in the companies they attack, combined together to reach the extremely low threshold (even after the recent amendments) for submitting proposals and submit standard form proposals to large numbers of companies.

E. Major Topics for Shareholder Proposals

1. Social and Environmental Topics

Social and environmental topics continued to gain significance in 2022, testing companies with new shareholder demands for greater disclosure, target-setting and action. Of the 868 shareholder proposals submitted in 2022, 287 were related to social topics (up 20 percent from 2021), and 169 were related to environmental topics (up 51 percent from 2021).

As discussed above, past bases for no-action relief have been pared back by recent SEC practice and guidance—in particular by SLB 14L. 77 percent of environmental shareholder proposals in 2022 were related to climate change, with 129 submitted (a substantial increase from 83 in 2021). 41 were voted on in 2022 (a 78 percent increase from 2021); that said, the average support for these proposals declined significantly from 2021, likely due to the aggressiveness of the proposals. BlackRock, for example, indicated that it would support proportionally fewer climate-related shareholder proposals in 2022 compared to 2021, due to their overly prescriptive nature.[259] ISS support declined in 2022 as well, from 83 percent to 61 percent.

Despite the dip in investor support, environmental proposals will likely continue to be a major theme in the coming years, given recent successes. For example, in May 2021, Engine No. 1 won three board seats at ExxonMobil's annual meeting, displacing three incumbent directors, after calling for ExxonMobil to set carbon emission reduction targets, rethink long-term capital allocation, and accelerate its transition to a low-carbon economy.[260] And also in May 2021, shareholders at ConocoPhillips approved a proposal requiring the company to set targets for emission reductions related to use of the company's fuels (Scope 3 emissions).[261] Companies have successfully negotiated withdrawal of such proposals by committing to a timeline for disclosure and target-setting. However, much uncertainty remains on the implementation, rigor, and follow-through associated with such commitments (for instance, ConocoPhillips recently declined to implement Phase 3 targets, despite a prior shareholder vote supporting such action).[262]

Diversity proposals have similarly gained prominence. For the 2022 proxy season, such proposals (including anti-discrimination-related proposals) represented 33 percent of all social proposals, with 97 submitted (down from 128 in 2021, but up significantly from 53 in 2020).

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[259] BlackRock Investment Stewardship, *2022 climate-related shareholder proposals more prescriptive than 2021* 3 (2022).

[260] *See* Wachtell, Lipton, Rosen & Katz, *EESG Activism After ExxonMobil* (July 22, 2021), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27750.21.pdf.

[261] Conoco Phillips, Current Report (Form 8-K) (May 13, 2021).

[262] Kevin Crowley, *ConocoPhilips Rejects Customer Emissions Goal Despite Vote*, BLOOMBERG (February 3, 2022), https://www.bloomberg.com/news/articles/2022-02-03/conocophillips-says-don-t-expect-plan-to-cut-customer-emissions.

Companies facing pressure for increased disclosure, particularly in line with the EEO-1 filing, should consider whether a compelling case can be made for why EEO-1 data do not accurately reflect workforce data.

Given ongoing institutional shareholder support, as well as issue-driven shareholders identifying the proposal process as a key avenue for driving change in corporate behavior, social and environmental topics will remain a top-of-mind issue as companies approach proxy seasons. Companies facing shareholders with an active appetite for social and environmental proposals should review the latest SEC precedents regarding no-action relief, be aware of peer approaches, and identify potential options for withdrawal.

2. Separation of Chairman and CEO Positions

Proposals to separate the Chairman and CEO roles peaked a few years ago, in 2015, with 64 proposals at S&P 500 companies.[263] Since then, there have typically been under 50 proposals each year.[264] It is possible that the successful model of independent lead or presiding directors has dampened the enthusiasm for separation. Support for these proposals has been strikingly low: for S&P 500 companies, no proposals passed in 2022, only one proposal in 2021 that went to a vote passed (none passed in 2016, 2017 or 2019 and two passed in 2020). The average level of support for such proposals in any of the last few years did not exceed one-third of votes cast.[265] It must be recognized, however, that many institutional investors support independent board leadership as a general rule, and a strong case will have to be made to retain a combined Chairman/CEO role if an effort is made to split those positions.

3. Succession Planning

In 2009, the SEC reversed its position that shareholder proposals relating to succession planning were excludable on the grounds that succession planning related to the company's ordinary operations. Since this reversal, a number of shareholder proposals have been submitted seeking to require development or disclosure of a company's succession plan. These proposals typically urge a company to adopt detailed policies regarding succession planning, often in their corporate governance guidelines, and to make certain disclosures relating to succession planning. For example, in 2012, the AFL-CIO filed a proposal calling for Berkshire Hathaway to adopt a succession planning policy that would include developing criteria for the CEO, identifying internal candidates and annually reviewing and publishing a report on the plan. Notwithstanding this initial flurry of interest, the proposal received less than five percent of votes cast. Only one succession planning proposal was received by S&P 500 companies during the 2019 and 2020 proxy seasons, and none were received in the 2021 and 2022 proxy seasons.[266]

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[263] FactSet. Includes all shareholder proposals for separation of CEO and Chairman positions received for inclusion at an annual or special meeting for U.S. companies in the S&P 500 Index at the time of the meeting.
[264] *Id.*
[265] *Id.*
[266] FactSet. Includes all proxy access shareholder proposals received for inclusion at an annual or special meeting for U.S. S&P 500 companies at the time of the meeting.

4. Executive Compensation

The advent of say-on-pay in 2011 reduced, but did not eliminate, compensation-based shareholder proposals. A total of 36 compensation-related shareholder proposals were brought in 2022 at S&P 500 companies, compared to 54 in 2021, 38 in 2020, 36 in 2019, 39 in 2018, 42 in 2017 and 57 in 2016.[267] Of the proposals received in 2021, one targeted "golden parachutes," seven sought to link pay or equity grants and vesting to performance and five sought adoption of clawback policies.[268] One compensation-related proposal passed in 2021, one in 2019, but none passed in 2020, 2018 or 2017.[269]

5. Exclusive Forum Bylaws

Recent history suggests that, despite activists' best efforts to the contrary, shareholders approve of exclusive forum provisions. In 2016, 24 companies sought ratification of an existing exclusive forum bylaw or put adoption of such a provision to a shareholder vote and only two proposals failed to pass despite ISS recommending "against" nearly all of the proposals.[270] And only 5 of the 71 such proposals submitted from 2017 to 2022 failed to pass despite ISS recommending "against" or "do not vote" for approximately 80 percent of them.[271]

6. Classified Boards

Given the large number of companies that have already eliminated their classified boards, it is not surprising that the number of declassification proposals has decreased over the past decade. Nine proposals were submitted to S&P 500 and Russell 3000 companies in 2022, compared to 35 in 2013.[272]

Shareholder activist groups, and the Harvard Law School's Shareholder Rights Project, in particular, played a significant role in the adoption of declassification proposals over the past decade. During 2012, 2013 and the first half of 2014, this Harvard clinical program submitted declassification proposals to 129 companies, 121 of which agreed to move toward annual elections after engaging with the project.[273] We believe that it is extremely regrettable that shareholder activists and some academics have succeeded in largely eliminating classified boards from large-cap American companies. A classified board combined with a shareholder rights plan is the best hope a company has of fending off an opportunistic hostile takeover attempt. Value-

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[267] *Id.* Includes all management and director compensation-related shareholder proposals other than say-on-pay proposals received for inclusion at an annual or special meeting for U.S. S&P 500 companies at the time of the meeting.

[268] *Id.*

[269] *Id.*

[270] Shirley Wescott, *2016 Proxy Season Review*, THE ADVISOR 9 (July 2015), http://allianceadvisorsllc.com/wp-content/uploads/2016/07/Alliance-Advisors-Newsletter-July-2016-2016-Proxy-Season-Review.pdf. In 2016, the only exclusive forum bylaw proposals that failed to garner the requisite support were at Progressive and Dean Foods, where they required 67 percent approval.

[271] *ISS Corporate Solutions: Voting Analytics*, https://login.isscorporatesolutions.com/newmain.php.

[272] FactSet. As of February 2023. Includes all board declassification shareholder proposals received for inclusion at an annual or special meeting for U.S. companies in the S&P 500 and Russell 3000 indices at the time of the meeting.

[273] Matteo Tonello & Melissa Aguilar, The Conference Board, *Proxy Voting Analytics (2010–2014)*, at 160, http://www.conference-board.org/publications/publicationdetail.cfm?publicationid=2857.

creating defenses, such as that of Airgas against the predations of Air Products a few years ago, would not have been possible had Airgas not had a classified board.[274] All that said, one must be realistic and accept that a company facing a precatory proposal to eliminate its classified board has little hope of convincing shareholders to vote against it. Once the shareholders have approved the resolution calling for its repeal, unless the board is willing to accept a high withhold vote and a measure of shareholder opprobrium, the question becomes whether to eliminate the classification at one time or to roll it off over a three-year period, as many companies have done.

[274] Wachtell, Lipton, Rosen & Katz, *"Just Say No" – The Long-Term Value of the Poison Pill* (December 17, 2015), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25026.15.pdf.

V. Proxy Contests

In a proxy contest, a shareholder solicits the proxies of other shareholders to support a matter up for shareholder vote in opposition to company management and the board. Most proxy fights concern the election of directors, but a dissident can also contest other issues, such as governance changes or a precatory proposal to sell or break up the company. Proxy fights also often accompany hostile takeover bids, as the raider needs to replace the board to eliminate a shareholder rights plan, or poison pill, to complete the acquisition. A proxy fight that is part of a takeover bid is not typically handled by the nominating and corporate governance committee, but instead by the full board. The nominating and corporate governance committee may, however, play a significant role in a stand-alone proxy fight (such as considering the qualifications of the dissident's candidates so that it can make a recommendation to the full board).

Unlike a shareholder proposal pursuant to Rule 14a-8 promulgated under the Exchange Act—in which the proponent seeks to include a proposal in the company's proxy statement—in a proxy contest, the dissident files its own separate proxy statement. Because the aim of a proxy contest is typically to replace a company's leadership and fundamentally alter the company's direction, the stakes are very high. A dissident may nominate a full slate, in which it proposes a candidate for each board seat, or a partial slate (a "short slate"), in which it nominates fewer candidates than there are available board seats, often stopping short of seeking to take control of the board. A dissident may run a partial slate because it has concluded that it could not garner support to replace the entire board or seize control, but may be able to elect a minority of directors to act as a catalyst for change in the boardroom. Under the universal proxy card rules, discussed in Section III.M above, both dissident and company nominees will appear on all proxy cards.

Well-capitalized activists seeking to place their candidates on a board generally have not relied, and are not expected to rely, on proxy access in place of their own proxy materials – and are expected to significantly benefit from the new universal proxy rules. Proxy access is more likely to be used by smaller activist funds and corporate governance activists, as well as special interest groups (such as unions), that do not want to—or are unable to—invest in a proxy contest. Proxy access may also be utilized by large institutional shareholders, although they already have (and have had for some time) the substantial ability to influence the board composition of their portfolio companies by direct engagement. Even where a company faces only a slate of proxy access candidates, and not a full-fledged counter solicitation, it will, in many cases, likely still see that as a "proxy fight" that threatens the corporation and will respond accordingly. Further, even if a company ultimately prevails in the proxy contest, it could suffer a high cost in terms of distraction and reputational damage (which some activists seek to exploit).

There were 41 proxy contests at Russell 3000 companies in 2022, compared to 39 in 2021, 48 in 2020 and 2019, 31 in 2018 and 41 in 2017.[275] Notably, the trend of activists targeting large companies continued in 2022: 27 of the 41 targeted companies had market capitalizations of over $1 billion, compared to 27 in 2021, 31 in 2020, 30 in 2019, 10 in 2018,

[275] FactSet. Data as of March 2023. Numbers include all proxy contests (not just those for board seats) at S&P 500 and Russell 3000 companies for each year, by date of campaign announcement.

28 in 2017 and 25 in 2016.[276] This indicates that even large companies once considered generally immune from activist investors have become targets. Activist success rates declined in 2019 and 2020 after rebounding to close to their 2014 levels in 2018. In 2022, activists were successful in proxy contests or agreed to favorable settlements at Russell 3000 companies 29 percent of the time, compared to 33 percent in 2021, 41 percent in 2020, 43 percent in 2019, 64 percent in 2018, 49 percent in 2017, 59 percent in 2016 and 53 percent in 2015.[277]

Although they play an important role in corporate governance and are in some cases justified, proxy contests are expensive and distracting. All companies should have state-of-the-art advance notice bylaws to limit their period of vulnerability and improve predictability.[278] In addition to establishing the time period in which a shareholder may submit nominations or other business, the bylaws may also specify reasonable qualification requirements and solicit the disclosure of important information (such as information about potential conflicts) in a director nomination questionnaire.

Depending on the issue at stake, a proxy fight may well command the attention of the board and the highest echelons of management. It is most important that a company facing a proxy fight have a qualified and experienced team of advisors, including lawyers, bankers, public relations and investor relations professionals and proxy solicitors. Proxy fights involve many strategic decisions in a fast-changing environment. They can also be emotionally draining, given the high stakes and the fact that some shareholder activists specialize in personal attacks. A company faced with a proxy contest may wish to consider settling prior to the actual vote. A settlement may require considerable concessions from both the company and proponent, but may also offer a better alternative to pursuing the fight all the way to the vote. Most campaigns in 2022 ended with announced settlements with activist hedge funds, and only a handful "went the distance" all the way to the annual meeting. Of the 135 board seats won by activists in 2022, 23 were won via a proxy contest and 112 board seats were won via settlement, consistent with trends over recent years.[279]

There are many negotiable elements that may be part of a settlement. A company may agree to expand its board size and to support some or all of the proponent's nominees for election at the annual meeting or to increase the number of independent board members. A proponent who is running a slate after having expressed the desire for economic changes may agree to withdraw the slate in exchange for the implementation of these economic changes (or a promise to consider them). A company may, in turn, require that the proponent agree to a

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[276] *Id.* Numbers include all proxy contests (not just those for board seats) at companies with market capitalizations greater than $1 billion for each year, by date of campaign announcement.

[277] *Id.* The numerator includes the sum of (i) all successful proxy contests and (ii) all proxy contests in which an activist agreed to a favorable settlement (not just those for board seats) at S&P 500 and Russell 3000 companies for each year, by date of campaign announcement.

[278] *See* Section III.F for a discussion on advance notice bylaws.

[279] FactSet as of April 2023. Companies may be particularly eager to avoid proxy battles and settle with well-established activists. In 2016, however, this perceived rush to settlement prompted some institutional investors to urge companies to engage with them before settling with activists, conveying their concern that such settlements could be detrimental to a company's long-term performance. Georgeson Report, *2016 Annual Corporate Governance Review* 12 (2016). These calls by institutional investors fall squarely in line with the new paradigm and serve as a reminder that companies facing a proxy contest may well benefit by constructively engaging with their core shareholder base.

"standstill" provision that prohibits the proponent from engaging in proxy contests, submitting proposals or proposing various transactions, such as additional stock purchases or tender offers, for a specified period of time. In evaluating whether to settle or fight in a given proxy contest, a company may consider the actual costs and distractions of conducting a protracted contest against the likelihood of success, as well as the ability of the existing members of a company's management and directors to productively engage with the dissident's proposed nominees. A company may also evaluate the likely terms or parameters of a potential settlement and the impact on the company's ongoing business of engaging in an extended fight.

VI. Shareholder Engagement

Among the many changes the corporate governance landscape has seen in recent years, one of the most fundamental is companies', and particularly directors', relations with their shareholders. In addition to the other escalating demands of board service, directors are increasingly called upon—and shareholders increasingly expect directors—to meet with shareholders on corporate governance and other matters. Shareholder engagement has grown increasingly important as institutionalization of share ownership has increased. Today, retail shareholders account for a minority of the float of most public companies and, of those shares they own, they vote only a small percentage of them. By contrast, the majority of public company stock is in the hands of institutional investors, who are themselves intermediaries representing the interests of the ultimate beneficial owners, and whose voting participation rate was 82 to 85 percent from 2018 to 2022 (as compared to 29 to 32 percent for retail investors over the same time period).[280] In recognition of the relatively small number of institutional investors that together control U.S. public companies, the new paradigm highlights the critical need for collaborative and ongoing interaction between companies and investors toward a shared goal of sustainable long-term value creation.

While a director's primary focus must remain on partnering with and overseeing management to enhance the long-term value of the company, the board must adjust to this new corporate governance landscape and be sensitive to shareholder demands. Shareholder concerns should be listened to and addressed in a constructive manner, and the nominating and corporate governance committee should ensure that the company maintains a shareholder relations program that clearly articulates the reasons for the company's strategies and governance policies and engenders support from the company's major shareholders. Ordinarily, management should serve as the primary point of contact for shareholder outreach. However, the nominating and corporate governance committee may sometimes find it appropriate and beneficial for this outreach to include direct communication between directors and shareholders, and it is becoming increasingly common for non-executive board members to engage with investors. In a 2022 PricewaterhouseCoopers survey, 60 percent of responding board members reported that a member of their board other than the CEO had direct engagement with shareholders in the past 12 months—an almost 50 percent increase in prevalence compared to five years ago.[281] In the event of such communication, management and the board should take care to coordinate their messages to avoid causing confusion among investors. The board and management should work out disagreements internally, and the company should speak to shareholders with a unified voice.

The SEC requires a company to disclose whether it has procedures for shareholders to communicate with the board of directors. If so, the company must describe how these communications may be sent to the board. If not, the company must disclose that it does not have such a policy and explain why the board believes it is appropriate for the company not to

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[280] ProxyPulse: A Broadridge Publication, *2023 Proxy Season Preview and 2022 Proxy Season Highlights* 7 (2022), https://www.broadridge.com/_assets/pdf/broadridge-2023-proxypulse-report.pdf.

[281] PricewaterhouseCoopers, *Charting the course through a changing governance landscape: PwC's 2022 Annual Corporate Directors Survey* 25 (2022), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2022-annual-corporate-directors-survey.pdf.

have such a process.[282] Companies are also increasingly using their public filings as an opportunity to highlight their engagement with shareholders.

Effective shareholder engagement is particularly important when a company finds itself under attack from activist investors or facing a hostile takeover bid or other corporate crisis. In an activist situation, especially one culminating in a proxy fight, well-established relationships with large shareholders can prove outcome-determinative. These relationships should be cultivated on a continual basis as part of the company's advance preparedness for an activist situation. A board that begins a dialogue with long-term shareholders only when it is under attack puts itself at a significant disadvantage.

Constructive discussions with the activist and other shareholders may allow the board to reach a compromise resulting in the withdrawal of a shareholder proposal. Indeed, for the 2022 proxy season, 26 percent of shareholder proposals submitted for shareholder meetings were withdrawn by the proponent, likely as a result of company actions and/or ongoing dialogue between the company and the shareholder proponent. Even if an accommodation is not reached, good-faith discussions with the activist will strengthen the company's position with respect to other shareholders and proxy advisory firms. This can be particularly valuable if the company solicits other shareholders and proxy advisory firms to vote against the proponent's proposal.

Although the need for shareholder engagement is felt most acutely during a proxy fight or in response to a specific crisis, the nominating and corporate governance committee must recognize that, in this new corporate governance landscape, shareholder outreach is best seen as a regular, ongoing initiative. As part of this ongoing initiative, the nominating and corporate governance committee should track the composition of the company's shareholders and stay abreast of any reports on the company by proxy advisory services. Majority voting standards, changes to stock exchange policies regarding discretionary broker votes, board declassification and other changes to best practices have reduced the predictability in voting outcomes. In this environment, strong shareholder relations and a robust explanation of the company's corporate governance policies are perhaps more important than ever before. Dialogue with shareholders can help to increase the board's credibility, enhance the transparency of governance decisions, preempt shareholder resolutions and proxy fights and otherwise navigate potentially contentious issues with shareholders.

[282] Item 407(f) of Regulation S-K. 17 C.F.R. § 229.407(f).

PART TWO:

THE "NOMINATING" FUNCTION OF THE NOMINATING AND CORPORATE GOVERNANCE COMMITTEE

VII. Building an Effective Board

Traditionally, identification and recommendation of board candidates constituted the primary roles of the nominating committee. Although, as discussed, this committee has now assumed a much greater role in formulating appropriate governance mechanisms and policies, its role in populating the board is still a core and vitally important function. Before the nominating and corporate governance committee undertakes the work of identifying individual director candidates or formulating specific corporate governance policies, it should first have a strong understanding of the role of the board of directors.

A. The Role and Responsibilities of the Board of Directors

1. The Dual Role of the Board

The board of directors serves as both a monitor and a partner of the management team it selects to run the day-to-day affairs of the company. To be effective, a board must find the right balance between its monitoring and advising functions; and between engaging in a "hands-on" approach to oversight and giving management the latitude necessary to operate the business. To properly oversee management, directors must maintain a thorough understanding of the company by asking the right questions and cultivating dialogue, transparency and robust information-sharing between the board and management. At the same time, the board must take care that this oversight does not encroach into areas better reserved for the company's management.

While boards have always played the dual role of monitor and partner, increased political and regulatory pressure in recent years for enhanced risk management together with an ongoing shift towards a more shareholder-centric model of corporate governance has tilted the balance in favor of monitoring. Specifically, many companies have reacted to those changes by more heavily emphasizing the board's monitoring function at the expense of the board's equally important advisory role. Although the board must diligently oversee management and be prepared to step in when necessary, most often a company is best served when directors and management work together to set and achieve the company's goals. So long as directors exercise their independent judgment, it is not only perfectly appropriate for directors and management to develop relationships of mutual trust and friendship, it is vital. Such relationships enable management to draw on the insights and judgment of directors and facilitate the board's oversight and partnership functions by fostering greater communication, thereby allowing the board to provide more meaningful input into key decisions. The need for a strong working relationship between the board and management is particularly important in the context of ESG oversight and related risk management where boards will need to lean on management to provide timely updates, share relevant expertise, gather data, solicit stakeholder input, execute on long-term strategies, track progress and performance and lead engagement and disclosure efforts. Indeed, if a director does not trust and respect management, the director should reconsider whether she or he is a good fit for the company, or, if enough other directors share this view, the board should consider whether changes to the management team might be in order.

2. Tone at the Top

Setting the right tone at the top is one of the most critical functions of an effective board. The board's culture and priorities, if properly instilled and communicated, will ripple through the company and its interactions with its various constituencies. The board should work with senior management to cultivate a corporate culture of integrity, compliance and professionalism. Transparency and communication are key to the board's ability to set the right tone at the top. Even the most involved boards will find that they are unable to micromanage conformance to the company's standards. Rather, the board should focus on setting the right tone and ensuring that monitoring programs are in place and regularly re-evaluated. The company's code of conduct and ethics should not be a mere formality; the code must be an ethos that is ingrained in the company's strategy and operations. As the unprecedented challenges resulting from the Covid-19 pandemic have shown, it is vital for the board to set the right tone during times of crisis, including an emphasis on the health and well-being of employees and all other stakeholders, a diligent focus on addressing the risks facing the company, and (hopefully, assuming warranted) a resolute confidence that the challenges to the enterprise arising from the crisis will be overcome.

3. Risk Management

In addition to its many other corrosive effects, a failure to instill the right corporate culture creates the risk of serious reputational, financial, regulatory and/or legal consequences. This has been underscored in recent years. Disasters and crises such as the Covid-19 pandemic and the last financial crisis have resulted in tens of billions of dollars in liabilities and brought an unprecedentedly bright spotlight on the board's role in overseeing risk management. Furthermore, examples of executive misconduct, more serious illegal behavior and shortcomings in corporate culture have resulted in material damage to company reputations and shareholder value and resulted in costly shareholder litigation and regulatory enforcement actions. The Covid-19 pandemic has also pressure-tested companies' risk management systems and practices. With the pandemic in the rear view, boards now have the opportunity to reflect on which risk management strategies proved most effective in helping their companies weather the pandemic. New corporate risks arising from societal tensions, geopolitical fragmentation, environmental degradation and significant labor market dislocation also continue to present new challenges to risk management processes, and boards will need to reexamine how risk management strategies should adapt to the changing operating context. With two "Black Swan" events in just the past three years (the other being the war in Ukraine), it should be clear that management, with oversight from boards, should endeavor to anticipate possible contingencies and be ready to respond quickly and nimbly when the unexpected occurs.

Corporate culture and executive and employee oversight is therefore an important focus for the board in its risk management role. SEC rules require disclosure of the extent of the board's role in risk oversight of the company.[283] Among many other changes targeting risk management, Dodd-Frank requires each publicly traded bank holding company with $10 billion or more in assets to establish a stand-alone, board-level risk committee.[284] While these crises and their backlash demonstrate the need for vigilant oversight, they do not change the

[283] Item 407(h) of Regulation S-K. 17 C.F.R. § 229.407(h).
[284] *See infra* footnote 401 and accompanying text.

fundamental principle of corporate governance that the proper role of the board in managing the company's risk is one of *oversight* rather than direct implementation (which is the role of management). Through proper oversight and setting the right tone at the top, the board can ensure that the company has an appropriate risk profile and that its officers and employees view risk management not as an impediment but as an important part of the company's success. In fulfilling its oversight duty, the roles and responsibilities of different board committees in overseeing specific categories of risk should be reviewed to ensure that, taken as a whole, the board's oversight function is coordinated and comprehensive.

Further, the board's focus on risk management continues to be a top priority of institutional investors. Major institutional investors such as BlackRock, State Street and Vanguard have been outspoken in their belief that strong risk oversight practices are key to enhancing long-term, sustainable value creation, and this view is reflected in both ISS and Glass Lewis proxy voting guidelines. Investor prioritization of the board's risk oversight role has become especially pronounced since the onset of the Covid-19 pandemic and the heightened expectations of boards with respect to oversight of ESG. In a 2022 survey of 851 public company directors, less than 65 percent of the surveyed directors felt that the board understood the internal processes and controls around ESG and only 56 percent think they understand the company's carbon emissions.[285]

In addition to industry- and company-specific risks, climate, cybersecurity, supply chain, human capital and geopolitical risks and risks associated with corporate culture and non-financial criminal activity among directors and management have emerged as requiring board attention.[286]

Climate-related risks have emerged as a hot button issue for both investors and regulators. In March 2022, the SEC issued proposed rules that would require companies to provide climate-related disclosure including disclosures relating to Scope 1, 2 and 3 emissions, financial disclosures setting forth the costs of climate transition, as well as scenario analyses and transition plans. The proposed rules also contemplate disclosures regarding board and management oversight of climate-related risks, including disclosures as to whether directors have expertise on climate-related risks.[287]

Regulators have focused on cybersecurity as an issue that companies must be prepared to address in securities disclosures. In February 2018, the SEC issued interpretive guidance to assist public companies in the preparation of disclosures about cybersecurity risks and incidents, emphasizing the importance of disclosing cybersecurity risks in periodic reports and to consider cybersecurity costs in the analysis of a company's financial condition, among other guidance.[288] In March 2022, the SEC issued proposed amendments to its rules to enhance and standardize

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[285] PricewaterhouseCoopers, *PwC's 2022 Annual Corporate Directors Survey* (2022), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2022-annual-corporate-directors-survey.pdf.

[286] *See id.*; *see also* National Association of Corporate Directors, *2023 Governance Outlook* (2022).

[287] *See* SEC, *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors*, https://www.sec.gov/news/press-release/2022-46.

[288] *See* Commission Statement and Guidance on Public Company Cybersecurity Disclosures, 17 C.F.R. Parts 229 and 249 (interpretation, February 21, 2018), https://www.sec.gov/rules/interp/2018/33-10459.pdf.

disclosures regarding cybersecurity risk management, strategy, governance, and incident reporting by public companies.[289]

Certain highly publicized cybersecurity breaches, and the potentially serious reputational and other consequences of such breaches (notably including those at Colonial Pipeline, SolarWinds, Capital One, Marriott, Equifax and Yahoo),[290] have highlighted the need for board involvement in such matters. Boards have recognized this need and have begun to become more engaged on the topic: in a 2022 survey, 34 percent of board members viewed changing cybersecurity threats as likely to have the most impact on their company and considered cybersecurity to be "very important" areas of board oversight improvement. In addition, 34 percent of board members indicated their board lacked sufficient expertise to handle cybersecurity threats.[291]

Boards should not assume that cybersecurity is too technical for meaningful director input or that the issue is best left to a company's IT function. As CII's 2016 *Prioritizing Cybersecurity* guide notes: "directors need not develop advanced technical expertise . . . . [Rather,] [d]irectors need to: understand management's cybersecurity strategy[,] learn where cybersecurity weaknesses lie [and] support informed, reasonable investment in the protection of critical data assets."[292] Boards have increased their understanding of cybersecurity, according to a recent survey of public companies in which 61 percent of surveyed boards indicated that they regard improvements to cybersecurity oversight to be made over the next 12 months to be "important" or "very important."[293] In fact, Gartner has predicted that 40 percent of boards will have a dedicated cybersecurity committee by 2025.[294] While the board should be actively involved in overseeing and advising efforts to prevent cyber-attacks, the board should also be actively involved in preparing for and putting into place a process for effectively managing the effects of any cyber-attack. A board must provide effective oversight over cybersecurity through risk and crisis management by ensuring that cybersecurity is well integrated into enterprise risk management and that the company has in place systems that enable it to respond effectively to cyber-attacks and cyber-breaches.

More recently, risks associated with negative corporate culture and non-financial criminal activity among directors and management have come to the attention of boards, which may be reluctant to address them.[295] Given the impact on corporate performance of sexual harassment in

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[289] *See* SEC, *SEC Proposes Rules on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies*, https://www.sec.gov/news/press-release/2022-39.

[290] *See, e.g.*, Kenneth Kiesnoski, *5 of the Biggest Data Breaches Ever*, CNBC (Julu 30, 2019), https://www.cnbc.com/2019/07/30/five-of-the-biggest-data-breaches-ever.html; Robert McMillan & Ryan Knutson, *Yahoo Triples Estimate of Breached Accounts to 3 Billion*, THE WALL ST. J. (October 3, 2017), https://www.wsj.com/articles/yahoo-triples-estimate-of-breached-accounts-to-3-billion-1507062804.

[291] National Association of Corporate Directors, *2023 Governance Outlook* (2022).

[292] Council of Institutional Investors, *Prioritizing Cybersecurity: Five Investor Questions for Portfolio Company Boards* 1 (April 2016), http://www.cii.org/files/publications/misc/4-27-16%20Prioritizing%20Cybersecurity.pdf.

[293] National Association of Corporate Directors, *2023 Governance Outlook* (2022).

[294] Gartner, *Predicts 2021: Cybersecurity Program Management and IT Risk Management* (2021).

[295] *See* Jennifer Elias, *Boards Unprepared to Deal with Sexual Harassment, Survey Shows*, SILICON VALLEY BUS. J. (October 31, 2017), https://www.bizjournals.com/baltimore/bizwomen/news/latest-news/2017/10/boards-unprepared-to-deal-with-sexual-harassment.html; *see also* David A. Katz & Laura A. McIntosh, *Boards, Sexual Harassment, and Gender Diversity*, N.Y.L.J. (January 25, 2018), https://www.law.com/newyorklawjournal/sites/newyorklawjournal/2018/01/24/boards-sexual-harassment-and-gender-diversity/.

the workplace, both directly and indirectly, it is a significant risk for the attention of board members.[296]

4. Crisis Management

Closely related to its role in risk management, the board must also be prepared to meet effectively any crisis that may confront the company. Examples of possible crises include an unexpected departure of the CEO or other key members of management, rapid deterioration of business conditions or liquidity, risk management or product failures, government investigations and major disasters or pandemics, including geopolitical crises. Crises, almost by definition, are unexpected, as illustrated by the ongoing Covid-19 pandemic and the war in Ukraine. That said, a board can prepare itself by thoroughly understanding the company's business and industry, with an eye towards anticipating what challenges the company is most likely to face.[297] When a crisis does strike, the CEO generally should lead the company's response, with guidance and input from the board. However, if the CEO has been compromised, the board must be ready to take a more active role in navigating the company through the crisis. The rapid and crippling spread of Covid-19 has shown that effective risk and crisis management needs to be dynamic, forward-looking, comprehensive and nimble, and that it should extend to the health and wellbeing of employees and the preservation of customer and supplier relationships and business reputation.[298]

Moreover, companies are increasingly being put in a position where they are under pressure from stakeholders, particularly employees, to speak out on issues of national or global importance. The decision whether to speak out on certain issues (or to remain silent) can have significant reputational, legal and financial costs, particularly as the anti-ESG backlash sweeps across certain parts of the country. The board has to guide, support and oversee management in navigating through these sensitive, high-impact events.[299]

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[296] *See, e.g.*, Carrie Hong & Daniela Wei, *Wynn Macau Shares Drop After U.S. Rout on Harassment Allegations*, BLOOMBERG (January 28, 2018), https://www.bloomberg.com/news/articles/2018-01-28/wynn-macau-shares-in-focus-after-u-s-rout-on-harassment-report; Nilofer Merchant, *The Insidious Economic Impact of Sexual Harassment*, HARV. BUS. REV. (November 29, 2017), https://hbr.org/2017/11/the-insidious-economic-impact-of-sexual-harassment.

[297] Recent evidence suggests that there is room for improvement on this front. In 2020, only 37 percent of surveyed directors reported having full understanding of their companies' crisis management plan. *See* PricewaterhouseCoopers, *Turning Crisis into Opportunity: PwC's 2020 Annual Corporate Directors Survey* 4 (2020), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2020-annual-corporate-directors-survey.pdf. A 2022 survey reported that 25 percent of respondents believe that crisis management oversight does not receive enough board time and attention. *See Charting the course through a changing governance landscape: PwC's 2022 Annual Corporate Directors Survey* 31 (2022), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2022-annual-corporate-directors-survey.pdf.

[298] *See* Wachtell, Lipton, Rosen & Katz, *Key ESG Considerations in the Crisis* (April 13, 2020), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.26916.20.pdf.

[299] *See* Wachtell, Lipton, Rosen & Katz, *War in Ukraine: Is ESG at a Crossroads?* (March 18, 2022), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.28007.22.pdf.

B. Board Composition

The most important factors in determining the effectiveness of a board are the quality of the people who serve as directors and their ability to work together. These factors make the nominating and corporate governance committee's role in identifying director nominees so critical to a company's success. Directors must possess integrity, character, commitment, judgment, energy, competence and professionalism, and the right mix of industry savvy and financial expertise, objectivity and diversity of perspectives and business backgrounds, among other qualities. Almost as crucial as the caliber of the directors as individuals is how well they function as a group. Although a director's qualifications may be discerned easily from a resume or profile, the dynamics of a board can only be understood by those directors and officers (and advisors) who actually participate in its meetings. A collegial board with mutual trust and complementary skill sets can add value to the corporate enterprise that is greater than the sum of its parts, while a balkanized board will usually be ineffective regardless of the quality of its individual directors. Unfortunately, board culture and cohesiveness are not easily captured and categorized on paper. The result is that such values are often underappreciated, especially in this age of one-size-fits-all "best practices."

The ever-increasing pressure from shareholder proxy advisory services, institutional investor groups, activist shareholders and other commentators for companies to conform to continuously evolving and escalating standards for so-called "best practices" has made the task of assembling a well-rounded board even more difficult in recent years. With the advent of the universal proxy, the process of designing and building a balanced and effective board will become that much more complicated and scrutiny on each director's contributions to the board will likely become more intense. One aspect of these "best practice" standards involves an intense, arguably even excessive, focus on director independence at the expense of other skills and qualifications. The combination of attributes, experiences and personalities that constitute an effective board is intrinsically difficult, if not impossible, to boil down to bright-line checklists or off-the-shelf mandates. Undeniably, these mandates, oversimplified governance grades and "best practices" are increasingly difficult to resist. Ultimately, however, directors serving on the nominating and corporate governance committee must be prepared to explain to shareholders that it is more important to have directors and governance policies that will best serve the company than to blindly conform to one-size-fits-all mandates.

1. Director Qualifications

The nominating and corporate governance committee's search for nominees naturally begins with an analysis of the qualities that the committee seeks in a candidate. This analysis should consist of both an assessment of the skills and experiences possessed by current board members and a vision of the ideal mix of director skills and experiences, given the company's circumstances. By comparing the skills and experiences already represented on the board with the ideal complement of skills and experiences, the nominating and corporate governance committee will be well positioned to create a candidate profile and to assess how well current board members fit the company's needs.

All directors should possess certain qualities, such as integrity, sound judgment and a commitment to representing all shareholders. But the nominating and corporate governance

committee's greatest challenge in composing a board is to find the right complement of abilities and experiences among the directors that best serves the company. This requires a thorough understanding of the company, its business, its competitive landscape and its strategy. Attributes and experiences typically sought by a nominating and corporate governance committee include financial or risk assessment expertise, background in the company's industry, familiarity with the company, gender and racial diversity, legal or regulatory compliance knowledge, valuable international or local connections, experience in academia or government and service as an executive officer or director of a public company.[300] Among other sources of data, committee members can consider previous board and committee reviews and director self-evaluations as indicators of skills, experiences and other traits that may be desired on the board. In addition, the Covid-19 pandemic has shown that companies benefit from longer-tenured directors who possess institutional knowledge and experience in navigating through prior crises, underlying the importance of a balance between longer-tenured directors and newer directors who can bring fresh perspectives to the board.

Although it is more common today for the CEO to be the only member of management on the board, the nominating and corporate governance committee may consider adding a second member to ensure that the board includes directors intimately familiar with the company and to provide an additional source of direct input on the company's operations to the rest of the board. The nominating and corporate governance committee should continually evaluate the composition of the board to ensure that its combination of attributes fits the company's strategy and direction. For example, a company suddenly finding itself with financial or competitive difficulties may seek to add a turnaround expert, while a company confronted with a scandal or government investigation may benefit from additional expertise in compliance, government or public relations. The importance of frequently reassessing the alignment of the board's composition with the company's needs is underscored by the remarkable pace of economic, technological and regulatory changes in recent years.

2. Skills Matrices

One increasingly popular tool for analyzing board composition against previously established criteria is the skills matrix. In the wake of universal proxies which will allow shareholders to "mix and match" director slates, director skills matrices will become even more important for showcasing the skill sets of individual directors. A skills matrix is a boxed chart with one axis listing each director or nominee and the other axis listing the attributes that the nominating and corporate governance committee desires to be represented on the board. These may include attributes that every director should possess as well as attributes that should be represented by some subset of the board. Examples of the latter include financial or risk assessment expertise, background in the company's industry, and legal or regulatory compliance

[300] A 2020 study found that shareholders believe financial expertise, operational expertise, risk management expertise and gender diversity expertise to be the most important attributes to have represented on a corporate board. PricewaterhouseCoopers, *Turning Crisis into Opportunity: PwC's 2020 Annual Corporate Directors Survey* 26 (2020), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2020-annual-corporate-directors-survey.pdf. Compared to the same survey in 2015, directors were much less likely to say that any particular area of expertise is "very important" to the board (for example, in 2015, 70 percent of directors indicated that industry experience was very important, compared to only 43 percent in 2020), indicating a broadening of attributes and skills that directors find valuable. *Id.* at 13.

knowledge. Experience and expertise in ESG issues such as climate, supply chains and cybersecurity are also increasingly valued, although the board will need to make a careful determination as to how expertise is assessed and to ensure that such assessment comports with the expectations set forth in the SEC's forthcoming rules on climate and cybersecurity.

A skills matrix can serve as a visual, straightforward way of understanding the strengths of the board and identifying any areas in which it may need improvement. It may also assist the nominating and corporate governance committee both in analyzing the areas in which current directors could benefit from additional training or exposure and also in evaluating which new candidate would best complement the board's current composition. However, when using a skills matrix, the nominating and corporate governance committee should be mindful of the less tangible characteristics of directors, like individual personalities, that may not be easily represented in the matrix but are nonetheless crucial in achieving a healthy board dynamic.

Including a skills matrix in the company's proxy statement can be helpful in preempting or responding to pressures for board refreshment and providing greater objectivity and transparency to the nomination process. Whether or not a nominating and corporate governance committee chooses to utilize or disclose a skills matrix, the focus remains the same: the committee should identify nominees who will best contribute to the formation of a well-rounded and effective board.

3. Diversity

The issue of boardroom diversity—both in terms of gender and race/ethnicity—has become increasingly prominent in recent years in the United States and abroad, as governments, regulators, stock exchanges, institutional investors and companies have all sharpened their focus on the issue. In 2018, the governor and legislature of California signed the first U.S. law mandating quotas for women on boards.[301] By its text, the law applies to all publicly traded corporations that have principal offices in California,[302] and requires the boards of such corporations to have at least one female director by December 31, 2019.[303] By year-end 2021, companies with five directors will be required to have at least two women on the board, and companies with six or more directors will be required to have at least three women on the board.[304] The penalties are $100,000 for a first-time violation and $300,000 for subsequent violations.[305] Following legal challenges, a California state court found the law unconstitutional under the California state constitution, striking it down in May 2022, but not before it had

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[301] 2018 Cal. Legis. Serv. 954 (S.B. 826) (West) (codified at CAL. CORP. CODE §§ 301.3, 2115.5).

[302] However, under long-standing principles enshrined in the Commerce Clause of the U.S. Constitution, the California law can apply only to corporations incorporated in California. *See* Wachtell, Lipton, Rosen & Katz, *California Law Awaiting Governor's Signature Exceeds State's Jurisdiction* (September 21, 2018), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26189.18.pdf. On April 20, 2020, the federal district court for the Eastern District of California dismissed an attempt to invalidate the California board gender diversity mandate on technical standing grounds. *See Meland* v. *Padilla*, No. 2:19-CV-02288-JAM-AC, 2020 WL 1911545 (E.D. Cal. April 20, 2020); *see also* Wachtell, Lipton, Rosen & Katz, *Federal District Court Dismisses Challenge to Board Diversity Statute* (April 24, 2020), https://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26927.20.pdf.

[303] CAL. CORP. CODE § 301.3(a).

[304] *Id.* § 301.3(b)

[305] *Id.* § 301.3(e)(1).

already had a substantial impact on boards that were diversity laggards.[306] Another California law (challenged by the same plaintiffs) requiring minority representation on boards of companies with their principal office in California (with at least one board member by the end of 2021 identifying as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian or Alaska Native, or LGBTQ+), was struck down in April 2022.[307] Both rulings have been appealed; in December 2022, the California appeals court reinstated injunctions against the laws' implementation while appeals are pending.[308]

In August 2021, the SEC approved Nasdaq's proposed rule changes regarding diversity on boards, which remains subject to an ongoing court challenge by several states.[309] Nasdaq's initial December 2020 proposal required each Nasdaq-listed company, subject to certain exceptions, to (1) annually publish in a standard format, either in the company's proxy statement, Form 10-K or on its website, statistical information regarding its directors' self-identified gender, race and LGBTQ+ status and (2) either have at least two "Diverse" directors—including at least one director who self-identifies as female and at least one director who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or LGBTQ+—or explain why its board does not have at least two "Diverse" directors.[310] In February 2021, Nasdaq proposed certain modifications to the new rules, including to offer more flexibility to companies with small boards and provide companies with a one-year grace period for companies that no longer meet the diversity objectives as a result of a vacancy.[311] The transition period for the now-approved rule requires companies on the Nasdaq Global Select Market and Nasdaq Global Market to have, or explain why they do not have, one diverse director by December 31, 2023, and two diverse directors by December 31, 2025. Nasdaq Capital Market companies are required to have, or explain why they do not have, one diverse director by December 31, 2023 and two diverse directors by December 31, 2026. Companies with boards of five or fewer directors, regardless of listing tier, are required to have, or explain why they do not have, one diverse director by December 31, 2023. Since 2022, companies were required to also annually disclose board diversity in alignment with Nasdaq's standardized disclosure template, the Board Diversity Matrix.[312]

In addition, ISS and Glass Lewis have also strengthened their expectations regarding board gender and racial diversity. Glass Lewis announced that beginning 2023, it will recommend against the chair of the nominating committees of companies that are on the Russell 3000 index that have fewer than 30 percent gender-diverse directors.[313] Beginning in 2023, ISS will recommend withhold or against the chair of the nominating committees of all companies where there are no women directors (a change from the policy applying only to companies in the

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[306] *Crest* v. *Padilla (Crest - SB 826)*, No. 19-STCV-27561 (Cal. Sup. Ct. L.A. Cty. May 13, 2022).
[307] *Crest* v. *Padilla (Crest - AB 979)*, No. 20 STCV 37513, 2022 WL 1073294 (Cal. Super. Ct. L.A. Cty. April 1, 2022) (striking down California Corporations Code § 301.4).
[308] Order, *Padilla* v. *Crest*, No. B322276 (Cal. Ct. App. 2d December 1, 2022); Order, *Crest et al.* v. *Padilla*, No. B321726 (Cal. Ct. App. 2d December 1, 2022).
[309] Securities Exchange Act Release No. 34-92590, https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf.
[310] The Nasdaq Stock Market LLC, Form 19b-4 (File No. SR-2020-081) (filed December 1, 2020).
[311] The Nasdaq Stock Market LLC, Form 19b-4 (File No. SR-2020-081) (filed February 26, 2021).
[312] Nasdaq, *Board Diversity Matrix* (last updated January 23, 2023), https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Matrix.pdf.
[313] Glass Lewis, *2023 Policy Guidelines* 7 (Novermber 12, 2022).

Russell 3000 and S&P 500 indices).[314] Several institutional investors have announced new expectations, with Blackstone announcing an expectation of 30 percent of board members qualifying as diverse, while State Street will require boards to be comprised of at least 30 percent women.[315] Relatedly, certain investors have begun pushing for disclosure of the diversity attributes of directors on an individual rather than aggregate basis, which is currently the most common practice among S&P 500 companies.

In Europe, several countries have adopted mandatory quotas for gender diversity, and after a 10-year delay, a 2012 proposal by the European Commission to require large public companies to introduce a new director selection procedure that would give priority to qualified female candidates unless at least 40 percent of the board's non-executive directors were comprised of women was adopted in November 2022.[316] Outside the legislative context, several organizations have formed to advocate for more diverse representation on public company boards.[317]

While the numerous regulatory and private sector initiatives aimed at promoting diversity may not be producing change at the speed that proponents may desire, progress is being made: according to a recent survey of S&P 500 companies, female representation among new independent directors was 46 percent in 2022 (up slightly from 43 percent in 2021), women make up 32 percent of all directors in 2022 and 46 percent of new independent directors were racially or ethnically diverse (compared with 22 percent in 2020).[318] Further, as of the publication date of the survey, all S&P 500 boards have at least one woman and only 2 percent of boards have only one woman.[319] Racial diversity is less advanced than gender diversity in the boardroom. Only 22 percent of the board seats in the S&P 500 are held by individuals from historically underrepresented groups.[320]

While the trend toward increased representation by female and racial minority directors has historically been less pronounced among a larger grouping of companies, companies outside of the S&P 500 have also seen strides, albeit recent data suggest that such advancement may be slowing. Among Russell 3000 companies, the number of women on boards increased slightly

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[314] ISS, *2023 U.S. Proxy Voting Guidelines* 12 (December 13, 2022).
[315] BlackRock Investment Stewardship: *Proxy Voting Guidelines for U.S. Securities* (January 2023), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf; Global Advisors, *CEO's Letter on Our 2022 Proxy Voting Agenda* (January 12, 2022), https://www.ssga.com/us/en/institutional/ic/insights/ceo-letter-2022-proxy-voting-agenda.
[316] Press Release, Euro. Comm'n, *Women on Boards: Commission Proposes 40% Objective* (November 14, 2012), http://europa.eu/rapid/press-release_IP-12-1205_en.htm; Statement, Euro. Comm'n, *Gender Equality: The EU is breaking the glass ceiling thanks to new gender balance targets on company boards* (November 22, 2022), https://ec.europa.eu/commission/presscorner/detail/en/statement_22_7074.
[317] *See, e.g.*, DirectWomen, https://directwomen.org/; Thirty Percent Coalition, https://www.30percentcoalition.org/who-we-are#faqnoanchor. For a detailed discussion of gender diversity on boards, *see, e.g.*, David A. Katz & Laura A. McIntosh, *Gender Diversity on Boards: The Future Is Almost Here*, N.Y.L.J. (March 24, 2016), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25194.16.pdf.
[318] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 4-6 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.
[319] *Id.* at 7.
[320] *Id.* at 34.

from 27.9 to 28.2 percent in Q3 2022—the smallest growth since Q4 2020.[321] However, there are signs that boards are selecting from a smaller pool of female candidates with an over-indexing of multi-boarded women. The number of Russell 3000 boards that have achieved gender parity jumped to 138 (or approximately 5 percent of the index) in Q3 2022, up from 92 during the same quarter in 2021.[322]

In terms of the effects diversity can have on performance, board members believe that gender, racial and other types of diversity among board members themselves promote "diversity of thought" in the boardroom. In a 2022 survey, 44 percent of directors indicated that gender diversity was a "very important" attribute while 40 percent of directors indicated that racial and ethnic diversity was a "very important" attribute.[323] Moreover, 86 percent of surveyed directors responded that board diversity enhances company performance,[324] which represented a significant change to directors' responses to the same question in 2017, when more than 41 percent of director respondents indicated their belief that diversity does not improve company performance at all.[325] Recent research has found that, globally, companies lacking board gender diversity tend to experience more governance controversies than companies with board gender diversity.[326] Multiple studies have also shown a correlation between board diversity and a higher return on equity.[327] While these studies do not establish causality, they are at least suggestive that board (and executive) diversity is associated with higher financial returns, a correlative relationship of which nominating and corporate governance committee members should be aware.

Since 2010, the SEC has required public companies to disclose in their proxy statements whether their nominating and corporate governance committee considers diversity in identifying director nominees. If there is such a policy, the company must describe how this policy is implemented, as well as how the nominating and corporate governance committee or the board

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[321] Equilar, *Gender Diversity Index (GDI)* (December 5, 2022), https://info.equilar.com/equilar-gender-diversity-index-2022-q3-nov2022.pdf.

[322] *Id.*

[323] PricewaterhouseCoopers, *PwC's 2022 Annual Corporate Directors Survey* 12, (2022), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2022-annual-corporate-directors-survey.pdf.

[324] *Id.* at 4.

[325] PricewaterhouseCoopers, *PwC's 2017 Annual Corporate Directors Survey: The Governance Divide; Boards and Investors in a Shifting World* 11, https://www.pwc.com/us/en/governance-insights-center/annual-corporate-directors-survey/assets/pwc-2017-annual-corporate--directors--survey.pdf.

[326] *See* MSCI ESG Research Inc., *Women on Boards: Global Trends in Gender Diversity on Corporate Boards* 4 (November 2015), https://www.msci.com/documents/10199/04b6f646-d638-4878-9c61-4eb91748a82b.

[327] *See id.* (showing correlation with gender diversity while also considering corporate executive leadership in its definition of diversity); *see also* McKinsey & Company, *Delivering Through Diversity* 8, 10, 13 (January 2018), https://www.mckinsey.com/~/media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity_full-report.ashx (analyzing a global data set and finding statistically significant correlations between likelihood of financial outperformance and each of (a) board ethnic diversity, (b) executive ethnic diversity and (c) executive gender diversity, but no statistically significant correlation between likelihood of financial outperformance and board gender diversity); and Marcus Noland *et al*., *Is Gender Diversity Profitable? Evidence from a Global Survey* 16 (Peterson Inst. For Int'l Econ. Working Paper Series, WP 16-3, 2016), https://piie.com/system/files/documents/wp16-3.pdf. Noland and his colleagues speculated that the correlation could reflect the impact of increased skill diversity on the firm or that the firm does not practice discrimination and will therefore exhibit superior performance. *Id.* at 6.

assesses the effectiveness of its policy.[328] Thus, any company stating that diversity is taken into account in identifying nominees may be requested to explain how the consideration of diversity is implemented and assessed. The SEC does not define "diversity" and notes that some companies may conceptualize diversity expansively and others more narrowly. The vast majority of large companies opts for the former expansive approach, considering diversity to encompass characteristics ranging from age, race, gender and geographic origin, to diversity of viewpoints and experience.

Institutional investors have been particularly outspoken on board diversity. BlackRock, State Street Global Advisors, CalSTRS and CalPERS now include board diversity in their voting policies. State Street has stated that it will vote against all board members on the nominating committee of any company not meeting its gender diversity criteria, including companies that have no women on their board and that have failed to engage in "successful dialogue on State Street Global Advisor's board diversity program for three consecutive years," and that, beginning in the 2023 proxy season, State Street will expect boards to be comprised of at least 30 percent women directors for companies in major indices in the United States, Canada, UK, Europe, and Australia. State Street has further indicated that it is willing to vote against the Chair of the board's Nominating Committee or the board leader should a company fail to meet these expectations.[329] In the 2022 proxy season, BlackRock disclosed that it had voted against directors of 107 companies in the Americas for insufficient diversity.[330] Vanguard has similarly stated that while "some companies have taken meaningful steps" to improve gender and racial/ethnic diversity, "too many others haven't" and that it will "continue to push for progress."[331] In October 2019, the Office of the New York City Comptroller, which had considerable success promoting the widespread adoption of proxy access under the Boardroom Accountability Project and pioneering the board "matrix" method for disclosing director details in the Boardroom Accountability Project 2.0, announced the Boardroom Accountability Project 3.0, which calls on the boards of 56 U.S. companies to adopt a policy requiring the consideration of both women and people of color for every open board seat and for CEO appointments, a version of the National Football League's "Rooney Rule."[332] In February 2023, the New York City Comptroller reiterated its focus on diversity, issuing a press release stating that board diversity is "an essential measure of sound governance and a critical attribute of a well-functioning board of directors." The Comptroller pledged, at elections of Russell 1000 companies, to vote (1) against all incumbent board nominees at companies with no board directors identifying as an underrepresented minority (as defined by federal Equal Employment Opportunity Commission, which includes one or more of the following: Black or African

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[328] Item 407(c)(2)(vi) of Regulation S-K. 17 C.F.R. § 229.407(c)(2). *See also* Proxy Disclosures Enhancements, Exchange Act Release Nos. 33-9089 and 34-61175 (December 16, 2009), http://www.sec.gov/rules/final/2009/33-9089.

[329] Harvard Law School Forum on Corporate Governance, *CEO's Letter on SSGA 2022 Proxy Voting Agenda* (January 18, 2022), https://corpgov.law.harvard.edu/2022/01/18/ceos-letter-on-ssga-2022-proxy-voting-agenda/.

[330] BlackRock Investment Stewardship, *Q4 2022 Stewardship Statistics* (2022), https://www.blackrock.com/corporate/literature/publication/investment-stewardship-by-the-numbers-q4-2022.pdf.

[331] The Vanguard Group, Inc., *Investment Stewardship 2020 Annual Report* 3 (2020), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/2020_investment_stewardship_annual_report.pdf.

[332] Office of the New York City Comptroller, Boardroom Accountability Project 3.0, https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/boardroom-accountability-project-3-0/.

American, Hispanic or Latino, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander); (2) against all incumbent nominating committee nominees when a board has just one director identifying as an underrepresented minority; (3) against all incumbent nominating committee nominees at companies that do not disclose the self-identified individual racial/ethnic diversity of their board directors; and (4) against all incumbent nominating committee nominees at companies that do not explicitly consider both gender and racial/ethnic diversity in their search for directors.[333]

Proxy advisors have also updated their voting policies to more directly address diversity—since 2021, ISS has highlighted in research reports the U.S. companies that lack racial and ethnic diversity (or disclosure of such) and beginning with the 2022 proxy season, ISS applied a new withhold-the-vote policy, generally recommending against the chair of the nominating committee (or other directors on a case-by-case basis) where there are no identified ethnic or racially diverse board members.[334] Glass Lewis has stated that it will generally recommend voting against the nominating committee chair of a board of a company in the Russell 3000 index with fewer than 30 percent female directors beginning with shareholder meetings held after January 1, 2023.[335]

Focusing on diversity can have a number of salutary effects, such as bringing a wider range of experiences and perspectives to the board and ensuring that the nominating and corporate governance committee selects from the largest pool of potential candidates. However, diversity is only one of many components of an effective board, and the nominating and corporate governance committee should be cautious not to adopt policies that will bind it to promoting diversity at the expense of other important components. Board policies must be carefully articulated to avoid creating absolute standards that may be difficult or imprudent to meet at particular times. For instance, boards of directors are ordinarily small enough that the departure of one or two directors could significantly alter the demographic makeup of the board. An absolute commitment to a certain level of diversity could restrict the nominating and corporate governance committee to considering only those potential candidates with the same diversity characteristics as the departing director. Determining board composition requires an individualized approach that takes all factors into account, rather than a one-size-fits-all requirement. The nominating and corporate governance committee should reexamine its diversity policies annually, perhaps in conjunction with reviews of the company's committee charters and governance guidelines.[336]

4. Regulatory Requirements

As part of the process of forming the right mix of directors, the nominating and corporate governance committee must be mindful of all applicable regulatory requirements. For example, the SEC requires disclosure of any specific minimum qualifications that a company's nominating

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[333] Office of the New York State Comptroller, *DiNapoli Seeks Increased Diversity at Pension Fund's Portfolio Companies* (February 15, 2023), https://www.osc.state.ny.us/press/releases/2023/02/dinapoli-seeks-increased-diversity-pension-funds-portfolio-companies.

[334] ISS, *2023 U.S. Proxy Voting Guidelines* 8 (December 13, 2022).

[335] Glass Lewis, *2023 Proxy Voting Guidelines* (November 17, 2022).

[336] *See also* Wachtell, Lipton, Rosen & Katz, *Governance Committee Charters and Governance Guidelines* (March 10, 2017), http://blog.wlrk.com/?p=1668.

and corporate governance committee believes must be met by a nominee and any specific qualities or skills that the committee believes are necessary for one or more of the company's directors to possess.[337] The SEC also requires disclosure of the specific experience, qualifications, attributes or skills that led to the conclusion that the nominee should serve as a director in light of the company's business and structure.[338] Combined, these two disclosures enable shareholders to compare a nominee's qualifications to the company's previously identified criteria. Additionally, SEC rules require companies to disclose whether their audit committee includes at least one qualified "financial expert" and, if the committee does not include at least one "financial expert," to provide an explanation.[339]

In addition to SEC requirements, the securities exchanges may have additional requirements. For instance, both the NYSE and Nasdaq require that all members of the audit committee be financially literate[340] and provide additional rules for independent director oversight of executive compensation and the director nomination process.[341] The NYSE requires its listed companies to include in their corporate governance guidelines director qualification standards that, at a minimum, reflect the NYSE's independence requirements.[342] These standards may address other substantive qualification requirements, including limitations on the number of boards on which a director may sit and director tenure, retirement and succession standards.[343] However, neither listing requirements nor state or federal law impose substantive standards that must be applied in the search for and selection of candidates, leaving the nominating and corporate governance committee to exercise its independent judgment in setting candidate criteria. An exercise of this judgment may include the decision not to adopt specific or rigid policies regarding director qualifications. While a nominating and corporate governance committee should carefully consider the qualifications and attributes it seeks in a candidate, the committee will often find it advisable to maintain the flexibility to adjust to the company's changing circumstances by avoiding rigid qualification requirements. Such an approach allows the committee to nominate the candidate it feels will best serve the company, even if the candidate does not fit neatly into a previously identified category.

C. Director Independence

In assessing a director's independence, the nominating and corporate governance committee should take into account a number of sources. Securities markets impose mandatory requirements regarding director independence and the SEC focuses on disclosures relating to director independence. State law, while not legally requiring independent directors, will sometimes view with heightened scrutiny the decisions of directors who are not independent. In addition to these regulatory considerations, the nominating and corporate governance committee should also be mindful of the independence views of proxy advisory services which contain nuanced differences to the securities exchange rules and which influence proxy voting recommendations. These independence requirements are discussed below for general board

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[337] Item 407(c)(2)(v) of Regulation S-K. 17 C.F.R. § 229.407(c)(2)(v).
[338] Item 401(e)(1) of Regulation S-K. 17 C.F.R. § 229.401(e)(1).
[339] Item 407(d)(5) of Regulation S-K. 17 C.F.R. § 229.407(d)(5).
[340] Commentary to NYSE Listed Company Manual, Rule 303A.07(a); Nasdaq Listing Rule 5605(c)(2)(A)(iv).
[341] Nasdaq Listing Rule 5601.
[342] Commentary to NYSE Listed Company Manual, Rule 303A.09.
[343] NYSE Listed Company Manual, Rule 303A.09.

positions, but nominating and corporate governance committee members should remain aware of heightened independence requirements for members of audit and compensation committees.

1. Securities Markets Independence Requirements

Director independence is, by far, the most significant regulatory requirement that the nominating and corporate governance committee must consider with respect to board composition. Subject to limited exceptions, both the NYSE and Nasdaq require boards to consist of a majority of independent directors and to have adopted specific rules as to who can qualify as an independent director. Both markets require the board of any listed company to make an affirmative determination, which must be publicly disclosed (along with the basis for such determination), that each director designated as "independent" has no material relationship with the company that would impair his or her independence.[344] Such disqualifying relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. However, ownership of a significant amount of stock, or affiliation with a major shareholder, should not, in and of itself, preclude a board from determining that an individual is independent.[345] As a general matter, these independence rules ask whether the director is a non-management director free of any material business relationships with the company and its management in the past three years (other than owning stock and serving as a director). Even if a director satisfies each listed requirement, the board must still determine whether the director could exercise independent judgment given all the facts and circumstances.

(a) The NYSE *Per Se* Bars to Independence

A director is not independent under the NYSE rules if:

- in the last three years, the director has been an employee of the listed company or an immediate family member[346] has been an executive officer of the listed company;[347]

- in any 12-month period in the last three years, the director or an immediate family member has received more than $120,000 in direct compensation from the listed company, other than as director, or committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service);[348]

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[344] NYSE Listed Company Manual, Rule 303A.02(a)(i); Nasdaq Listing Rules 5605(a)(2) and IM-5605.
[345] Commentary to NYSE Listed Company Manual, Rule 303A.02; Nasdaq Listing Rule IM-5605.
[346] "Immediate family member" is defined to include a person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone (other than domestic employees) who shares such person's home. General Commentary to NYSE Listed Company Manual, Rule 303A.02(b).
[347] NYSE Listed Company Manual, Rule 303A.02(b)(i). Employment as an interim chairman, CEO or other executive officer will not disqualify a director from being considered independent following that employment. Commentary to NYSE Listed Company Manual, Rule 303A.02(b)(i).
[348] NYSE Listed Company Manual, Rule 303A.02(b)(ii). This $120,000 limit does not apply to compensation received for former service as an interim chairman, CEO or other executive officer; compensation received by an immediate family member for service as an employee of the listed company (other than as an executive officer); or

- the director is a current partner or employee of the company's auditor, an immediate family member is a current partner of the company's auditor or an employee who personally works on the listed company's audit or within the past three years the director or an immediate family member personally worked on the listed company's audit;[349]

- in the last three years, the director or an immediate family member has been employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on that company's compensation committee;[350] or

- the director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the listed company for property or services in an amount that, in any of the last three fiscal years, exceeded the greater of $1 million, or two percent of such other company's consolidated gross revenues.[351]

(b) Nasdaq *Per Se* Bars to Independence

A director of a company that is not an investment company is not independent under Nasdaq rules if:

- in the last three years, the director has been employed by the listed company or was a family member[352] of an executive of the listed company;[353]

- in any 12-month period in the last three years, the director or a family member has accepted more than $120,000 in any compensation from the company during any period of 12 consecutive months, other than as director or committee compensation or compensation paid to a family member who is an employee of the company or benefits under a tax-qualified retirement plan or non-discretionary compensation;[354]

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pension or other forms of deferred compensation for prior service, provided that such compensation is not contingent in any way on continued service. Commentary to NYSE Listed Company Manual, Rule 303A.02(b)(ii).

[349] NYSE Listed Company Manual, Rule 303A.02(b)(iii).

[350] NYSE Listed Company Manual, Rule 303A.02(b)(iv).

[351] Contributions to tax-exempt organizations are excepted from this limitation, but such contributions must be disclosed either on the company's website or in its annual proxy statement. Despite this exception, contributions to tax-exempt organizations may, in some circumstances, constitute a material relationship that compromises director independence. Commentary to NYSE Listed Company Manual, Disclosure Requirement, Rule 303A.02(b)(v).

[352] "Family member" is defined to mean a person's spouse, parents, children and siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone (other than domestic employees) who shares such person's home. Nasdaq Listing Rule 5605(a)(2).

[353] Nasdaq Listing Rules 5605(a)(2)(A), 5605(a)(2)(C). Service as an interim executive officer will not render a director non-independent after the cessation of the employment, provided that the interim employment lasted less than one year. Nasdaq Listing Rule IM-5605.

[354] Nasdaq Listing Rule 5605(a)(2)(B). Note that, unlike the NYSE rules, Nasdaq rules include indirect compensation in this $120,000 threshold. For example, Nasdaq provides that political contributions to the campaign of a director or a family member would be considered indirect compensation. Nasdaq Listing Rule IM-5605.

- the director or a family member is a partner in, or a controlling shareholder or an executive officer of, any organization to which the listed company made, or from which the listed company received, payments that in any of the past three fiscal years exceeded the greater of $200,000 or five percent of the recipient's consolidated gross revenue for that year;[355]

- the director or a family member is employed as an executive officer of another entity where at any time in the last three years any of the company's executive officers served on that entity's compensation committee;[356] or

- the director or a family member is a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit in the last three years.[357]

2. SEC Disclosure Requirements

The SEC requires disclosure of the following information relating to director independence in either a company's Form 10-K or its proxy statement:

- Whether each director is independent under the company's independence standards. Listed companies should use the independence standards of the applicable securities exchange. If the company is not a listed issuer, it should use a definition of independence used by one of the exchanges and disclose which definition it has selected. If such company relies on an exemption from a national securities exchange requirement for independence of a majority of the board, the company must disclose the exemption and explain the basis for its conclusion that the exemption is applicable. If the company has adopted its own set of independence standards, the company must either state that the standards are posted on its website (and provide its website address) or include a copy of these independence standards as an appendix to its proxy statement once every three years.[358]

However, this $120,000 restriction does not apply to compensation paid to a family member who is an employee (other than an executive officer) of the company, or to benefits under a tax-qualified retirement plan or non-discretionary compensation. Nasdaq Listing Rule 5605(a)(2)(B)(ii)-(iii). It likewise does not apply to compensation received for former service as an interim executive officer, so long as that service did not last more than one year. Nasdaq Listing Rule IM-5605.

[355] Payments arising solely from investments in the company's securities or under a non-discretionary charitable contribution matching program are exempt from this restriction. Nasdaq Listing Rule 5605(a)(2)(D)(i)-(ii). However, except for the non-discretionary charitable contribution matching program, a director may not be considered independent if the director or a family member serves as an executive officer of a charitable organization to which the company makes payments in excess of the greater of five percent of the charity's revenues or $200,000. Nasdaq Listing Rule IM-5605.

[356] Nasdaq Listing Rule 5605(a)(2)(E).

[357] Nasdaq Listing Rule 5605(a)(2)(F). In the case of an investment company, in lieu of these restrictions, a director's independence is determined by reference to the "interested person" definition provided in Section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee. Nasdaq Listing Rule 5605(a)(2)(G).

[358] Items 407(a)(1)-(2) of Regulation S-K. 17 C.F.R. §§ 229.407(a)(1)-(2).

- For each independent director, the types of transactions and relationships that the board considered in making its determination that the director was independent.[359]

3. State Law

The board of directors should also be cognizant of the criteria for independence in its company's state of incorporation when selecting directors and committee members. Courts apply heightened scrutiny when reviewing actions taken by directors with perceived conflicts of interest; accordingly, a company should strive to select its nominating and corporate governance committee in a way that will avoid judicial second-guessing. Consideration of independence when selecting committee members is particularly important because certain decisions are sometimes delegated to a committee precisely because the board as a whole may be viewed as tainted by a conflict of interest.

States ordinarily determine a director's independence based on his or her economic and familial relationships. Thus, a director who qualifies as independent under the NYSE or Nasdaq standards will typically also be considered independent under state corporate law. However, boards should consider all of the facts and circumstances surrounding a director's relationship to the company and management, appreciating that non-economic relationships may sometimes be found relevant. While each case depends on its own facts, in *Beam ex rel. Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, the Delaware Supreme Court rejected the argument that a run-of-the-mill personal friendship, without more, casts doubt on a director's independence.[360] This decision accords with the long-standing principle of Delaware corporate law that a non-management director is presumed to be independent in the absence of real evidence suggesting otherwise. By contrast, in *In re Tesla Motors, Inc. Stockholder Litigation*, the Delaware Court of Chancery considered the length of a director's tenure; gifts received by the director from Elon Musk, the company's controlling shareholder and CEO; the director's connections with other

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[359] Item 407(a)(3) of Regulation S-K. 17 C.F.R. § 229.407(a)(3).

[360] *Beam ex rel. Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, 845 A.2d 1040, 1051 (Del. 2004). Plaintiffs argued that certain board members were not independent from Martha Stewart because "Stewart and the other directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends' . . . ." *Id.* In 2015, the Delaware Supreme Court clarified that *Beam* was not intended to suggest "that deeper human friendships could not exist that would have the effect of compromising a director's independence." *Delaware Cty. Emps. Ret. Fund* v. *Sanchez*, 124 A.3d 1017, 1022 (Del. 2015). Drawing on this notion, the Delaware Supreme Court questioned the independence of a director who: (i) had a close friendship of over 50 years with the controlling shareholder and chairman of the company; and (ii) was an executive at an insurance brokerage that is a wholly owned subsidiary of a separate corporation of which the same chairman is the largest stockholder. *Id.* at 1022-23. Additionally, in *Sandys* v. *Pincus*, 152 A.3d 124, 130 (Del. 2016), the Delaware Supreme Court opined that the standard in *Beam* did "not require a plaintiff to plead a detailed calendar of social interaction to prove that directors have a very substantial personal relationship rendering them unable to act independently of each other," and consequently found that plaintiffs had pleaded sufficiently particularized facts to create a reasonable doubt that the directors in question were independent, including the fact that they co-owned a private airplane with the company's controlling stockholder. *Id.* at 11. In 2017, the Chancery Court clarified that past business relationships alone are not determinative of an absence of director independence. *See In re Martha Stewart Living Omnimedia, Inc. Stockholder Litig.*, C.A. No. 11202–VCS, 2017 WL 3568089, at *20-21 (Del. Ch. August 18, 2017). The fact that the subject company of the litigation had been in the business portfolio of one of the directors in a previous role that director held at an accounting firm was "bare allegation of a past business relationship that does nothing to call into question [her] independence." *Id.* at *21.

entities affiliated with Musk; and other business relationships between the director and Musk as evidence of the director's lack of independence from Musk.[361] And in *Cumming on behalf of New Senior Investment Group, Inc.* v. *Edens*, the Delaware Court of Chancery found that the fees a director received from his service on the board of a non-profit organization to which another, interested director's family made substantial financial contributions raised reasons to doubt the first director's independence from the interested director.[362]

Notably, in the 2013 *MFW* case, then-Chancellor Strine stated that directors' satisfaction of the NYSE independence standards was informative, although not dispositive, of their independence under Delaware law.[363] Then-Chancellor Strine observed that the NYSE independence standards "were influenced by experience in Delaware . . . [,] cover many of the key factors that tend to bear on independence, including whether things like consulting fees rise to a level where they compromise a director's independence, and they are a useful source for this court to consider when assessing an argument that a director lacks independence."[364] The *MFW* case provides valuable guidance to nominating and corporate governance committees by reaffirming that directors who satisfy listing requirements for independence will generally qualify as independent under Delaware law.

4. Proxy Advisory Services

Proxy advisory services have developed definitions of director independence that differ in some respects from, and are stricter than, those of the NYSE and Nasdaq. While proxy advisories' guidelines are not binding, they carry substantial influence among institutional investors, and the nominating and corporate governance committee should be cognizant of them when assessing director independence.

ISS categorizes director independence into three groups, which categories the proxy advisor revised in recently issued guidelines.[365] The first group is "Executive Director," which is a director who is a current officer of the company or an affiliate (as defined under Section 16 of the Exchange Act). The second group is "Non-Independent Non-Executive Director," which includes controlling or significant shareholders, former CEOs of the company or officers of the company, its affiliates or acquired entities, family members of former or current officers and those with certain transactional, professional, financial or charitable relationships with the company. These relationships include providing, or having certain relationships with an organization that provides, professional services to the company or to one of its affiliates in excess of $10,000 per year. This $10,000 threshold is well below the thresholds set by the NYSE and Nasdaq. The third group is "Independent Director," which is a director who has no material connection to the company other than a board seat. ISS recommends a vote "against" or

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[361] *In re Tesla Motors, Inc. S'holder Litig.*, C.A. No. 12711–VCS, 2018 WL 1560293, at *18 (Del. Ch. March 28, 2018).

[362] *Cumming on behalf of New Senior Inv. Grp., Inc.* v. *Edens*, C.A. No. 13007-VCS, 2018 WL 992877, at *15 (Del. Ch. February 20, 2018).

[363] *See In re MFW S'holders Litig.*, 67 A.3d 496, 509 (Del. Ch. 2013), *aff'd sub nom. Kahn* v. *M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

[364] *Id.* at 511 (internal citation omitted).

[365] The following description is set forth in greater detail in ISS, *2023 U.S. Proxy Voting Guidelines* 10-12 (December 13, 2022).

"withhold" vote for any Executive Directors and Non-Independent Non-Executive Directors when any of the following conditions exist: (i) "Independent Directors" make up half or less of the board; (ii) such director that is up for a vote serves on the audit, compensation or nominating and corporate governance committee; (iii) where the company lacks an audit, compensation or nominating and corporate governance committee so that the full board functions in any of those committee roles; or (iv) the company lacks a formal nominating committee, even if the board attests that the independent directors fulfill the functions of such a committee.

Glass Lewis guidelines state that, in assessing a director's independence, it will consider both compliance with the applicable exchange listing requirements and the judgments made by such director.[366] Like ISS, Glass Lewis has three categories of director independence. An "Independent Director" has no material financial, familial or other current relationships with the company, its executives or other board members. Glass Lewis defines material relationships to include relationships where the dollar value exceeds (1) $50,000 (or where no amount is disclosed) for directors who are paid for a service they have agreed to perform for the company, outside of their service as a director, including professional or other services (including instances where the directors are the majority or principal owner of a firm that receives such payments) or (2) $120,000 (or where no amount is disclosed) for those directors employed by a professional services firm such as a law firm, investment bank, or consulting firm and the company pay the firm, not the individual, for expenses. An "Affiliated Director" is a director that has, or within the past three years has had, a material financial, familial or other relationship with the company or its executives, but is not an employee of the company. "Affiliated Directors" include directors whose employers have a material financial relationship with the company. In addition, Glass Lewis views a director who either owns or controls 20 percent or more of the company's voting stock, or is an employee or affiliate of an entity that controls such amount, as an "affiliate director." An "Inside Director" simultaneously serves as a director and as an employee of the company. Glass Lewis states that it will typically recommend voting "against" Inside or Affiliated Directors serving on a company's audit, compensation or nominating and corporate governance committees (or who has served in those capacities in the past year), and against some Inside and/or Affiliated Directors if the board is less than two-thirds independent.

5. Balancing Independence against Expertise

The financial crisis revealed that boards sometimes lack the industry expertise and intricate knowledge of their companies that is necessary to properly oversee businesses of tremendous complexity.[367] This realization, in part, prompted the SEC in 2009 to adopt disclosure rules requiring companies to discuss the specific experience, qualifications and skills that led to a director's nomination.[368] However, these disclosure requirements have far from

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[366] The following description is set forth in greater detail in Glass Lewis, *2023 Policy Guidelines* 12-14 (2022). A material financial relationship is one in which the director received over $50,000 for services outside of service as a director or if the director's employer received over $120,000 or an amount exceeding one percent of either company's consolidated gross revenue from other business relationships.

[367] Surveys of directors in each of 2015, 2016 and 2017 found that they view industry expertise as the single most desirable characteristic that a candidate for director can possess. National Association of Corporate Directors, *2015–2016 NACD Public Company Governance Survey* 26 (November 2015); National Association of Corporate Directors, *2016–2017 NACD Public Company Governance Survey* 29 (November 2016); National Association of Corporate Directors, *2017–2018 NACD Public Company Governance Survey* 35 (November 2017).

[368] *See* Section VII.B.4.

solved the problems that are created by mandatory independence requirements and undue focus on board refreshment as an end in and of itself. While some individuals with expertise will satisfy the exchanges' stringent independence standards, these standards do preclude selection of insiders—those with the most intimate day-to-day knowledge of the company—and often limit the ability to include industry experts who over their careers have developed networks and affiliations in the company's sector.[369] As stated in a 2009 study published by Professor Jay W. Lorsch and other members of the Harvard Business School's Corporate Governance Initiative, "[a]s a practical matter it is difficult, if not impossible, to find directors who possess deep knowledge of a company's process, products and industries but who can also be considered independent."[370] All boards can and should gain insight into the company's business through regular communication with management. Yet a board may find that even the most robust communications are an imperfect substitute for actual membership of those best positioned to understand the company. This was acknowledged in a report issued by the NYSE's Commission on Corporate Governance, which noted that "a minority of directors who possess in-depth knowledge of the company and its industry could be helpful for the board as it assesses the company's strategy, risk profile, competition and alternative courses of action" and reminded companies that "a properly functioning board can include more than one non-independent director."[371]

[369] The effects of these independence requirements may have recently peaked. Average board independence may have peaked among S&P 500 companies. In 2022, 86 percent of all directorships were held by independent directors and companies with fewer than average independent directors typically have governance structures that make near-term change unlikely. Spencer Stuart, *Spencer Stuart Board Index 2022*, at 4, 14 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf; *see also* ISS, *2018 U.S. Board Study: Board Accountability Practices Review* 11 (April 17, 2018).

[370] Jay W. Lorsch, *You Can't Know It All: Why Directors Have Such Difficulty Understanding Their Companies*, *Directors & Boards*, Annual Report (Summer 2012), 64.

[371] Report of the New York Stock Exchange Commission on Corporate Governance 5 (September 23, 2010), http://www1.nyse.com/pdfs/CCGReport.pdf.

VIII. Director Selection

A. Identifying and Recruiting Directors

Recruiting a balanced board of highly qualified directors is the central challenge for the nominating and corporate governance committee. Achieving this balanced, high-quality board is complicated by a number of factors. First, as noted above, the emphasis on exacting standards of independence often comes at the expense of relevant experience and knowledge of the company's business and industry. Stock exchange standards and governance activists' "best practices" limit considerably the nominating and corporate governance committee's flexibility in managing this tradeoff. Second, the workload and time commitment required for board service has never been greater and investors are increasingly scrutinizing whether directors have adequate time to devote to their board duties. Third, highly qualified individuals who manage to clear the independence hurdle and are willing and able to shoulder the substantial time commitment of board service may nevertheless be dissuaded by the potential for withhold-the-vote campaigns, sensationalist publicity over executive compensation, shareholder litigation and other reputational risks. In the current corporate governance environment, even directors of impeccable reputation at highly successful companies sometimes find themselves under attack from shareholder activists. Finally, the heightened emphasis on diversity (especially gender diversity at the moment but applicable to all forms of diversity) provides both opportunities—as previously neglected pools of candidates receive more attention—and challenges—as the demand for qualified diverse candidates experiences explosive growth. All of these factors pose a very real danger that companies will struggle to fill board seats with the experienced and highly capable types of directors that have been such an essential element of the phenomenal success of the American corporation.

This reality makes all the more critical the nominating and corporate governance committee's ability to effectively identify and recruit actual candidates once it has developed a target profile. Identifying and recruiting candidates should be an ongoing process that takes into account both the immediate needs of the board and its anticipated longer-term needs based on expected director turnover. This will allow the nominating and corporate governance committee to prepare for the departure of key directors by either grooming internal replacements for leadership positions or recruiting new directors before a critical skills gap appears.

1. Networking

At many companies, new directors are sourced primarily from individuals already known to members of the nominating and corporate governance committee, the chairman, other directors or the CEO, or are recommended by internal or external advisors. This approach can be particularly effective if the members of the nominating and corporate governance committee have extensive experience in the company's industry or on other company boards. Personal familiarity with a candidate enables the nominating and corporate governance committee to assess more quickly and accurately the candidate's fit with the board's culture, which is especially important when there is a need to expedite a search process. Drawbacks of reliance on networking include the possible limiting of the nominating and corporate governance

committee's range of candidates, the vulnerability to accusations of cronyism or a failure to value new viewpoints and a potentially less diverse candidate set.

2. Third-Party Search Firms

To limit the downsides of relying on directors' networks, to cast a wider net and to add an outside and arguably broader perspective, companies often engage third-party search firms to assist them in identifying director candidates, although there is no requirement to seek outside advice. Ordinarily, the nominating and corporate governance committee will be charged with engaging such advisors, and NYSE-listed companies are required to vest the committee with sole authority to retain, terminate and approve the fees of any firm used in the search process.[372] A third-party search firm can help identify a wider range of candidates and bring greater, more specialized resources to bear than the company possesses internally, which can be especially useful when searching for director candidates with particular attributes or specialized skills. Use of a third party may also have a benefit in terms of public perception in that it helps to confirm that the process is being driven by the nominating and corporate governance committee rather than by management. On the other hand, a search firm may in certain circumstances add unnecessary expense and complexity to the nomination process. The nominating and corporate governance committee should consider the needs and capacities of the company and make an independent determination as to whether retention of an outside advisor is appropriate. If a third-party advisor is retained, the nominating and corporate governance committee should be as specific as possible about its precise role and the relevant search parameters. For example, the third party may simply provide a list of prospects that meet specified criteria and have been checked for conflicts, or may actually interview candidates on behalf of the nominating and corporate governance committee. At minimum, a nominating and corporate governance committee would be well advised to engage a third party to perform background and reference checks of candidates before formally nominating them. The SEC requires disclosure of any fees paid to third parties to assist in identifying or evaluating potential nominees, as well as the function they performed.[373]

3. Input from within the Company

While the nominating and corporate governance committee should lead the search process, it should seek the input of others inside the company. Nothing in the requirement that a nominating and corporate governance committee consist entirely of independent directors precludes nonmembers from contributing to the committee's work. The NYSE rules provide that the nominating and corporate governance committee is to select director nominees "consistent with criteria approved by the board," which of course includes the CEO and any other non-independent directors.[374] In most cases, the committee would struggle to perform effectively without the participation of senior management, particularly the CEO, who is uniquely positioned in his or her understanding of the company, its strategy and its challenges. Thus, unless unusual circumstances suggest otherwise, the nominating and corporate governance committee would be well advised to work closely with the CEO when identifying, vetting,

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[372] Commentary to NYSE Listed Company Manual, Rule 303A.04(b).
[373] Item 407(c)(2)(viii) of Regulation S-K. 17 C.F.R. § 229.407(c)(2)(viii).
[374] NYSE Listed Company Manual, Rule 303A.04(b)(i).

interviewing and selecting candidates. *Ultimately*, however, the CEO's input should only be one factor in the committee's process of reaching an informed and independent judgment. The nominating and corporate governance committee should conduct regular executive sessions to avoid any perception that the CEO has unduly controlled the nomination process.

Among other negative consequences, such a misperception can result in a backlash from proxy advisory services. For example, several years ago, ISS recommended a "no" vote for the members of Hewlett Packard's nominating and corporate governance committee based on ISS's view that the committee's search for new directors was tainted by the CEO's involvement. While remaining cognizant of the policies of proxy advisory services, it is important that the nominating committee conduct its search in the way it deems most effective. And, absent unusual circumstances, a nominating and corporate governance committee is unlikely to find effective a search process that excludes the views of a director—particularly one uniquely positioned to understand the company's needs.

4. SEC Requirements

For each nominee approved by the committee for inclusion on the company's proxy card (other than executive officers and directors standing for reelection), the SEC requires companies to identify whether the nominee was recommended by a security holder, a non-management director, the CEO, another executive officer, a third-party search firm or another specified source.[375]

B. Shareholder Nominations and Universal Proxy Rules

As a general matter, the right of shareholders to nominate candidates to be considered for election to the board of directors is well established in state law. In Delaware, for example, then-Vice Chancellor Strine stated: "Put simply, Delaware law recognizes that the 'right of shareholders to participate in the voting process includes the right to nominate an opposing slate . . . the unadorned right to cast a ballot in a contest for [corporate] office . . . is meaningless without the right to participate in selecting the contestants. As the nominating process circumscribes the range of choice to be made, it is a fundamental and outcome-determinative step in the election of officeholders. To allow for voting while maintaining a closed selection process thus renders the former an empty exercise.'"[376]

As the body with primary responsibility for reviewing candidates for nomination to be elected as directors, and for making a recommendation to the full board, the nominating and corporate governance committee is the logical and appropriate forum for consideration of director candidates recommended by shareholders. The survey's authors suggest that shareholder-nominated directors may be growing in popularity among boards because they avoid the use of increasingly permissible proxy access and minimize proxy fights with activists.[377] As a general rule, shareholder nominees should be considered on the basis of the same criteria as are used to evaluate board nominees. Even if it may be readily apparent that some candidates are not

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[375] Item 407(c)(2)(vii) of Regulation S-K. 17 C.F.R. § 229.407(c)(2)(vii).
[376] *Harrah's Entm't, Inc.* v. *JCC Holding Co.*, 802 A.2d 294, 310-11 (Del. Ch. 2002) (citations omitted).
[377] *See id.*

adequately qualified, it is good practice for the record to reflect that these candidates were fairly evaluated.

1. SEC Disclosure Requirements

The SEC requires companies to disclose whether they have a policy regarding the consideration of director candidates recommended by shareholders.[378] If the company does have such a policy, it must describe the material elements of its policy, including whether it will consider shareholder nominations and, if so, the procedures that shareholders must follow to submit nominations.[379] If a company's nominating committee does not have a policy regarding shareholder recommendations for director, the company must state that fact and the basis for the view of its board of directors that it is appropriate for the company not to have such a policy.[380] The company must disclose whether, and, if so, how, the nominating and corporate governance committee evaluates recommendations submitted by shareholders differently than it evaluates recommendations from other sources.[381] If, at least 120 days before a company's proxy statement is released, the company's nominating and corporate governance committee receives a nominee from a shareholder (or group of shareholders) that has beneficially owned at least five percent of the company's voting common stock for at least a year, the company is required to disclose such director candidate recommendation and the shareholder or group of shareholders backing such candidate.[382]

2. Restrictions on Shareholder Nomination Rights

The right of shareholders to nominate director candidates is not unfettered. Many states, including Delaware, have strong policies favoring freedom of contract and allowing parties in contractual relationships to establish their own rules by contract. The certificate of incorporation (or charter) and bylaws of a corporation establish a quasi-contractual relationship between a company and its shareholders that may vary from, or even opt out of, the default voting and nominating rules. Most listed companies have adopted bylaws establishing advance notice requirements for shareholder nominations and other proposals by shareholders for business to be brought before annual and special shareholder meetings.[383] In addition, many companies have adopted bylaws that include specified qualification requirements for nominees for the board.

Traditionally, it has been within the purview of the board to establish reasonable qualification standards for director candidates. Many companies have, for example, adopted bylaws that include age restrictions, residential requirements or shareholding requirements. These sorts of qualification criteria have typically been implemented in bylaws adopted by the board. As with all bylaws, they are generally subject to amendment or elimination by the company's shareholders. The board's decision to adopt such bylaws could be challenged in

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[378] Item 407(c)(2)(ii) of Regulation S-K.
[379] *Id.*
[380] Item 407(c)(2)(iii) of Regulation S-K. 17 C.F.R. § 229.407(c)(2)(iii).
[381] Items 407(c)(2)(iv), (vi) of Regulation S-K. 17 C.F.R. §§ 229.407(c)(2)(iv), (vi).
[382] Item 407(c)(2)(ix) of Regulation S-K. 17 C.F.R. § 229.407(c)(2)(ix).
[383] For a discussion of advance notice bylaws, *see* Section III.F.

court, and would generally be viewed as a matter of the board's business judgment, unless there was an indication that directors failed to satisfy their duties of care and loyalty.

Although advance notice and qualification bylaws have generally been adopted by the full board, their subject matter places them squarely in the area of focus of the nominating and corporate governance committee, which often makes recommendations to the board for their adoption, amendment or removal.

Boards and nominating and corporate governance committees should think very carefully about adopting any form of restrictive qualification requirements in the future and may want to engage with significant shareholders regarding any changes that may be controversial.

3. Universal Proxy Rules

(a) SEC Rules

As discussed in Section III.M, previously, dissidents needed to rely on the company's advance notice bylaws or proxy access bylaws to nominate directors for election and only proxy access bylaws permitted dissidents to nominate directors on the company's proxy card. However, recently adopted "universal" proxy rules that came into force on September 1, 2022 now require that in contested elections, voting shareholders receive a single proxy card presenting both the company's and the dissident's nominees, likely diminishing the relevance of proxy access bylaws (whose main remaining advantage is to allow dissidents to avoid proxy-related expenses).[273][849]

Under the new universal proxy rules, all candidates will be required to be listed on both the company and dissident proxy cards, subject to compliance with requirements of Rule 14a-19 of the Exchange Act. In particular, nominating shareholders will be required to:

- provide the company notice of the nominating shareholder's intent to solicit proxies and the names of dissident nominees no later than 60 calendar days[385] prior to the anniversary of the previous year's annual meeting;
- represent that it intends to solicit shareholders representing at least 67 percent of the voting power of the shares entitled to vote on the election of directors;
- file a definitive proxy statement by the later of (i) 25 calendar days prior to the meeting date or (ii) five calendar days after the date the company files its definitive proxy statement;

[384] 17 C.F.R. Part 240 (final rule, January 31, 2022), https://www.sec.gov/rules/final/2021/34-93596.pdf.

[385] The nominating shareholder will still need to comply with the deadlines under the company's advance notice bylaws, including deadlines that require notice earlier than the 60 calendar days prescribed under the universal proxy rules.

The company must also notify the nominating shareholder of the names of the company's nominees no later than 50 calendar days before the anniversary of the previous year's annual meeting.

The universal proxy rules replace the "short slate rule" that set forth requirements as to when and how dissidents can solicit support for nominees that would comprise a minority of the board; however, it is likely that dissidents will continue to single out which company directors they would not support on the dissident's proxy card. In addition, the bona fide nominee rule has been amended to require all nominees to consent to being named in the proxy statement of their side of the contest.

(b) Delaware Law

In contrast to the one-size-fits-all approach to proxy access espoused by the SEC under the new universal proxy rules, Delaware has adopted a framework that allows companies to tailor proxy access to their particular circumstances. In 2009, Delaware amended its corporate law to provide that the board or shareholders of a Delaware company may adopt a bylaw requiring the inclusion of a shareholder's director nominees in the company's proxy solicitation materials.[386] The statute includes a non-exclusive list of conditions that the bylaws may impose on proxy access, including minimum ownership requirements, mandatory disclosures by the nominating shareholder and restrictions on nominations by persons who have acquired a specified percentage of the company's outstanding voting power. Another 2009 amendment to Delaware's corporate law provides that a company's bylaws may require the company to reimburse a stockholder for expenses incurred soliciting proxies in connection with an election of directors.[387] Again, a company may impose any lawful condition or procedure on such reimbursement, including limitations based on the amount of support the shareholder's nominee received. This private ordering approach to proxy access allows companies and their shareholders to adopt rules tailored to the specific circumstances of a company. Many consider this state law approach to be more appropriate than the federalization of the election process that the SEC had proposed, including the universal proxy requirements that further relax the ownership requirements on proponents.[388]

[386] 8 *Del. C.* § 112.
[387] 8 *Del. C.* § 113.
[388] *See* Sections III.K, IV.A.2 and IV.E.3 for more on proxy access.

IX. Director Orientation and Continuing Education

A. Orientation

The nominating and corporate governance committee should ensure that new directors are provided with a thorough orientation that will accelerate their adjustment to the board. If the board takes an annual retreat, the retreat may offer an opportunity to satisfy a large portion of this orientation. The content of director orientation should focus on enabling new directors to quickly gain a full understanding of the company's business and risk profile. If the director is to serve on a board committee or otherwise perform a specialized role, his or her orientation program should be customized to reflect those added responsibilities. Orientation programs should be regularly reviewed and modified to ensure that they are tailored to address the most important issues facing the company. As part of their orientation, new directors should be provided with the company's corporate governance documents, including committee charters, policies and ethics codes, biographies of the company's directors and executive officers, selected public documents of the company, including proxy statements and annual and quarterly reports, minutes of the board and its committees' recent meetings, and a calendar of upcoming meetings and key dates for the company. New directors should also meet with their fellow directors and with executive officers. If a physical inspection of one or more facilities or sites would aid in the new director's understanding of a company, the nominating and corporate governance committee should consider including a tour as part of its orientation program. A selection of key analyst reports by third-party analysts covering the company may also enhance a new director's appreciation for the company and how it is perceived.

Especially if it is the new director's first time serving on a public company board, orientation should also include a thorough briefing on applicable laws, including securities laws and a director's fiduciary duties. Director orientation must strike the right balance by providing substantive information that will allow a new director to "hit the ground running" without overwhelming him or her with a barrage of documents. Striking this balance requires an ongoing focus on, and reassessment of, the company's priorities by the nominating and corporate governance committee.

The importance of director orientation is greater now than ever before. Directors today not only serve in an environment of unprecedented complexity and time demands, but a large number of them are serving without any considerable experience with either the company or public company boards generally. In 2022, 34 percent of the number of new directors on S&P 500 company boards served on their first public board, an increase from 28 percent in 2020.[389] And, as discussed at length in Section VII.C.5, the outsized emphasis placed on director independence by advocates of one-size-fits-all corporate governance "best practices" often precludes adding to the board the most experienced individuals with the strongest grasp of the company. First-time directors are, on average, younger and are more likely than new directors with previous board experience to be current or former division leaders, subsidiary leaders or functional leaders, but less likely to be CEOs, chairs, presidents or chief operating officers.[390]

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[389] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 7 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

[390] *Id.*

However, to a certain extent, nominating and corporate governance committees must accept that this has become a part of the corporate governance landscape and ensure that orientation programs are as robust as possible to get new directors up to speed.

B. Continuing Education

Director education should not end once a new director is brought up to speed. While there is no legal requirement for directors to receive tutorials to satisfy their fiduciary obligations, such education can be very useful, particularly as boards continue to face heightened expectations on oversight of matters relating to cybersecurity, climate and human capital. Indeed, the complexity of the many financial, risk management and other issues facing companies today that was highlighted by the financial crisis and the Covid-19 pandemic has led to a renewed focus on the information and education programs provided to directors. In a constantly changing competitive and regulatory environment, continuing education is vital to ensure that directors remain aware of the challenges and opportunities the company faces and develop a comprehensive understanding of environmental, social and governance issues that may materially impact the business. Even a long-serving director with an intimate familiarity with the company's industry and strategy will be unable to perform effectively if he or she does not stay abreast of many regulatory and other developments. To the extent that directors lack the knowledge required to maintain a strong grasp of current industry- and company-specific developments and specialized issues, the nominating and corporate governance committee should consider periodic tutorials as a supplement to board and committee meetings.

Despite the importance of continuing education, directors generally did not identify director education as a board improvement priority in 2022.[391] Approximately, seven percent of the 300 directors surveyed by the National Association of Corporate Directors rated board education as "very important," which also had the same level of priority as director onboarding.[392] At the same time, only 56 percent of the 700 public company directors surveyed in a separate study stated they understood their company's carbon emissions and only 63 percent stated they understood their company's climate strategy or the internal processes around data collection.[393] Training and tutorials may consist of outside programs, training in the boardroom through management and advisor presentations or some combination of the two and should be tailored to the issues most relevant and important to the company and its business. Outside experts, while not required, may be helpful for certain training and tutorials, although in many cases the company's own experts are better positioned than outsiders to explain the particular issues facing the company.

C. Information Received by Directors

The ability of the board or a committee to perform its oversight role is, to a large extent, dependent upon the relationship and the flow of information between the directors, senior management and the risk managers in the company. In this vein, the board and management

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[391] National Association of Corporate Directors, *2023 Corporate Governance Outlook* (2022).
[392] *Id.*
[393] PricewaterhouseCoopers LLC, *Charting the course through a changing governance landscape: PwC's 2022 Annual Corporate Directors Survey* (2022), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2022-annual-corporate-directors-survey.pdf.

should together determine, and periodically reassess, the information the directors should receive so that the board can effectively perform its oversight function. As a starting point, the board should receive financial information that makes readily accessible the company's results of operations, variations from budgeted expenditures, trends in the industry and the company's performance relative to its peers, as well as copies of media and analyst reports on the company. However, for the board to properly fulfill its oversight role, companies should work to ensure that the board is receiving information about all aspects of the company's operations, including information relating to material environmental, social and governance matters. If directors do not believe that they are receiving sufficient information, including information regarding the external and internal risk environment, the specific material risk exposures affecting the company, how these risks are assessed and prioritized, risk response strategies, implementation of risk management procedures and infrastructure and the strengths and weaknesses of the company's overall risk management system, then they should be proactive in asking for more.

Obtaining this information will not only aid directors in guiding the company but will also avoid the possibility of directors being accused of failing to be aware of discoverable facts that they should have known. The nominating and corporate governance committee should also promote lines of communication between the board, its committees and senior management that foster open and frank discussion of developments and concerns. As with director orientation, the key is to provide useful and timely information without overloading the board with, for example, the volume of information that the CEO and senior management receive.

X. Restrictions on Director Service

A. Other Directorships and "Overboarding"

The workload and time commitment required for board service has escalated dramatically in recent years: a 2020 survey of the National Association of Corporate Directors reported that public company independent directors spent, on average, 246 hours performing board-related activities in 2020, compared to 261 hours the previous year and the 155 hours reported in 2003.[394] As the time commitment of board service increases, so does the importance of ensuring that directors are able to shoulder this commitment. Therefore, the nominating and corporate governance committee should consider adopting a policy regarding additional directorships. The nominating and corporate governance committee may similarly choose to limit the directorships of the company's officers. According to a 2022 Spencer Stuart survey, only 25 percent of S&P 500 company boards specifically limit the number of outside boards on which their CEO may serve; of those restricted companies, nearly all limit CEOs to one or two outside boards.[395] Additionally, 70 percent of S&P 500 companies now impose some restriction on their directors' service on other boards.[396] Restrictions on additional directorships may apply across the board or only to a subset of directors, such as those serving on the audit committee or those fully employed by the company or another public company. For example, the NYSE requires that if an audit committee member simultaneously serves on the audit committee of more than three public companies, the board must disclose its determination that this would not impair the member's ability to serve effectively on the company's audit committee.[397] Of the 70 percent of S&P 500 companies that have set a numerical limit for additional directorships applying to all directors, most of these companies have set the cap at three or four.[398] Among those companies without established numerical limits, nearly all (98 percent) require directors to provide the company notice before accepting another directorship and/or encourage directors to reasonably limit their additional board service.[399]

As with many other issues confronting the nominating and corporate governance committee, the committee should be wary of establishing hard and fast rules regarding other directorships that limit its flexibility to exercise its best judgment based on particular circumstances. One approach is to eschew a numerical limit but require a director to seek approval of the nominating and corporate governance committee before accepting another directorship. Another approach is to adopt a numerical limit but provide that the nominating and corporate governance committee may waive this limit if it determines that the additional

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[394] National Association of Corporate Directors, *2020-2021 NACD Trends and Priorities of the American Boardroom* 10 (2021); National Association of Corporate Directors, *2016–2017 Public Company Governance Survey* 18 (2016); National Association of Corporate Directors, *2014–2015 Public Company Governance Survey* 12 (2014).

[395] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 28 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

[396] *Id.*

[397] Commentary to NYSE Listed Company Manual, Disclosure Requirement, Rule 303A.07(a).

[398] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 29 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

[399] *Id*.

directorship will not impair the director's ability to carry out his or her duties, or that his or her unique contributions to the board would be difficult to replace.

At a minimum, the nominating and corporate governance committee would be well advised to adopt a policy of prior notification regarding other directorships or employment. Such a policy can be included in the governance guidelines or in individual director-level agreements. Some companies also require their board members seeking to serve on other boards to obtain prior approval to do so. This is important not only to ensure that the director remains able to shoulder capably the responsibilities of board service but also to check for any conflicts or other impacts on the company, including publicity considerations. In particular, antitrust laws prohibit simultaneous service as a director or officer of two competing corporations, subject to certain *de minimis* exceptions.[400] Companies should carefully weigh the costs and benefits of having directors who are affiliated with competitors, as this may become a lightning rod for activist criticism, even if the overlap falls well within the legal safe harbors. Such requirements should be carefully phrased to ensure they include in their scope a director agreeing to be nominated or otherwise serve (or be submitted to serve) on a slate of candidates for the particular company, whether as a board candidate or a shareholder candidate (*e.g.*, on a dissident slate), rather than being triggered only by such director's actual election to the board. Consideration should also be given to the company's policies for understanding other commitments that a director may take on, such as joining advisory boards of, or becoming consultants to, shareholders or funds that may have positions in the company's competitors or business partners.

Since February 2017, ISS has tightened its "overboarding" policy, recommending an "against" or "withhold" vote for "overboarded directors," now defined as those sitting on more than five public company boards, rather than six. Additionally, ISS recommends an "against" or "withhold" vote against CEOs sitting on more than two public company boards besides their own (although ISS recommends a "withhold" only with respect to the CEO's outside boards).[401] Glass Lewis recommends voting "against" directors who serve on more than five public company boards, who serve as an executive chair of any public company while serving on more than two other public company boards, and who serve as an executive officer of any public company while serving on more than one other public company board.[402]

In their proxy voting guidelines, several institutional investors have also developed policies on "overboarding." The Council of Institutional Investors suggests that companies should establish guidelines on how many other boards their directors may serve and states that, except in unusual circumstances, directors with full-time jobs should not serve on more than two

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[400] Clayton Act § 8, 15 U.S.C. § 19. Under the thresholds for 2021, simultaneous service as director or officer of two corporations each with capital, surplus and undivided profits in excess of $37,382,000 and "competitive sales" of $3,738,200 or more is prohibited, subject to several exceptions. Revised Jurisdictional Thresholds for Section 8 of the Clayton Act, 86 Fed. Reg. 6330 (January 21, 2021). In particular, if the "competitive sales" of either corporation are less than two percent of that firm's total sales, or less than four percent of each firm's total sales, the interlock is exempt under the statute. 15 U.S.C. § 19(a)(2). In addition, the statute expressly prohibits service on competing corporations, not other business structures (*e.g.*, partnerships or limited liability companies). *Id.* § 19(a)(1). Finally, Section 8 does not apply to interlocks between banks. *Id.* Section 8 provides a one-year grace period for an individual to resolve an interlock issue that arises as a result of entry into new markets through acquisition or expansion. *Id.* § 19(b).

[401] ISS, *2023 U.S. Proxy Voting Guidelines* 12 (December 13, 2022).

[402] Glass Lewis, *2032 Policy Guidelines* 31 (November 17, 2022).

other for-profit boards and that all other directors should serve on no more than four for-profit company boards.[403]

In recent months, the Antitrust Division of the Department of Justice (the "DOJ") has stepped up focus on enforcement of Section 8 of the Clayton Act, a statute prohibiting officers and directors from simultaneously serving with competing companies. Section 8 prohibits competing companies from sharing officers and directors. The statute is intended to foreclose opportunities for competitors to collude illegally. There are certain *de minimis* safe harbors for interlocked companies whose competing sales are less than $4.5 million (as of 2023) or where the competing sales make up only a minimal percentage of total sales, as well as a one-year "grace" period to resolve a violation created by changed circumstances. No damages have ever been awarded under the statute, and there are no fines or penalties. Removal of the interlock typically remedies the situation, and director resignations from one board seem to have resolved the matters in DOJ's release.

In addition to the risk of overboarding and antitrust complications, companies sometimes face the risk that their directors could find themselves embroiled in a controversial situation that could be a detriment to the company as a result of other boards they sit on or stand for. For example, a director of a company may be invited by an activist to be on a slate for a proxy contest it is running against another company. While this may not pose a direct conflict, it may be unhelpful or embarrassing for the company on which board that person sits. It would be prudent for companies to require at a minimum prior notification before any director agrees to be part of a slate of director candidates.

B. Term Limits and Mandatory Retirement Ages

The question of appropriate director tenure has become a hot topic in recent years. Corporate governance activists are increasingly calling for director term limits and mandatory

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[403] Council of Institutional Investors, *Corporate Governance Guidelines*, Section 2.11 (March 2023), https://www.cii.org/corp_gov_policies. CalPERS recommends that boards adopt and disclose guidelines in proxy statements "to address competing time commitments that are faced when directors, especially acting CEOs, serve on multiple boards." CalPERS, *Governance & Sustainability Principles* 10 (September 2019). CalPERS also sets out that it will consider a director overboarded if the director (1) "is a non-executive director who serves on more than four public boards," or (2) "is an executive director who serves on more than two public boards." CalPERS, *Proxy Voting Guidelines* 2 (February 2023). BlackRock sets out a maximum number of boards on which a director may serve before he/she is considered overboarded and subject to withhold votes: where the director (1) serves on more than four public company boards (including the company under review); or (2) is a CEO at a public company and is serving on more than two public company boards (including the company under review where he/she serves as CEO). BlackRock Investment Stewardship, *Proxy Voting Guidelines for U.S. Securities* 5 (January 2023), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf. State Street Global Advisors states that it may withhold votes from a director who sits on more than four public company boards, from non-executive board chairs or lead independent directors who sit on more than three public company boards, and from any named executive officer of a public company who sits on more than two public company boards. State Street Global Advisors, *Proxy Voting and Engagement Guidelines: North America* 5 (March 2022), https://www.ssga.com/library-content/pdfs/ic/proxy-voting-and-engagement-guidelines-us-canada.pdf. T. Rowe Price will generally vote against directors who sit on more than five public company boards and against CEOs who sit on more than one other public company board. T. Rowe Price, *Proxy Voting Guidelines* 2 (February 2023), https://www.troweprice.com/content/dam/trowecorp/Pdfs/proxy-voting-guidelines-TRPA.pdf.

retirement ages, both as a means of promoting "board refreshment" and because of a growing view that serving on a board for an extended period of time affects a director's independence.

As in all matters, we do not believe that a one-size-fits-all rule is an appropriate method for making this determination. Notably, the Covid-19 pandemic underscored the need for boards to balance newer voices on the board with those possessing institutional experience. In some cases it may be appropriate for a particular director to leave after an extended period on the board, and it is certainly advisable to periodically bring new directors on to a board so that it can benefit from fresh (and more diverse) perspectives and ideas. However, directors who have served on a board for a long time have an intimate familiarity with the company and its business, history and values that cannot be easily or quickly replicated by a new candidate. Long-term directors provide continuity, cultural stability and institutional knowledge that can prove invaluable. We are also skeptical of the depiction of long-serving directors as categorically less independent, given that such directors are more likely to have preceded the current CEO (and thus not to have been chosen by him or her) and to have the deep knowledge of the company necessary to make independent judgments.

To date, only seven percent of S&P 500 companies specify a term limit for director service making this one of the few areas where calls for so-called best practices have gone largely unanswered.[404] Companies' policies in this area suggest they may see value in having more experienced directors. The average tenure of a director at S&P 500 companies in 2022 was approximately eight years, roughly stable in recent years.[405] Additionally, despite evidence of increasing board refreshment, both the average age and mandatory retirement age of directors have been trending upwards in recent years.[406] The average director is 63 years old, a year older than a decade ago, and 53 percent of companies that have mandatory director retirement ages set such age at 75 or older.[407]

Term limits and mandatory retirement ages are indeed one way to bring fresh perspectives and skills to the board. They may also in some cases relieve the nominating and corporate governance committee from the often difficult decision to recommend against a directors' renomination. However, given the many potential negative consequences of such policies, these blunt instruments are a poor substitute for the considered judgment of the nominating and corporate governance committee. Increased turnover may needlessly disrupt the cohesion of an effectively functioning board. A board, like any organization, depends heavily on the trust and familiarity of its members. This cautions against adopting rigid policies, such as term limits, that make it more difficult to develop and maintain these relationships. Moreover, long-serving directors that have grown knowledgeable about the company and its industry are often the most valuable contributors to a board. A policy requiring such a director to depart after a certain number of years risks depriving the company of a valuable director who still has much to offer. An across-the-board rule may strike some as more expedient, but ultimately the

[404] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 30 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.
[405] *Id.* at 11.
[406] *Id.*
[407] *Id.*

company will best be served by the nominating and corporate governance committee making a determination based on the facts and circumstances of each situation.

ISS currently recommends voting against shareholder proposals seeking to impose age limits, but on a case-by-case basis on shareholder proposals seeking to impose director term or tenure limits, considering the "scope of the shareholder proposal" and "evidence of problematic issues at the company combined with, or exacerbated by, a lack of board refreshment."[408] Under ISS's QualityScore governance ranking, the proportion of non-executive directors that have been on the board for less than six years has been added as a weighted factor to the "Board Structure" pillar, but ISS will not deduct credit from this factor unless more than one-third of directors exceed the lengthy tenure definition.[409]

Many institutional investors have their own views on these matters. While most favor board refreshment generally, institutional investors have taken varied positions on whether—and when—mandatory term limits or retirement ages are appropriate mechanisms for achieving such refreshment. The Council of Institutional Investors has urged boards "to consider carefully whether a seasoned director should no longer be considered independent,"[410] and, in 2016, CalPERS's adopted a bright-line rule for how it views the impact of director tenure on independence: "[CalPERS] believe[s] director independence can be compromised at 12 years of service—in these situations a company should carry out rigorous evaluations to either classify the director as non-independent or provide a detailed annual explanation of why the director can continue to be classified as independent."[411] In contrast, BlackRock generally defers to the board's determination in setting age or term limits for "ensuring periodic board refreshment."[412] In terms of confidence in the board's existing refreshment process, disclosure and transparency go a long way to alleviating potential concerns, particularly as the new universal proxy rules increase scrutiny on individual director attributes and their contributions to the board.

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[408] ISS, *2023 U.S. Proxy Voting Guidelines* 18 (December 2022).

[409] This factor awards increasing credit for increasing proportions of the board represented by directors with less than six years of tenure, but gives no additional credit once such proportion exceeds one-third and does not count executive directors. Another factor, "Does the board have any mechanisms to encourage director refreshment?," is for informational purposes only and does not impact a company's QualityScore. *See* ISS, *Governance QualityScore: Methodology Guide* 38-39 (January 2021).

[410] Amy Borrus, Council of Institutional Investors, *More on CII's New Policies on Universal Proxy and Board Tenure* (October 1, 2013), http://www.cii.org/article_content.asp?article=208.

[411] CalPERS, *Governance & Sustainability Principles* 17 (September 2019). Additionally, CalSTRS advocates that boards should have a mechanism to ensure that there is periodic refreshment and believes that the board should review the director's years of board service as part of its annual board review, but does not support limiting director tenure. CalSTRS, *Corporate Governance Principles* 6 (January 2021), https://www.calstrs.com/files/885d7b73b/corporate_governance_principles_1.pdf. State Street Global Advisors, *Proxy Voting and Engagement Guidelines: North America* 5 (March 2022), https://www.ssga.com/library-content/pdfs/ic/proxy-voting-and-engagement-guidelines-us-canada. State Street will generally vote against age and term limits unless the company is found to have poor board refreshment and director succession practices and has a preponderance of non-executive directors with excessively long tenures serving on the board.

[412] BlackRock Investment Stewardship, *Proxy Voting Guidelines for U.S. Securities* 6 (January 2023), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

XI. The Functioning of the Board

A. Executive Sessions

Whether or not a board has an independent chairman, its non-management directors should meet regularly outside the presence of management in executive sessions. Executive sessions allow for frank review of certain issues, such as management performance and succession planning, that at times may be better discussed outside the presence of management. They can also serve as a safety valve to address problems that directors may hesitate to bring up before the full board. However, boards should be careful that the use of executive sessions does not have a corrosive effect on board collegiality and its relations with the CEO. To guard against this danger, boards should not use executive sessions as a forum for revisiting matters already considered by the full board or to usurp functions that properly fall within the province of the full board. Board minute books should reflect when executive sessions of the board were held and who was in attendance, but it is not necessary, and in some cases may be inappropriate, to have detailed minutes of those sessions. Of course, there may also be times when, for reasons of confidentiality or sensitivity, it is preferable for the independent directors to meet informally.

The NYSE requires listed companies to hold regular executive sessions of either non-management directors or independent directors and, if those executive sessions include directors who do not qualify as independent under the NYSE standards, the NYSE recommends that companies also schedule an executive session of independent directors at least once a year.[413]

Nasdaq requires regular executive sessions, contemplated to mean at least twice a year.[414] While many "best practices" proponents recommend holding an executive session along with every regularly scheduled board meeting, the board should tailor the frequency of, and agenda for, executive sessions to the particular needs of its company, rather than reflexively following the latest trend. Each executive session should have a presiding director, although it need not be the same director each time.

B. Committees

A large proportion of the "heavy lifting" of board service is performed on the board's committees. In addition to the standing audit, compensation, and nominating and corporate governance committees that companies are required or expected to have, boards may choose to create other committees, either as standing committees or on an ad hoc basis, to deal with specific issues that arise. Board committees have whatever powers and authorities the board chooses to vest in them (subject to modest legal requirements; for example, a committee generally cannot agree to a merger or to sell the company). Their function is to enable the board to perform its many functions more efficiently and effectively.

We direct readers to our separate guides on the Audit Committee and the Compensation Committee, but provide a brief description of the requirements for those committees below because ensuring that the board is properly populated so that each of the committees will be able

[413] Commentary to NYSE Listed Company Manual, Rule 303A.03.
[414] Nasdaq Listing Rules 5605(b)(2), IM 5605-2.

to meet all requirements and perform its work well is central to the mission of the nominating and corporate governance committee.

1. Audit Committee

(a) Independence

In addition to qualifying as independent under the listing standards of the securities market(s) on which a company's securities are traded, audit committee members also must satisfy the more stringent definition of audit committee independence set forth in Sarbanes-Oxley and SEC Rule 10A-3. Both the NYSE and Nasdaq explicitly require compliance with those independence requirements.[415] Audit committee members may not, directly or indirectly, receive any compensation from the company—such as consulting, advisory or similar fees—other than their director fees, and may not be affiliates of the company. The affiliate disqualification covers any individual that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the company. The prohibition on acceptance of compensatory fees precludes audit committee service if the company makes any such payments either directly to the director, or indirectly to an immediate family member, or to law firms, accounting firms, consulting firms, investment banks or financial advisory firms in which the director is a partner, member, managing director, executive officer or holds a similar position.

(b) Financial Literacy

The major securities markets require that each member of an audit committee be able to read and understand fundamental financial statements. Under the NYSE listing standards, it is the board's duty to determine, in its business judgment, whether each member of the audit committee is financially literate.[416] While Nasdaq requires that each member be financially literate upon joining the audit committee, the NYSE permits members to become financially literate within a reasonable period of time after joining.[417]

(c) Financial Expertise

The NYSE requires that at least one member of the audit committee have accounting or related financial management expertise as determined by the board in its business judgment.[418] The expertise requirement generally is fulfilled by a background in finance that permits a board to conclude, in good faith, that the director is capable of understanding the most complex issues of accounting and finance that are likely to be encountered in the course of a company's business. The NYSE permits a board to presume that an individual who is an "audit committee financial expert" within the meaning of the SEC's rules (described below) has the requisite

[415] NYSE Listed Company Manual, Rule 303A.06; Nasdaq Listing Rules 5605(c)(2), IM-5605-4.
[416] Commentary to NYSE Listed Company Manual, Rule 303A.07(a).
[417] Nasdaq Listing Rule 5605(c)(2)(A)(iv); Commentary to NYSE Listed Company Manual, Rule 303A.07(a).
[418] Commentary to NYSE Listed Company Manual, Rule 303A.07(a).

"accounting or related financial management expertise" to satisfy the NYSE's listing standards.[419]

Under Nasdaq rules, at least one member of an audit committee must have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication, including being or having been a CEO, CFO or other senior officer with financial oversight responsibilities. An individual who is an "audit committee financial expert" within the meaning of the SEC's rules is deemed to fulfill this latter requirement.[420]

(d) Audit Committee Financial Expert

Under the direction of Sarbanes-Oxley, the SEC issued rules requiring a public company to disclose in its annual reports (or annual proxy statements) whether any member of its audit committee qualifies as an audit committee financial expert, as determined by the board.[421] The SEC regulations define an "audit committee financial expert" as an individual who has *all* of the following attributes:

- an understanding of GAAP and financial statements;
- the ability to assess the general application of GAAP in connection with accounting for estimates, accruals and reserves;
- experience in preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that can reasonably be expected to be raised by the company's financial statements, or experience actively supervising persons engaged in such activities;
- an understanding of internal controls and procedures for financial reporting; and
- an understanding of audit committee functions.[422]

An individual must have acquired the foregoing five audit committee financial expert attributes through any one or more of the following:

- education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor, or experience in one or more positions that involve the performance of similar functions;

[419] Commentary to NYSE Listed Company Manual, Rule 303.07A(a).
[420] Nasdaq Listing Rules 5605(c)(2)(A), IM-5605-4.
[421] Item 407(d)(5)(i) of Regulation S-K. 17 C.F.R. § 229.407(d)(5)(i).
[422] Item 407(d)(5)(ii) of Regulation S-K. 17 C.F.R. § 229.407(d)(5)(ii).

- experience in actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;

- experience in overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or

- other relevant experience.[423]

2. Compensation Committee

Both the NYSE and Nasdaq impose additional independence requirements on directors that serve on a compensation committee.

The NYSE rules require that, when evaluating the independence of any director who will serve on the compensation committee, a board consider all relevant factors that could impair independent judgments about executive compensation including, but not limited to: (a) the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the company and (b) whether the director is affiliated with the company or one of its subsidiaries or affiliates.[424]

Nasdaq rules prohibit compensation committee members from accepting any consulting, advisory or other compensatory fees from the company or its subsidiaries (other than directors' fees). Under Nasdaq listing standards adopted in response to Dodd-Frank as reflected in SEC Rule 10C-1, Nasdaq-listed companies are now required to have a compensation committee consisting of at least two independent directors. Nasdaq provides, however, that, if a compensation committee is composed of at least three members, then, under exceptional and limited circumstances and if certain conditions are met, one director who is not independent under its rules may be appointed to the compensation committee without disqualifying the compensation committee from considering the compensation matters that would ordinarily be entrusted to it had it been fully independent.[425] Additionally, a compensation committee or a company's independent directors must approve equity compensation arrangements that are exempted from the Nasdaq shareholder approval requirement as a prerequisite to taking advantage of such exemption.[426]

It should also be noted that until the passage of the Tax Cuts and Jobs Act of 2017 (the "Tax Reform Act"), under the "performance-based compensation"[427] provisions of Section

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[423] Item 407(d)(5)(iii) of Regulation S-K. 17 C.F.R. § 229.407(d)(5)(iii).
[424] NYSE Listed Company Manual, Rule 303A.02(a)(ii).
[425] The specific conditions that must be met for such exemption to be available, as well as the precise contours of the Nasdaq definition of "independent," are discussed in Annex A and Section VII.C.1 of this Guide, respectively.
[426] Nasdaq Listing Rules 5635(c)(2), (c)(4). Under these Nasdaq rules, shareholder approval is required prior to the issuance of securities when an equity compensation plan is to be established or materially amended, except for, among other things, tax-qualified non-discriminatory employee benefits plans that are approved by the company's compensation committee and certain "sign-on" equity compensation awards that are approved by the company's compensation committee.
[427] 26 U.S.C. § 162(m)(4)(C), I.R.C. § 162(m)(4)(C); 26 C.F.R. § 1.162-27(e), Treasury Regulations § 1.162-27(e).

162(m) of the Internal Revenue Code (the "Code"), a listed company that was a U.S. taxpayer could generally fully deduct all "performance-based compensation" paid to executive officers so long as, among other factors, the company's compensation committee (or a designated subcommittee thereof) was composed solely of two or more "outside directors."[428] If a compensation committee (or a designated subcommittee thereof) is comprised solely of two or more outside directors, then the company could, so long as certain other requirements of Section 162(m) of the Code are satisfied, structure compensation that is to be paid to certain of its executives in a manner that qualifies as fully tax deductible. Although the Tax Reform Act has eliminated this deduction provision for most compensation paid after December 31, 2017, it is recommended that listed companies that are U.S. taxpayers continue to cause their compensation committees (or designated subcommittees thereof) to comply with these requirements, as certain compensation may still be deductible if paid under grandfathered arrangements, pending further guidance from the Department of Treasury.

3. Risk Management Committee

The growing complexity of companies and the fallout from the financial crisis have led to an increased focus on how boards oversee the management of their companies' risk. The NYSE rules require a company's audit committee to "discuss guidelines and policies to govern the process by which risk assessment and management is undertaken." Accordingly, the audit committee often takes the lead in risk management oversight. However, the NYSE rules permit a company to create a separate committee or subcommittee to be charged with the primary risk oversight function, as long as the audit committee reviews the separate committee's work in a general manner and continues to discuss policies regarding risk assessment and management. Given the audit committee's various other responsibilities, the scope and complexity of a company's business risks may make a separate risk committee desirable. Such a committee is mandated for some companies: Dodd-Frank requires each publicly traded bank holding company with greater than $10 billion of assets to establish a stand-alone, board-level risk committee.[429]

There is, however, no one-size-fits-all approach to risk management. Many boards choose not to create a separate risk committee, instead charging the audit committee with risk oversight, coupled with periodic review by the full board. In fact, a 2022 survey found that while the number has been growing, still only 12 percent of S&P 500 companies have a stand-alone risk management committee.[430] When this is the case, the audit committee must be sure to devote adequate time and attention to its risk oversight function, outside the context of its review of financial statements and accounting compliance. A board may also choose to allocate different areas of risk management among multiple existing committees, which may result in a

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[428] 26 U.S.C. § 162(m)(4)(C), I.R.C. § 162(m)(4)(C); 26 C.F.R. § 1.162-27(e), Treasury Regulations § 1.162-27(e). The general test for determining whether an individual can qualify as an outside director for these purposes is set forth in Annex D, the Directors' and Officers' Questionnaire, Part II, Item 12. If an individual cannot answer "No" to each of the questions listed in such Item 12, the individual should contact the company's designated legal counsel to discuss the facts and circumstances of the individual's answers, so that a more detailed determination can be made as to whether the individual constitutes an outside director for purposes of Section 162(m) of the Code.

[429] 12 U.S.C. § 5365(h)(2)(A).

[430] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 42 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

more balanced workload and a wider appreciation of the company's risks. Moreover, specialized committees may be tasked with specific areas of risk exposure. Banks, for instance, often maintain credit or finance committees, while some energy companies have public policy committees largely devoted to environmental and safety issues. As cybersecurity is becoming a greater and better understood source of risk, boards are having to spend more time managing cyber-risk. Cybersecurity board committees are still rare, but it is a trend that may grow as the threat increases. If responsibility for risk oversight is divided among multiple committees, however, care must be taken to coordinate the committees' work and to share information appropriately with each committee and with the full board. The board and the nominating and corporate governance committee should carefully consider what approach makes the most sense for its particular company and ensure that risk management is treated as a priority throughout the organization.

4. Special Committees

A company may want to form a special committee of the board of directors in the face of certain corporate situations. Generally, a special committee will be needed in situations where the majority of the directors on a board has, or could reasonably appear to have, a conflict of interest in a transaction or matter. In such situations, a special committee comprised of independent, disinterested members of the board can provide a way to assure shareholders that a corporate decision is fair and not the result of any undue influence by potentially conflicted directors. Directors may be considered interested to the extent they may have an interest or potential interest on both sides of a transaction, or could otherwise gain an economic benefit above and beyond that of the company generally. Specific examples of transactions that may lead to the formation of a special committee include management buyouts and controlling shareholder transactions, in each case where members of the board represent or are influenced by the conflicted party. If formed, in addition to requiring all members of the special committee to be independent with respect to the potential conflict, the special committee may also engage independent legal and financial advisors. The terms and breadth of the board resolution establishing the special committee are extremely important and may be analyzed by courts in determining the level of judicial scrutiny warranted in a conflict situation. In many cases, the special committee should be given the power to act on behalf of the company as the independent negotiator for the transaction as necessary, with the full ability to take any requisite actions to come to a fair, independent and informed determination.

A company may also want to form a special committee in the face of shareholder derivative litigation. Special litigation committees may be formed to determine whether certain shareholder derivative claims should be pursued, settled or dismissed, but since a majority of directors will often be interested as defendants in the face of litigation, the standard by which independence is evaluated may be more stringent than in the context of a corporate transaction. As the Delaware Supreme Court stated in *Beam ex rel. Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, "[i]ndependence is a fact-specific determination made in the context of a particular case. The court must make that determination by answering the inquiries: independent from whom and independent for what purpose?"[431] In *Beam* v. *Stewart*, the Delaware Supreme Court determined that a personal friendship or outside business relationship, standing alone, is

[431] *Beam ex rel. Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, 845 A.2d 1040, 1049-50 (Del. 2004).

insufficient to raise a reasonable doubt about a director's independence in the context of pre-suit demand on the board.[432] However, by contrast, in *In re Oracle Corporation Derivative Litigation*, the Delaware Court of Chancery, in looking at the purpose for which the special committee was formed, found that the members of a special litigation committee formed to investigate alleged insider trading by other directors lacked the requisite level of independence because, like the investigated directors, the special committee members had personal and professional ties to Stanford University.[433]

5. Other Committees

Some companies form other committees to address their specific needs, which may be done on a permanent or ad hoc basis. Companies operating in industries subject to substantial environmental regulation and oversight, for example, may establish committees to address environmental matters. Exxon Mobil Corporation, for instance, has established an ongoing Public Issues and Contributions Committee that "reviews the effectiveness of the Corporation's policies, programs, and practices with respect to safety, security, health, the environment, and social issues."[434] BP p.l.c. formed a Gulf of Mexico committee in July 2010 to help the company monitor its response to the Deepwater Horizon accident and "to oversee the management and mitigation of legal and license-to-operate risks arising out of the Deepwater Horizon accident and oil spill."[435] Companies may also establish ad hoc committees to evaluate strategic initiatives or other tasks for a limited time period and may subsequently dissolve any such committee upon completion of its specific task.

Committees are also often formed for short-term purposes of convenience, such as to give final approval to the terms of an agreement within parameters identified by the board, or to formally establish a meeting date. Sometimes this committee consists of just one director, often the CEO, when the formal action should be taken by the board rather than by officers.[436]

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[432] *Beam* v. *Stewart*, 845 A.2d at 1049-52. However, in 2015, the Delaware Supreme Court clarified that *Beam* was not intended to suggest "that deeper human friendships could not exist that would have the effect of compromising a director's independence." *Delaware Cty. Emps. Ret. Fund* v. *Sanchez*, 124 A.3d 1017, 1022 (Del. 2015). Drawing on this notion, the Delaware Supreme Court questioned the independence of a director who: (i) had a close friendship of over 50 years with the controlling shareholder and chairman of the company; and (ii) was an executive at an insurance brokerage that is a wholly owned subsidiary of a separate corporation of which the same chairman was the largest stockholder. *Id.* at 1022-23. Additionally, in *Sandys* v. *Pincus*, 152 A.3d 124, 130 (Del. 2016), the Delaware Supreme Court opined that the standard in *Beam* did "not require a plaintiff to plead a detailed calendar of social interaction to prove that directors have a very substantial personal relationship rendering them unable to act independently of each other," and consequently found that plaintiffs had pleaded sufficiently particularized facts to create a reasonable doubt that the directors in question were independent, including the fact that they co-owned a private airplane with the company's controlling stockholder. *Id.* at 11.

[433] *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917 (Del. Ch. 2003).

[434] Exxon Mobil Corp. Proxy Statement (Schedule 14A), at 14 (April 11, 2014), http://cdn.exxonmobil.com/~/media/Reports/Other%20Reports/2014/2014_Proxy_Statement.pdf.

[435] BP p.l.c., 2014 Annual Report (Form 20-F), at 69 (March 3, 2015), http://www.bp.com/content/dam/bp/pdf/investors/BP_Annual_Report_and_Form_20F_2014.pdf.

[436] However, it should be noted that there has been significant pushback against small (*i.e.*, two-person) board committees when the committee plays a critical function from both governance activists and institutional shareholders. Glass Lewis opposes reelection of directors at companies with fewer than three audit committee members, and the Global Head of Corporate Governance at BlackRock has noted that two-member committees are "out of step with how other boards operate." Joann S. Lublin, *Two-Person Board Committees Exist at Some Big*

Firms, THE WALL ST. J. (January 27, 2016), http://www.wsj.com/articles/two-person-board-committees-exist-at-some-big-firms-1453942169.

XII. Succession Planning

A. CEO Succession Planning

Arguably the single most important responsibility of the board is selecting the company's CEO and planning for his or her succession. The integrity, dedication and competence of the CEO are critical to the success of the company and the creation of long-term shareholder value. Management succession planning is, in addition to prudent practice, a requirement for NYSE-listed companies. The NYSE corporate governance guidelines state that succession planning should include formulating policies and principles for CEO selection and performance reviews, as well as policies regarding succession in the event of an emergency or the retirement of the CEO.[437] Nasdaq does not have such a requirement.

Historically, the nominating and corporate governance committee has led this process and recommended to the board the CEO's successor, and most boards continue to charge the committee with this responsibility.[438] As executive compensation has become a more central and scrutinized issue, boards have increasingly given their compensation committees a role in succession planning. Some boards involve both the nominating and corporate governance committee and the compensation committee in succession planning. If a board takes this approach, it is important that the responsibilities of the two committees be clearly delineated to avoid conflict, redundancy or parts of the process slipping through the cracks. Regardless of which committee is charged with leading the effort, a board must remember that it bears the ultimate responsibility for succession planning. In 2020, according to a study conducted by The Conference Board, approximately 10 percent of the S&P 500 companies managed a forced CEO departure.[439] The consequences of failing to effectively plan for the CEO's succession can be dire. If a company is unprepared when a vacancy occurs—which could happen unexpectedly for a number of reasons—a leadership vacuum can arise that can shake confidence in the company, both internally and externally, make the company more vulnerable to takeover attempts or shareholder activism and render it unable to effectively seize opportunities or respond to challenges in the interim. The absence of a thorough, well-formulated plan upon an unexpected departure of the CEO will likely force the board to respond reactively and without an opportunity for calm deliberation.

Despite the obvious importance of succession planning, a number of factors may impede the board from giving this function the attention it warrants.[440] Succession planning can be a

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[437] NYSE Listed Company Manual, Rule 303A.09.

[438] This is particularly the case for smaller companies. A 2019 survey found that approximately 25 percent of surveyed companies valued under $1 billion in annual revenue formally assign succession-planning responsibilities to the nominating and corporate governance committee, compared to 21 percent of companies valued between $1 billion to $4.9 billion, 14 percent of companies valued between $5 billion to $19.9 billion and 11 percent of companies valued at $20 billion or more. The Conference Board, *CEO Succession Practices in the Russell 3000 and S&P 500* 62 (2019), https://www.conference-board.org/publications/publicationdetail.cfm?publicationid=8857.

[439] The Conference Board, *CEO Succession Practices in the Russell 3000 and S&P 500* (June 2021), https://www.conference-board.org/pdfdownload.cfm?masterProductID=27498.

[440] A 2017 survey found that 69 percent of boards formally discuss CEO succession at least once per year, 20 percent two or three times a year and nine percent four or more times per year. Spencer Stuart, *Spencer Stuart Board Index 2017*, at 23 (2017), https://www.spencerstuart.com/research-and-insight/ssbi-2017.

sensitive topic. Some boards may be hesitant to consider the replacement of the CEO when the company is thriving or to compound his or her concerns when the company is facing difficulties. Perhaps an even greater danger to effective succession planning is the natural tendency to focus on the more immediate challenges of running the company at the expense of long-term or contingency planning. This danger is especially acute when the board lacks a formalized structure and process for succession planning. Progress may have been made recently, at least among larger companies—in a 2021 survey, the percentage of forced successions among S&P 500 companies declined to approximately 11 percent, the lowest of the past four years.[441]

1. Long-Term and Contingency Planning

The nominating and corporate governance committee should ensure that the company is engaged in both long-term succession planning as well as contingency or emergency planning. A recent survey found that 74 percent of boards have both emergency and long-term succession plans.[442] Long-term planning should have an eye toward the expected timeline for the incumbent CEO's departure in the normal course and cultivating potential successors with that timeline in mind. To do this effectively, the nominating and corporate governance committee should maintain an ongoing dialogue with the incumbent CEO regarding his or her future plans. The nominating and corporate governance committee should also assess the likelihood and timing of a change of CEO based on his or her performance and the direction of the company. This may be most efficiently done in conjunction with the board's annual review of the CEO.[443] Note that to do this may require a joint review with the compensation committee, as many companies delegate CEO performance review to that committee.

Contingency planning aims to keep the company prepared in the event the company must fill an unexpected vacancy, which may occur due to a scandal or the death or departure of the CEO. The nature of contingency planning requires the nominating and corporate governance committee to adopt an "expect the unexpected" mindset. The turnover rate for CEOs at Russell 3000 companies was 11.3 percent in 2021 (down from 13.5 percent in 2019), potentially reflecting the need to reduce instability during an already challenging period.[444] To avoid being caught flat-footed, the nominating and corporate governance committee should ensure that it has considered and developed internal candidates for both the long-term and in the event of an immediate and unexpected vacancy.

2. Approach

There are no prescribed procedures for effective succession planning, and each board and nominating and corporate governance committee should take the time to fashion a process appropriate for its particular company. However, while the process should be tailored to the unique circumstances of each company, there are certain guiding principles that all companies

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[441] The Conference Board, *CEO Succession Practices in the Russell 3000 and S&P 500* 16 (2021), https://www.conference-board.org/pdfdownload.cfm?masterProductID=27498.

[442] The Conference Board, *CEO Succession Practices* 35 (2019), https://www.conference-board.org/publications/publicationdetail.cfm?publicationid=8857.

[443] *See* Section XIV.C.

[444] The Conference Board, *CEO Succession Practices in the Russell 3000 and S&P 500* (2021), https://www.conference-board.org/pdfdownload.cfm?masterProductID=27498.

should follow. Most fundamentally, succession planning should be a proactive, comprehensive and ongoing process, rather than an ad hoc or check-the-box activity. This should include, at minimum, an annual comprehensive discussion of internal candidates and emergency plans, which is often combined with the board's annual evaluation of itself and management.[445]

Effective succession planning requires the board and the nominating and corporate governance committee to possess an in-depth knowledge of its company and its internal pipeline of candidates and, possibly, to monitor outside candidates as well. The board, and the nominating and corporate governance committee, if it has been tasked with leading the effort, must take a hands-on approach. It should not unduly defer to the current CEO, rely on résumés or otherwise outsource the process. The nominating and corporate governance committee should take the lead in ensuring that succession planning is regularly discussed at the board level and that a systematic process for succession planning is in place. As part of this systematic process, the board should regularly review its procedures and may find it helpful to formulate a list of qualities it seeks in a candidate. With the tremendous and ever-increasing demands on boards' time, a board that fails to make succession planning an institutionalized priority risks falling into the trap of ignoring the issue until an unforeseen crisis has occurred.

3. Creating a Candidate Profile

The search for a CEO should begin with identifying the challenges and opportunities that the company is expected to encounter in the applicable time frame. Once this has been done, the board and the nominating and corporate governance committee can identify the traits and qualities in a prospective CEO that would be most useful in leading the company going forward. The board and nominating and corporate governance committee should bear in mind that, as the circumstances and strategic direction of the company change, these traits and qualities may not be the same ones that distinguished the incumbent CEO. These desired traits should be narrowed to a manageable number to facilitate the nominating and corporate governance committee's focus on the most essential areas.

After formulating a desired profile for the next CEO, the board and the nominating and corporate governance committee must establish a well-designed selection process to find candidates who meet these requirements. This will provide a roadmap to keep the search focused and will also provide a neutral, agreed-upon path to help avoid or resolve the differences of opinion that often arise during the selection process.

Once the selection process has winnowed down a short list of the potential candidates possessing the desired qualities, the nominating and corporate governance committee should consider two key corporate governance-related elements before reaching a final decision. First, the new CEO should be a good fit with the culture of the board and the company. Second, the new CEO's long-term vision for the company must align with the vision of the board. No matter the candidate's other qualifications, if these two elements are absent, the candidate is likely to end up a poor fit for the company. The importance of cultural compatibility and a shared strategic vision underscores the necessity of the board getting to know candidates personally, as these elements cannot be ascertained from reviewing résumés or soliciting recommendations

[445] *See* Section XIV.A.

from a search firm. It should be noted that both of these elements depend heavily on the ability of the CEO and the board to communicate and collaborate effectively. This, in turn, depends on a shared understanding of the respective roles of the CEO and the board. A CEO must understand that the board has the ultimate responsibility for overseeing the management of the company, while the board should appreciate that the day-to-day business of the company falls within the purview of management, led by the CEO. This understanding will enable the CEO and the board to sustain an ongoing cooperative relationship founded on mutual respect.

4. Internal and External Candidates

The most promising prospects for the next CEO often reside within the company. Indeed, promotion from within has often proven to be far more successful than hiring a CEO from the outside. CEOs promoted internally benefit from greater familiarity with the company and are typically less expensive (and their compensation less scrutinized) than CEOs recruited from the outside. Development of an internal talent pipeline is therefore a strategic imperative for any company, and the board has an important role to play in this process. The search team should actively identify promising leaders to keep a bench of qualified candidates at the ready. Boards use a variety of approaches to evaluate candidates.[446] One useful step is to create opportunities for promising officers to interact with or appear before the board. This has the benefit of both familiarizing the board with potential candidates and developing the officers' ability to interact with the board. The succession planning team should also consider working with the CEO to establish policies to evaluate internal candidates and to ensure that they are given opportunities to develop the skills and experience needed to possibly head the company in the future; for example, by rotating candidates through the company's key departments. While the CEO should exercise primary responsibility for building the company's management team, the board can also help develop its talent pipeline by seeing that appropriate recruiting and retention policies are in place at all levels of management.

Despite the importance of developing a talent pipeline and the benefits of internal promotion, a CEO succession plan should also include ongoing consideration of external candidates. This will enable the nominating and corporate governance committee to assess all of its options and will take on additional importance if the board determines that a change in strategic direction is in the company's best interest. In all cases, consideration of external candidates will help the board reach a more informed decision by having both a wider pool of candidates and an added ability to benchmark internal candidates. Indeed, a recent survey found that 75 percent of companies have a formal process for reviewing internal succession candidates.[447]

5. Seeking the Input of Others

Succession planning should be a collaborative process that enables the nominating and corporate governance committee, and ultimately the board, to benefit from a number of

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[446] These approaches include being briefed on candidates' specific gaps in readiness (85 percent); formal assessments of internal successor candidates (75 percent); and familiarity with the development plans for potential successors (72 percent). *See* Spencer Stuart, *Spencer Stuart Board Index 2017*, at 23 (2017), https://www.spencerstuart.com/research-and-insight/ssbi-2017.

[447] *Id.*

perspectives and to utilize all of the company's resources. One such resource is the compensation committee, whose role has become increasingly important due to the centrality of executive compensation in attracting and retaining a qualified CEO, and because of the increased scrutiny generated by the topic in recent years. The nominating and corporate governance committee may also benefit from discussions with senior officers in the company's human resources department, who should have detailed knowledge about pipeline talent as well as a specialized understanding of what skills these promising candidates need to develop.

The nominating and corporate governance committee should consider engaging outside advisors to aid in the canvassing for, and assessment of, external candidates. While it is by no means necessary to engage an outside advisor to lead the CEO search process, the broader reach and perspective they can bring to bear can be invaluable in certain circumstances. It is true that the services of a top-flight recruiting agency can be expensive, but the board must keep in mind that this is one of the most important decisions they will make. A third party should, at a minimum, be retained to lead a thorough verification and background check so that the board can reasonably rely on this information when selecting a candidate.

6. Involvement of the Current CEO

When a company's CEO enjoys the full confidence of the board, he or she should play a prominent role in the succession planning process. In many circumstances, the board may want the CEO to manage the process, with the board or the nominating and corporate governance committee's oversight. This is because the incumbent CEO is uniquely positioned to understand the needs of the position and determine the successor best prepared to lead the company going forward. Absent special circumstances, any process not involving the CEO presents a number of disadvantages and will be a poor substitute. Without the insight of the CEO, the board may struggle to reach consensus on priorities or candidates. This reality has been exacerbated in the past decade by the tremendous emphasis placed on director independence, given the potential challenges in finding candidates with special expertise and experience in the industry who also qualify as independent.

The incumbent CEO should keep the chair or lead director regularly involved in the process and coordinate his or her efforts with those of the nominating and corporate governance committee. The chair or lead director and the nominating and corporate governance committee should, in turn, update the rest of the board during the board's executive sessions. This will enable the other independent directors to express their views privately, while reinforcing an understanding that choosing the next CEO is ultimately the responsibility of the entire board.

In certain circumstances, such as when the board lacks full confidence in the incumbent CEO or when a crisis prevents use of the normal succession process, the nominating and corporate governance committee may need to take a larger role and minimize the CEO's involvement. Regardless of the circumstances, the committee must take an active role in the process and avoid even the perception that it is merely a rubber stamp for the incumbent CEO. Choosing the company's next CEO is one of the most difficult and consequential decisions a board must make. The nominating and corporate governance committee must work vigilantly to ensure that the board is well-prepared to make this decision when the time comes.

B. Director Succession Planning

As with CEO succession planning, nominating and corporate governance committees should take many of these same steps with respect to succession planning for the board. Of course, the risk of crisis is lower with respect to the board because there are many directors but only one CEO. Directors expressed satisfaction with the amount of attention that boards have dedicated to director succession planning in 2020, with 64 percent expressing their belief that their boards had allocated enough time in meetings to board succession planning in 2020, according to one survey.[448] The nominating and corporate governance committee should have both long-term and contingency plans in place to prepare for the departure of directors. This planning is particularly important for directors who occupy leadership positions on the board or possess important qualities, such as financial expertise. The nominating and corporate governance committee may find this planning most effectively done in conjunction with the annual evaluation of the board, its committees and directors.[449]

There are various ways to change the board's composition. Many boards have the authority under their company's charter to increase or decrease the size of the board through a resolution. This power can be used to proactively strengthen the board by adding an attractive candidate without waiting for a vacancy or replacing an incumbent director. Alternatively, there may be circumstances where decreasing the board size, at least temporarily, is the best option. Ordinary attrition of directors often provides an opportunity to update the board's skill set to better match the company's changing circumstances. Sometimes a nominating and corporate governance committee may determine that an incumbent director no longer fits the company's needs and recommend against that director's renomination. In a recent survey by PricewaterhouseCoopers, nearly half of the directors polled suggested that at least one person on their board should be replaced.[450] Directors pointed to specific deficiencies among underperforming directors: 19 percent responded that a director was reluctant to challenge management; 17 percent that a director overstepped the boundary of the board's oversight role; and 52 percent did not name any specific complaints (down 11 percent compared to 2021).[451] If the nominating and corporate governance committee holds this sort of view on a director, it must be prepared to recommend a change. However, it should resist attempts by corporate governance activists to disrupt a well-functioning team in the name of "board refreshment" as an end in itself. This newly popular phrase has been seized upon to promote various agendas, including diversity goals and director independence. However important those criteria may be, they only should be a part of the nominating and corporate governance committee's holistic assessment and not simply an excuse to make changes.

As discussed in Section X.B, there is a growing view among shareholder activist groups and proxy advisory firms that long director tenure can affect a director's independence. As it

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[448] National Association of Corporate Directors, *2020-2021 NACD Trends and Priorities of the American Boardroom* 20 (2021).

[449] *See* Section XIV.A. For an extensive discussion of board composition and qualifications that the nominating committee should consider during board succession planning, *see* Section VII.B.1. The process of identifying and recruiting new directors is discussed in Section VIII.A.

[450] PricewaterhouseCoopers, *Charting the course through a changing governance landscape: PwC's 2022 Annual Corporate Directors Survey* 4 (2022).

[451] *Id.* at 7.

plans for board succession, the nominating and corporate governance committee must be aware of that view and monitor its prevalence, but should always remember the benefits that flow from having experienced and long-term directors on the board in terms of familiarity with the company business, history, values and institutional knowledge.

Sometimes the regular succession planning process of a board is interrupted by an unexpected event. One such event that is occurring with increasing regularity (and that may escalate as the universal proxy is used) is the loss of key directors in a short-slate proxy contest. Such an event will require the nominating and corporate governance committee to reevaluate its available resources, in terms of qualifications and skill sets, to ensure that the board continues to be able to fulfill its many duties. Although not always the case, it has been our experience that dissident directors who are elected to boards as a result of proxy fights quite often go on to become valuable and productive members of the board. Understandably, however, nominating and corporate governance committees may be reluctant to assign newly elected dissident directors to particular committees or roles until they appreciate how they will affect the dynamic of the board and have a sense of their expected longevity on the board.

XIII. Director Compensation

A. Vesting Responsibility for Setting Director Compensation

While the NYSE and Nasdaq rules do not require a particular process for setting director compensation, this responsibility should be entrusted either to a committee, such as the nominating and corporate governance committee or, in some instances, the compensation committee or to the full board. When directors who would directly benefit from a plan are charged with approving the plan, courts will review the plan under the entire fairness standard, rather than the more deferential business judgment rule. Thus, it is generally best for the board to charge the nominating and corporate governance committee with setting director compensation, subject to the approval of the full board. Some boards place this responsibility with a company's compensation committee. In either case, the committee's decision with respect to non-employee director compensation should always be subject to full board review and approval. To avoid an inference that the two are connected, boards should strive not to increase the compensation of management at the same time they increase the compensation of non-management directors. Note that officers of the company serving on the board typically receive no compensation for their board service.

B. Selecting the Form and Amount of Compensation

If the nominating and corporate governance committee participates in recommending director compensation, it should carefully consider both the form and the amount of the compensation. As to form, director compensation ordinarily consists of a mix of cash and equity payments in an effort to align directors' incentives with those of the company. A recent survey found that 76 percent of directors receive compensation paid in grants of the company's stock in addition to a cash retainer and 11 percent of companies grant stock options to directors.[452] While the percent of stock-based compensation has increased in recent years, these programs should be carefully designed to ensure that they do not create the wrong type of incentives. Restricted stock grants, for example, are generally considered to be preferable to option grants, and ISS views performance-based compensation unfavorably, in each case because they expose a holder to both upside potential and downside risk, which may better align director and shareholder interests and reduce excessive risk taking. As the responsibilities, time commitment, public scrutiny and risk of personal liability entailed in board service have increased in recent years, so has the average director's compensation. Indeed, the average director retainer for S&P 500 directors has nearly doubled in the past decade, and the average total director compensation for S&P 500 directors is now roughly $316,091, a 10 percent increase from 2016.[453] The nominating and corporate governance committee should consider the time commitment and other responsibilities of the directors as well as "benchmarking" the compensation against that being paid to directors of comparable companies. While directors are not employees and compensation is not their primary motivation for serving, offering appropriate and competitive compensation is an important factor in attracting high quality directors. As part of the board's annual self-evaluation, the nominating and corporate governance committee should therefore consider

[452] Spencer Stuart, *Spencer Stuart Board Index 2022*, at 45 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.
[453] *Id*. at 10.

whether director compensation programs need adjustment to reflect the increased responsibilities of director service and director pay at comparable companies. It is also worth noting that during the period of significant stock price volatility that coincided with the height of the Covid-19 pandemic, some boards considered reducing the number of shares of stock that might otherwise be granted to them as part of their compensation program, and reduced fee amounts.

The nominating and corporate governance committee should carefully consider the mix between individual meeting fees and retainers, particularly in light of the business and regulatory demands that have deepened director involvement and the technological innovations that have changed the way directors meet. Most companies have de-emphasized per-meeting fees and instead increased retainers in light of these developments. In 2022, only five percent of S&P 500 companies paid committee meeting fees, compared to 77 percent in 2011.[454] Increasing retainers in place of meeting fees offers the dual benefits of simplifying director pay and avoiding the issues that arise from electronic forms of communication and frequent, short telephonic meetings.

It should be noted that there has been increased focus in Delaware courts on director compensation. To that end, directors and company executives of Delaware corporations may wish to consider including, in new or amended equity incentive plans otherwise being put to a shareholder vote, realistic limits on director awards, specifying the amount and form of individual grants to directors or a meaningful and reasonable director-specific individual award limit, and also consider including overall limits on director compensation. For Delaware companies that do not have shareholder approved plans with these features and that have director pay at levels that could be a target for plaintiffs' lawyers, consideration may even be given to amending an existing plan to include these features and putting the plan to a shareholder vote even if such a vote otherwise would not be sought. While these limits are not required under any rule, they may help to deter, or bolster a defense against, claims challenging the amount or form of director compensation.

C. Compensation for Additional Director Responsibilities

As companies transition away from per-meeting fees toward increased retainers, they should consider whether additional retainer pay is appropriate for committee service that entails extra responsibilities and time commitment. Such supplemental pay is legal and appropriate, and indeed, 97 percent of S&P 500 companies provide some retainer to committee chairpersons and 48 percent pay some retainer to committee members.[455] The increase in responsibilities required of directors is especially pronounced for non-executive board chairs, lead directors and committee chairs. Accordingly, particular attention should be paid to whether these individuals are being fairly compensated for their efforts and contribution. Note also that in response to greater shareholder sensitivities, companies may wish to review any director perquisite programs, as well as director legacy and charitable award programs. Survey data will provide a useful starting point in determining appropriate additional director compensation. Nonetheless, the nominating and corporate governance committee should be willing to step outside of

[454] *Id.* at 47.
[455] *Id.* at 47.

common practice if it has a persuasive reason that the best interests of the company are advanced by so doing.

Director compensation is one of the more difficult corporate governance issues, as the need to appropriately compensate directors runs up against the risk that their compensation may result in factionalism on the board, raise an issue as to directors' independence or cause distraction by shareholder activists or, increasingly, plaintiff's firms in search of shareholders. The NYSE warns that questions as to a director's independence may be raised if compensation is beyond what is customary, if the company makes substantial charitable contributions to organizations with which a director is affiliated or if the company enters into consulting contracts with, or provides other indirect compensation to, a director.[456] All of these issues should be tracked and carefully scrutinized by the nominating and corporate governance committee to avoid jeopardizing directors' independence or creating any appearance of impropriety.

D. SEC Disclosure

SEC rules do not currently require companies to file Form 8-Ks in respect of director compensation. However, SEC rules require a director compensation table that discloses director compensation during the prior fiscal year that is comparable to the summary compensation table for named executive officers, subject to certain exceptions for emerging growth companies.[457] The director compensation table must disclose, among other things, director perquisites, consulting fees and payments or promises in connection with director legacy and charitable award programs.[458] Additionally, the company must provide narrative disclosure of its processes and procedures for the determination of director compensation.[459]

[456] NYSE Listed Company Manual, Rule 303A.09.
[457] Item 402(k) of Regulation S-K. 17 C.F.R. § 229.402(k).
[458] Item 402(k)(2)(vii) and Instruction to Item 402(k)(vii) of Regulation S-K. 17 C.F.R. § 229.402(k)(2)(vii).
[459] Item 402(k)(3) of Regulation S-K. 17 C.F.R. § 229.402(k)(3).

XIV. Evaluations of the Board, Committees and Management

Boards of NYSE-listed companies are required to conduct annual performance evaluations of the board itself and board committees, and the nominating and corporate governance committee must be tasked with "oversee[ing] the evaluation of the board and management."[460] While not required by Nasdaq, the annual board evaluation is now a nearly universal practice, with 98 percent of companies engaging in some form of annual board evaluation/assessment process.[461] The board and the nominating and corporate governance committee are not required by listing standards or other law to adopt any particular approach to conducting this evaluation, leaving flexibility to proceed in a way tailored to the company's and board's particular needs and culture.

A. The Board's Annual Governance Review

The board's annual self-evaluation provides an opportunity and forum for a comprehensive review of the company's performance, strategy, culture, corporate governance and responses to adversity during the previous year. The board should review its structure, processes and procedures to ensure that they are enabling the board to effectively carry out its responsibilities. This should include a review of the number and mix of directors; the role and functioning of the chairman or lead director and executive board sessions; board agendas; board committee structure and composition; and the quality of information and professional and other resources made available to directors. The board should examine its role in overseeing corporate culture and developing and monitoring corporate strategy, and evaluate the effectiveness of the board and management in implementing this strategy. As part of this evaluation, directors should consider whether the board's structure, processes and proceedings afforded them sufficient opportunity to converse with the company's senior executives regarding the company's culture, strategy and performance. The board should also review corporate governance matters such as monitoring of corporate controls, management review, succession planning and executive compensation.

The board's annual evaluation should include a review of the company's corporate governance guidelines to make certain that they are clear and relevant and that they adequately address key topics such as related-party transactions and conflicts of interest. Corporate governance documents should be updated to reflect any applicable legal or regulatory changes. They should also be company-specific, rather than generic and overbroad. This will serve both to make the documents a more useful guide and also to avoid a failure to comply with a policy that may be considered in hindsight as indicative of a lack of due care. Conversely, keeping policies up to date and adhering to these procedures in good faith can be important factors in establishing the applicability of exculpatory charter provisions in any litigation that might arise challenging board actions. It is therefore important that the nominating and corporate governance committee implement and update corporate governance guidelines and measure the board's and its committees' performance against these guidelines.

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[460] NYSE Listed Company Manual, Rule 303A.04(b)(i).

[461] Spencer Stuart, *Spencer Stuart Board Index* 2022, at 9 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

If the company faced any crises during the year, the annual evaluation should include a review of how the crises came about and how they were handled. Any review should identify the factors that caused or exacerbated the crises and examine the steps taken to correct any deficiencies. Directors should consider the effectiveness of the board's and management's response to the crises. As part of this inquiry, directors should ask whether they received adequate and timely information from management and whether closer contact with management could help avoid future crises. Directors should also evaluate the contributions of outside advisors, if any were retained, in responding to the crises. Similarly, the evaluation should examine the appropriateness of the board's and management's response to any whistleblower complaints or shareholder proposals made during the year. During the evaluation, the whole board should be briefed on the status and results of any investigations into whistleblower allegations. The board should also review the company's shareholder relations program and ensure that it is maintaining an appropriate level of interaction with key shareholders.

1. Methods of Evaluation

A questionnaire or survey of directors is the most common method of evaluating the full board, with group discussions and interviews of individual directors also widely used.[462] Each of these methods has its advantages. For example, questionnaires and surveys are time-efficient, produce quantifiable results and may encourage directors to speak more freely, whereas interviews and group discussions allow for in-depth and interactive discussion. Additionally, many nominating and corporate governance committees seek management's perspective on the interaction between the board and management as part of the review. However, there is no single, established procedure for a board's annual review of its corporate governance. To effectively perform its oversight function, it is important for each nominating and corporate governance committee to develop a customized approach to its annual review using the combination of methods it determines is appropriate for its company's particular circumstances. The board should avoid an overemphasis on check-the-box paperwork and should instead substantively focus on the most critical issues facing its company. More important than the method employed is the result of facilitating an honest assessment of the board's performance and a meaningful discussion of areas for improvement.

It is perfectly acceptable for a board to conduct its annual review during a board meeting without the engagement of third-party advisors.[463] Outside advisors such as accountants, lawyers and consultants offer a plethora of agendas, checklists and forms to assist the board in its review. While these products can, in some instances, facilitate a productive and transparent review, boards must guard against the danger of sacrificing substance for the sake of form. The nominating and corporate governance committee should bear in mind that if a charter or checklist requires review or other action, the failure to take such action may be argued in

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[462] *See* Stephen Klemash, Leader, EY Americas Center for Board Matters, *Six Ways Boards Are Enhancing their Evaluations and Related Disclosures* (September 3, 2020), https://www.ey.com/en_us/board-matters/six-ways-boards-are-enhancing-their-evaluations-and-related-disclosures; Spencer Stuart, *Spencer Stuart Board Index 2013*, at 30 (2013), https://www.spencerstuart.com/research-and-insight/spencer-stuart-us-board-index-2013.

[463] In 2022, 25 percent of S&P 500 companies disclosed engagement of an independent third party to facilitate and conduct all or a portion of the board evaluation process, up from 20 percent in 2021. Spencer Stuart, *Spencer Stuart Board Index 2022*, at 44 (October 2022), https://www.spencerstuart.com//media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

hindsight to be evidence of lack of due care. Documents and minutes pertaining to the board's self-evaluation are not privileged; thus, a board should take care to avoid damaging the collegiality of the board or creating ambiguous records that may be used against the company or the board in litigation. The nominating and corporate governance committee need not create volumes of records to demonstrate that the directors have fulfilled their responsibilities with respect to the board's self-evaluation. As in other matters, a good-faith effort and a reasonable, tailored process will entitle directors to the protection of the business judgment rule.

2. Following Through

As important as the annual evaluation is, it should be seen as only one step in a continuous process to enhance corporate governance. First, the nominating and corporate governance committee must ensure that the board proactively addresses corporate governance challenges as they arise, rather than waiting for the next annual review. Second, it should be remembered that assessment is not an end in itself—the findings of the annual review must be translated into a plan of action, and the implementation of this plan should be monitored and reassessed on an ongoing basis. A 2021 survey of directors found that 72 percent of boards act on issues identified in their evaluations, up from only 49 percent in 2016, with the most common changes being to add additional expertise on the board or to change the composition of board committees.[464]

B. Committee Self-Evaluations

The NYSE requires that audit, compensation and nominating and corporate governance committees conduct annual self-evaluations.[465] Many of the same steps discussed above that should be taken by a board during its self-evaluation are also appropriate during committee self-evaluations. Committees should assess their effectiveness and consider whether they have an adequate structure and procedures to carry out their responsibilities, whether they have sufficient access to the full board and to management and the usefulness of any outside advisors. Committees should also review their charters for any desirable changes and measure their performance against their charters. Additionally, committees may choose to evaluate the contributions of individual members through group discussion or peer or self-evaluations.

Committees should pay particular attention to their relationships with the board as a whole. Committees are an essential element to an effective board because they allow for specialized and focused attention to important issues. This function is undermined, however, if the work of a committee is either duplicated or ignored by the whole board.[466] An annual evaluation of a committee should therefore ensure that the work of the committee is being

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[464] PricewaterhouseCoopers, *The Director's New Playbook: Taking on Change: PwC's 2021 Annual Corporate Directors Survey* 19 (2021), https://www.pwc.com/us/en/services/governance-insights-center/assets/pwc-2021-annual-corporate-directors-survey.pdf; PricewaterhouseCoopers, *The Governance Divide: Boards and Investors in a Shifting World: PwC's Annual Corporate Directors Survey* 32 (2017).

[465] NYSE Listed Company Manual, Rules 303A.07(b)(ii); 303A.05(b)(ii); 303A.04(b)(ii).

[466] Nearly half of S&P 500 boards evaluate the full board and its committees annually and the same percentage of S&P 500 boards (47 percent) evaluate the full board, committees and individual directors, up two percent from 2021. *See* Spencer Stuart, *Spencer Stuart Board Index 2022*, at 44 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

efficiently integrated into the overall work of the board. The results of the committees' evaluations should be shared with the full board to further this integration.

C. Evaluation of the CEO

CEOs currently face unprecedented levels of scrutiny from investors (often including activist investors) and the general public, and boards have responded by engaging in more probing reviews of their CEOs. This increased scrutiny, and say-on-pay legislation in particular, has led to nearly universal annual reviews of CEO performance.[467]

1. Tasking the Responsibility

The NYSE listing standards require that the compensation committee be responsible for reviewing and approving corporate goals and objectives relevant to CEO compensation and for evaluating the CEO's performance in light of those goals.[468] Alternatively, the board may allocate the responsibilities of the compensation committee to another committee composed entirely of independent directors. Given that the NYSE listing standards also require the nominating and corporate governance committee to oversee the evaluation of management,[469] the nominating and corporate governance committee is often involved in CEO evaluation as well.

2. Finding the Right Approach

CEO evaluations present challenges that do not arise in the board's self-evaluation. The board's self-evaluation is typically focused on the board as a group, whereas CEO evaluations necessarily focus on the individual. This difference increases the chance for acrimony or misunderstanding, making it imperative that the evaluation process be thoughtful. Each year, the board should set clear objectives for the CEO and maintain an ongoing dialogue with the CEO regarding progress towards those objectives. An ongoing dialogue will not only benefit the company by addressing problems as they arise, it will also avoid the surprise and confusion of a CEO discovering at an annual evaluation that the board has been dissatisfied with his or her performance.

3. Considering Replacing the CEO

As part of its annual review, a board may well determine that a change in management leadership—either immediately or in the near future—is in the company's best interests. Thus, evaluation of the current CEO and succession planning are closely intertwined. The decision to replace the CEO must be based on the directors' independent judgment of the best interests of the company. While replacing the CEO will sometimes be necessary, boards should carefully

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[467] *See, e.g.*, Spencer Stuart, *Spencer Stuart Board Index 2014*, at 32 (2014), https://www.spencerstuart.com/~/media/PDF%20Files/Research%20and%20Insight%20PDFs/SSBI2014web14Nov2014.pdf.

[468] NYSE Listed Company Manual, Rule 303A.05(a)(i)(A).

[469] NYSE Listed Company Manual, Rule 303A.04(b)(i).

weigh the costs of replacement and also consider whether some measure short of removal may be appropriate.

D. Evaluation of Individual Directors

Approximately 44 percent of boards evaluate individual directors as part of their annual reviews.[470] Although this percentage has been gradually increasing, the fact that a minority of companies evaluate directors individually is likely the result of boards' reluctance to single out individual directors and a recognition that the effectiveness of a board or committee cannot be easily disaggregated. It is also likely that, even if there is no official evaluation of directors individually, if there are any significant problems with individual directors, they will come to light as part of an overall board evaluation. While the board is certainly more than the sum of its parts, evaluation of individual directors may identify areas for improvement that an evaluation of the entire board does not. The nominating and corporate governance committee should weigh these considerations and determine whether individual evaluations are in the company's best interests.

1. Methods of Evaluation

If the nominating and corporate governance committee decides to conduct individual director evaluations, it should consider whether to conduct these assessments through self-evaluations or peer evaluations. These evaluations ask directors to rate themselves or their fellow directors in a number of categories, such as meeting attendance and contribution or grasp of the company and its industry. Both peer and self-evaluations can provide an opportunity for constructive assessment of the board, and the nominating and corporate governance committee may decide to use some combination of the two. Peer evaluations may in many cases prove more informative and objective than self-evaluations, but they also risk damaging the collegiality that is vital to a well-functioning board. If peer evaluation is used, the aggregate results should be presented to each director privately. Alternatively, the nominating and corporate governance committee may decide that a group discussion is the most beneficial format. The nominating and corporate governance committee should also consider procedures to engage with directors who receive negative feedback in their evaluations.

2. Addressing Underperforming Directors

Addressing the problem of underperforming directors is one of the most sensitive tasks that a board faces. The ever-increasing responsibilities and time commitments that board service entails have raised the bar for board services. In some cases, additional training or a reduction in a director's other responsibilities may address the problem. In other cases, personality conflicts may lead to a balkanized board, stifling candid discussion and undermining the board's effectiveness. Although there is generally no easy way to convince an underperforming director to resign, the situation is typically best handled by the chairman of the nominating and corporate governance committee or the lead independent director. Short of seeking a director's

[470] Nearly half of S&P 500 boards evaluate the full board and its committees annually and the same percentage of S&P 500 boards (47 percent) evaluate the full board, committees and individual directors, up two percent from 2021. *See* Spencer Stuart, *Spencer Stuart Board Index 2022*, at 44 (October 2022), https://www.spencerstuart.com/-/media/2022/october/ssbi2022/2022_us_spencerstuart_board_index_final.pdf.

resignation, the nominating and corporate governance committee should consider ways to restructure the composition of the board and its committees.

The nominating and corporate governance committee is responsible for deciding whether to recommend incumbent directors for renomination. Whether or not the board engages in a formal review of individual directors, the board's annual review provides an opportunity for the nominating and corporate governance committee to assess whether the company's interests would be best served by the continued service of each director. While the importance of board continuity dictates that a decision to replace an incumbent director not be made lightly, renomination must not be seen as a given. Rather, the nominating and corporate governance committee must carefully assess the contributions and skills of each director and ensure that they continue to fit the company's needs and strategy. If the nominating and corporate governance committee determines not to renominate a director, that director typically should be informed privately to provide him or her with the opportunity to exit gracefully.

Sometimes a senior and well-respected director who is departing from the board himself or herself can be helpful in encouraging other directors whom the committee or board would like to replace to step down at the same time.

E. Director Questionnaires

Whether or not the nominating and corporate governance committee chooses to engage in individual director evaluations as part of its annual review, it should ensure that directors fill out a questionnaire at least annually. Among the topics typically covered by a director questionnaire are: material relationships with an officer, parent, subsidiary or affiliate of the company; current employment and other directorships; other directorships held in the past five years; relevant experience; certain legal actions in the past 10 years; beneficial ownership and trading of securities; compensation, benefits and other perquisites; and questions tailored to service on particular committees.

These questionnaires serve a number of functions. First, the SEC requires extensive disclosure regarding directors, and thus, gathering information from the directors is necessary to make full and accurate disclosures in the company's filings. Similarly, both the NYSE and Nasdaq require a listed company to make a finding that its independent directors are indeed independent, and the questionnaire will help identify any relationships that may compromise director independence. Director questionnaires also may help the company to flag interlocking directorships that may be problematic under antitrust laws or determine that a director may simply have too many other commitments to serve effectively. Lastly, the questionnaires aid in the nominating and corporate governance committee's task of maintaining an up-to-date picture of its board composition, particularly with respect to experience and skills, as part of the process of matching directors' attributes to the company's needs.

An example of a director and officer questionnaire is attached as Annex D.

PART THREE:

NOMINATING AND CORPORATE GOVERNANCE COMMITTEE ORGANIZATION AND PROCEDURES

XV. Key Responsibilities of the Nominating and Corporate Governance Committee

The nominating and corporate governance committee is a standing committee of the board to which the board delegates primary responsibilities for reviewing and recommending to the board director nominees and the formulation, recommendation and implementation, if appropriate, of corporate governance policies and practices.

A. Existence and Composition

1. NYSE Requirements

The NYSE requires its listed companies to have a nominating and corporate governance committee composed entirely of independent directors.[471] Independence, for purposes of serving on the nominating and corporate governance committee, is determined by the same standards generally applicable to directors.[472] So long as the committee members ultimately decide any matters within the sole province of the committee, the NYSE's independence requirement does not prohibit officers or non-committee member directors from attending a committee meeting, making a recommendation to the committee or requesting that a matter be addressed by the full board.

2. Nasdaq Requirements

Companies listed with Nasdaq may perform nominating and corporate governance tasks through a committee of independent directors.[473] Alternatively, Nasdaq allows director nominees to be selected or recommended by a majority of the board's independent directors so long as only independent directors participate in the vote.[474] The stated purpose of this rule is to provide companies with the flexibility to choose an appropriate board structure and reduce resource burdens, while ensuring that independent directors approve all nominations.[475]

Additionally, Nasdaq provides a limited exception to the requirement for complete committee-member independence. If the nominating and corporate governance committee is composed of at least three members, a non-independent director who is not currently an executive officer or employee or a family member of an executive officer may serve on the committee if the board, under exceptional and limited circumstances, determines that it is required by the best interests of the company and its shareholders.[476] A member appointed under this exception may serve no longer than two years.[477] As with the NYSE, Nasdaq's rules regarding committee member independence do not prohibit non-committee members or non-

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[471] NYSE Listed Company Manual, Rule 303A.04(a).
[472] For a description of the NYSE's independence requirements, *see* Section VII.C.1(a).
[473] Nasdaq Listing Rule 5605(e)(1).
[474] For a description of Nasdaq's independence requirements, *see* Section VII.C.1(b).
[475] Nasdaq Listing Rule IM-5605-7.
[476] Nasdaq Listing Rule 5605(e)(3).
[477] Note, however, that ISS recommends "against" or "withhold" votes for non-independent directors of companies that lack a formal nominating committee or if non-independent directors serve on such committee. *See* ISS, *2023 U.S. Proxy Voting Guidelines* 9 (December 13, 2022).

committee member directors from attending meetings or otherwise contributing to the work of the committee.

3. SEC Requirements

The SEC does not establish mandatory standards regarding the existence and composition of the nominating and corporate governance committee but instead specifies certain disclosure obligations. A listed company must state whether or not it has a standing nominating and corporate governance committee (or another committee performing a similar function).[478] A company with a nominating and corporate governance committee must identify each committee member, state the number of meetings held by the committee during the last fiscal year and describe briefly the functions performed by the committee.[479] A company without such a committee must identify each director who participates in the consideration of director nominees and must state the basis for the view of the company's board that it is appropriate not to have such a committee.[480]

The SEC requires a company to identify each member of its nominating and corporate governance committee who is not independent under applicable independence standards.[481] A listed company may use its own definition of independence, provided that the definition complies with the independence standards of the exchange on which the company is listed.[482] In the absence of company-defined independence standards for a committee, the applicable standard is the one used by its exchange.[483] A company that relies on an exemption from the independence requirements of the exchange on which it is listed must identify the exemption and explain its basis for reliance.[484]

B. Nominating and Corporate Governance Committee Charter and Responsibilities

A NYSE-listed company must have a written nominating and corporate governance committee charter vesting the committee with certain responsibilities.[485] By contrast, a Nasdaq-listed company need not have a formal nominating and corporate governance committee at all, and therefore need not have a formal committee charter. Nasdaq requires only that each company certify that it has adopted either a written charter or board resolution addressing the process by which directors are selected for nomination.[486] Further, unlike a NYSE-listed company, a Nasdaq-listed company is not required to task a specific committee with formulating its corporate governance standards. Nonetheless, in recent years there has been a notable trend among Nasdaq-listed companies, especially large-cap companies, towards having formal nominating and corporate governance committees and including within their ambit a leading role

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[478] Item 407(b)(3) of Regulation S-K. 17 C.F.R. § 229.407(b)(3).
[479] *Id*.
[480] Item 407(c)(1) of Regulation S-K. 17 C.F.R. § 229.407(c)(1).
[481] Item 407(a) of Regulation S-K. 17 C.F.R. § 229.407(a).
[482] Item 407(a)(1)(i) of Regulation S-K. 17 C.F.R. § 229.407(a)(1)(i).
[483] *Id*.
[484] Instruction 1 to Item 407(a) of Regulation S-K. 17 C.F.R. § 229.407(a).
[485] NYSE Listed Company Manual, Rule 303A.04(b).
[486] Nasdaq Listing Rule 5605(e)(2).

in forming and implementing corporate governance policy.[487] An example of a nominating and corporate governance committee charter is attached as Annex E.

As a matter of good corporate governance, it is recommended that a company review its nominating and corporate governance charter (or equivalent standards if a company does not have a formal committee) at least annually, and more frequently if circumstances warrant. The nominating and corporate governance committee should lead this review, making sure that corporate governance guidelines adequately address key topics such as director elections, related-party transactions and conflicts of interest. As part of any review, a nominating and corporate governance committee should ensure that the company's charter, bylaws, corporate governance guidelines, procedures and committee charters do not set inconsistent standards.

1. NYSE Requirements

As noted, the nominating and corporate governance committee of a NYSE-listed company must have a written charter that describes the committee's purpose and responsibilities. Because the charter is originally adopted by the board and is subject to amendment by the board, the authority and procedures of the committee can be altered as long as the committee retains the responsibilities required under the NYSE rules. The responsibilities that the charter must provide for include:

- identification of individuals qualified to become board members who meet the criteria for board membership approved by the board;[488]
- selection, or recommendation to the board, of director nominees to be presented at the next annual meeting of shareholders;[489]
- development and recommendation to the board of corporate governance guidelines applicable to the corporation;[490]
- oversight of the evaluation of the board and management;[491] and
- annual evaluation of the committee's performance.[492]

Commentary to the NYSE rules instructs that the charter should also address a number of topics concerning the committee itself, including:

- committee member qualifications;

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[487] In 2014, 99 percent of S&P 500 companies had a nominating and corporate governance committee. Ernst & Young LLP, *Let's Talk: Governance, Beyond key committees: Boards create committees to support oversight responsibilities* 1 (April 2014).
[488] NYSE Listed Company Manual, Rule 303A.04(b)(i).
[489] *Id.*
[490] *Id.*
[491] *Id.*
[492] NYSE Listed Company Manual, Rule 303A.04(b)(ii).

- the process for committee member appointment and removal;

- committee structure and operations (including authority to delegate to subcommittees); and

- committee reporting to the board.[493]

The commentary also states that the charter should give the nominating and corporate governance committee sole authority to retain and terminate a search firm to assist in identifying director candidates, including sole authority to approve the search firm's fees and other retention terms.[494] Boards may allocate the responsibilities of the nominating and corporate governance committee to committees of their own denomination, provided that any such committee has a committee charter and is composed entirely of independent directors.

The NYSE listing standards also instruct that the nominating and corporate governance committee is responsible for taking a leadership role in shaping a company's corporate governance.[495] As noted above, the NYSE-listed companies are required to adopt a nominating and corporate governance committee charter giving the committee responsibility for the development and recommendation to the board of a set of corporate governance guidelines applicable to the company. These corporate governance guidelines must address the following subjects:

- director qualification standards (which must reflect, at a minimum, the NYSE independence requirements, but may also address other substantive qualification requirements, such as policies limiting the number of boards on which a director may sit, and director tenure, retirement, and succession);

- director responsibilities (which should clearly articulate what is expected from a director, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials);

- director access to management and, as necessary and appropriate, independent advisors;

- director compensation (which should include general principles for determining the form and amount, and for reviewing those principles, as appropriate);

- director orientation and continuing education;

- management succession (which should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO); and

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[493] Commentary to NYSE Listed Company Manual, Rule 303A.04.
[494] *Id*.
[495] *Id.*

- annual performance evaluation of the board (which should provide for board self-evaluation at least annually to determine whether it and its committees are functioning effectively).[496]

This charter[497] and corporate governance guidelines[498] must be made available on or through the company's website.

2. Nasdaq Requirements

Nasdaq is again more flexible in its charter requirements than the NYSE, and differs from those of the NYSE in two notable respects. First, whereas the NYSE lists a number of responsibilities that must be entrusted to the nominating and corporate governance committee, and also lists with greater specificity the topics that should be addressed in the committee charter, Nasdaq requires only that the charter or board resolution outline a company's director nomination process and any related matters as may be required by federal securities laws. Second, while the NYSE requires a company to make its committee charter available online, Nasdaq requires only that a company certify that it has adopted a committee charter or board resolution.[499]

Although Nasdaq's requirements offer greater flexibility, recent years have seen a notable trend among Nasdaq-listed companies towards expanding the role of the nominating and corporate governance committee to include a leading role in forming and implementing corporate governance policy.

3. SEC Requirements

The SEC requires a company to disclose whether its nominating committee has a charter.[500] If it does, the company must disclose whether a current copy of the charter is available on its website and, if it is, the website address. If a copy is not available on the company's website, one must be included in the company's proxy or information statement once every three fiscal years and every year that the charter has been materially amended. If the company relies on a prior year's filing to fulfill this requirement, the company must identify the prior year.[501]

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[496] Commentary to NYSE Listed Company Manual, Rule 303A.09.
[497] NYSE Listed Company Manual, Rule 303A.04.
[498] NYSE Listed Company Manual, Rule 303A.09.
[499] Nasdaq Listing Rule 5605(e)(2).
[500] Item 407(c)(2)(i) of Regulation S-K. 17 C.F.R. § 229.407(c)(2)(i).
[501] Instruction 2 to Item 407 of Regulation S-K. 17 C.F.R. § 229.407.

XVI. The Membership and Functioning of the Nominating and Corporate Governance Committee

A. Membership

1. Size and Composition of the Committee

Neither federal law nor stock exchange listing requirements prescribe a minimum or maximum number of members for a nominating and corporate governance committee.[502] The appropriate number of members will vary depending on such factors as the composition of the board as a whole, the size and complexity of the company and the breadth of responsibilities tasked to the committee. The size of the nominating and corporate governance committee varies, although a committee of three or four members is fairly common. As part of its annual review, the committee and the board should consider the attributes of the committee members to ensure that the committee is appropriately constituted to effectively perform its tasks.

A company must be mindful of the director independence requirements imposed by its stock exchange and other sources when selecting directors to serve on the nominating and corporate governance committee. The NYSE requires a nominating and corporate governance committee to be composed of independent directors and sets standards governing who can qualify as an independent director.[503] While Nasdaq does not require a formal nominating and corporate governance committee, it does require that a company's independent directors perform the nominating function generally assigned to a nominating and corporate governance committee.[504] Unlike members of the audit and compensation committees, who face additional independence requirements, the independence of members of the nominating and corporate governance committee is judged by the same standards the NYSE and Nasdaq employ to determine director independence generally.

2. Chairperson

While the effectiveness of the nominating and corporate governance committee ultimately depends upon the contributions of each of its members, the chairperson has a particularly important role to play. He or she establishes the agenda for committee meetings and leads committee discussions to ensure that meetings are conducted regularly and efficiently and that each item receives appropriate attention. Moreover, the chairperson is typically the voice of the committee in its interactions with outside advisors, senior management and the full board. Many committee chairs rotate every few years, and that rotation can serve to enhance the experience and effectiveness of directors.[505] It is not unusual for the chair of the nominating and corporate governance committee to also serve as lead director when the chief executive of the company also chairs the board. Although this is by no means necessarily the right choice for any

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[502] NYSE Listed Company Manual does not prescribe a minimum or maximum number of members, Nasdaq does not require the formation of a nominating and corporate governance committee, and the SEC requires only disclosure of committee-related information.

[503] NYSE Listed Company Manual, Rule 303A.04.

[504] Nasdaq Listing Rule 5605(e)(1).

[505] *See* The Conference Board, *Corporate Board Practices in the Russell 3000 and S&P 500* 16 (2019).

given company, the role that the nominating and corporate governance committee plays in establishing appropriate corporate governance policies and practices for the company positions its chair well to perform the lead director role (which is described in Section III.G).

3. Term of Service

There are no rules that prescribe a particular length or term of service for members of a nominating and corporate governance committee. Consequently, a board is free to fashion policies it determines are appropriate. As a general matter, the board should strike a balance between experience and stability on the one hand, and facilitating the exchange of fresh ideas and perspectives on the other. High turnover on the committee may reduce cohesion, lead to inefficiency and make it harder to develop and implement long-term plans, such as board development plans, corporate governance evolution, and management succession planning. Conversely, having little or no turnover risks depriving the committee of the benefit of fresh ideas and perspectives. In striking this balance, a board should consider periodically rotating its qualified directors onto the committee. Boardroom diversity is an increasingly important consideration, and can be especially important for the nominating and corporate governance committee, given its central role in identifying, reviewing and recommending candidates for the board.[506]

B. Meetings

1. Regular Meetings

Apart from the requirement that the nominating and corporate governance committee conduct an annual self-evaluation and oversee the annual self-evaluation of the board, neither the SEC nor the major securities exchanges mandate the frequency of committee meetings. A nominating and corporate governance committee should meet with sufficient regularity to properly carry out its duties. The appropriate frequency will depend on various factors, including the scope of the committee's responsibilities, the size of the company and whether any circumstances, such as an anticipated leadership transition or unusual shareholder activism, require extraordinary committee attention. In addition to other meetings throughout the year, the committee should meet in advance of the board's annual nomination of directors. A 2022 report found that in the 2022 proxy year, S&P 500 companies held on average 4.7 nominating and corporate governance committee meetings, the same number as last year and a decade ago.[507]

As with a meeting of the board, a meeting of the nominating and corporate governance committee should provide adequate time for the discussion and consideration of each agenda item. To help ensure productive discussion, the committee should devote sufficient attention to planning the meeting's timing, agenda and attendees.

2. Minutes

Nominating and corporate governance committees ordinarily prepare minutes of their regular meetings but not of their executive sessions. These minutes should identify the topics

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[506] *See* Section VII.B.3 for a discussion of diversity on boards.

[507] Spencer Stuart, *2022 U.S. Spencer Stuart Board Index*, at 15, 43 (2022).

discussed, but it is neither necessary nor prudent to attempt to create a transcript of meetings. Rather, minutes should be sufficiently detailed to document that the committee requested, received, reviewed and discussed the information it deemed relevant in light of the facts and circumstances as they were known at the time. Courts and regulators reviewing a committee's actions often regard minutes as the most reliable contemporaneous evidence of what transpired at a meeting. In litigation concerning director-level conduct and decision-making, board and committee minutes are regularly used as evidence and can provide a guide to opposing counsel as to which directors to depose and what topics to cover in such depositions. It is therefore of vital importance that minutes be thoughtfully drafted to reflect the topics discussed at meetings and the substance of the committee's discussion to avoid creating an ambiguous record that may later be used against the directors in litigation.[508] As part of this effort, and because directors today are often engaged in work with one another for their companies outside of formal meetings, committees should consider including in the minutes reference to any discussion that occurred among the members prior to or after the meeting.

Minutes should also reflect which members of the committee were present and whether any non-committee members attended (and for what portions of the meeting they were in attendance). It is good practice for directors who do not serve on the committee to have the opportunity to ask the committee questions, and the committee should consider providing the full board with a report or copy of the minutes for each committee meeting. Drafts of minutes should be prepared and circulated to each committee member reasonably promptly after each meeting to help ensure accuracy. Where possible, the minutes should also be circulated sufficiently in advance of a future (ideally, the next) committee meeting to allow each committee member a full opportunity to review them before approval.

3. Rights of Inspection

The danger of improvidently drafted minutes is especially acute because state law often provides shareholders a right to inspect the books and records of the company, including committee meeting minutes.[509] For example, any stockholder of a Delaware company may make

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[508] The need to document board actions with care was brought into sharp focus by the Delaware Supreme Court's ruling in *KT4 Partners LLC* v. *Palantir Techs. Inc.*, 203 A.3d 738 (Del. 2019), which involved a stockholder's books-and-records demand under Section 220 of the DGCL. The trial court permitted Palantir to exclude email from its production, but the Delaware Supreme Court reversed, holding that while a stockholder's inspection rights are generally properly limited to formal board-level materials such as meeting minutes, resolutions and presentations, Palantir's "history of not complying with required corporate formalities," including its failure to maintain any board-level documents responsive to the inspection demand, made necessary its production of responsive emails. *Id.* at 756-57. The decision makes clear that the diligent preparation and maintenance of minutes can help corporations avoid intrusive inspection requests from stockholders. *See also* Wachtell, Lipton, Rosen & Katz, Delaware Provides Guidance on Books-and-Records Inspection Rights (January 31, 2019), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26353.19.pdf.

[509] A glaring example of the expansive nature such requests can occasionally take occurred in 2014, when the Delaware courts required Wal-Mart, in response to a shareholder demand to investigate potential wrongdoing associated with illegal payments to Mexican officials, to produce documents from 11 different custodians, including those on disaster recovery tapes, spanning a seven-year time period. The order also required production of documents that were otherwise protected by attorney-client privilege. The stockholder investigation was prompted by an April 2012 *New York Times* article entitled "Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle." *Wal-Mart Stores, Inc.* v. *Ind. Elec. Workers Pension Trust Fund IBEW*, 95 A.3d 1264 (Del. 2014); *cf. United Techs. Corp.* v. *Treppel*, 109 A.3d 553, 559 (Del. 2014) (permitting the company to condition use of

a written demand to inspect board of director and committee meeting minutes.[510] Although such inspection rights are limited to situations where stockholders have a "proper purpose" for their requested inspections, courts throughout the country have encouraged stockholders seeking to bring derivative litigation to take pre-suit discovery via these statutory inspection rights. Delaware's proper purpose requirement is a "notably low standard,"[511] which requires only that stockholders produce evidence demonstrating a credible basis of actionable corporate wrongdoing.[512]

However, to some extent, recent cases have limited the contours of "proper purpose." In *Southeastern Pennsylvania Transit Authority* v. *AbbVie, Inc.*, stockholders of AbbVie demanded the company's books and records in order to investigate a potential breach of fiduciary duty after the board abandoned its plans to pursue an inversion transaction and was forced to pay a $1.635 billion termination fee.[513] The board called off its merger with Shire plc in response to changes in Treasury Department inversion regulations, which the media had been speculating might occur for some time prior to AbbVie signing up the deal.[514] On this basis, stockholders alleged that "the risk of loss of the tax advantages inherent in the merger with Shire was so substantial, and so obvious, that the directors must have breached their fiduciary duties to the stockholders by entering the deal."[515] The Chancery Court noted that although the "directors [had taken] a risky decision that failed at substantial cost to the stockholders," this in no way suggested that the directors had breached their duty of loyalty and denied the stockholders' request to inspect AbbVie's records.[516] By contrast, in *AmerisourceBergen Corporation* v. *Lebanon County Employees' Retirement Fund, et al.*, the Delaware Supreme Court upheld the Chancery Court's order requiring that AmerisourceBergen produce board materials in response to an inspection request by stockholders investigating whether the company engaged in wrongdoing in connection with the distribution of opioids.[517] In doing so, the court held that a

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materials obtained in an inspection of its books and records only to cases filed in Delaware courts and noting that "the stockholder's inspection right is a 'qualified one'" for which the "Court of Chancery has wide discretion to shape the breadth and use of inspections under § 220 to protect the legitimate interests of Delaware corporations"); *see also* David Barstow, "Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle," N.Y. TIMES (April 21, 2012), https://archive.nytimes.com/www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html.

[510] 8 *Del. C.* § 220.

[511] *Se. Penn. Trans. Auth.* v. *AbbVie Inc.*, C.A. No. 10374-VCG, 2015 WL 1753033, at *1 (Del. Ch. April 15, 2015), *aff'd*, No. 239,2015, 2016 WL 235217 (Del. January 20, 2016).

[512] *See Wal-Mart Stores, Inc.* v. *Ind. Elec. Workers Pension Trust Fund IBEW*, 95 A.3d 1264, 1283 (Del. 2014) (finding a credible basis of actionable corporate wrongdoing and noting "[w]here a Section 220 claim is based on alleged corporate wrongdoing, and assuming the allegation is meritorious, the stockholder should be given enough information to effectively address the problem") (internal quotations omitted).

[513] *Se. Penn. Trans. Auth.* v. *AbbVie Inc.*, 2015 WL 1753033, at *1.

[514] *Id.* at *7-8. The record was mixed as to whether the government was likely to act in the short term, despite "heated anti-inversion" political rhetoric. For example, on the day before AbbVie's board voted to approve the terms of the proposed inversion, the *New York Times* reported that "[l]awmakers say they want to stop United States companies from reincorporating overseas to lower their tax bills, but the Obama administration and Congress appear unlikely to take any action to stem the tide of such deals anytime soon." David Gelles, *Treasury Urges End to Foreign Tax Flights, but Quick Action Is Unlikely*, N.Y. TIMES (July 16, 2014), https://dealbook.nytimes.com/2014/07/16/obama-administration-seeks-end-to-inversion-deals/.

[515] *Se. Penn. Trans. Auth.* v. *AbbVie Inc.*, No. 10374-VCG, 2015 WL 1753033, at *1.

[516] *Id*. AbbVie's directors were exculpated from liability for breaches of their duty of care pursuant to Section 102(b)(7) of the DGCL.

[517] *See AmerisourceBergen Corp.* v. *Lebanon Cnty. Emps.' Ret. Fund*, 243 A.3d 417, 421 (Del. 2020).

shareholder inspection request need not disclose what the stockholders intend to do with the materials they obtain if such materials confirm the stockholder's suspicion of wrongdoing, nor does the shareholder need to establish that the wrongdoing it is investigating would be actionable in a future derivative action.[518]

A second and arguably more serious consideration for companies is that where stockholders are granted the right to inspect the committee's minutes, they may be able to make them available to the public broadly. While companies have often been able to negotiate confidentiality agreements with shareholders when providing materials in response to books-and-records inspection requests, Delaware courts, at least, have declined to adopt a categorical rule of confidentiality in favor of a balancing test. Specifically, Delaware case law provides that a court must balance a company's interest in privacy against its shareholders' legitimate interest in communicating regarding matters of common interest.[519]

4. Third-Party Advisors

The NYSE requires listed companies to grant the nominating and corporate governance committee sole authority to retain and terminate any search firm to assist it in identifying director candidates, including sole authority to approve the search firm's fees and other retention terms.[520] Nasdaq imposes no such requirement, but boards of companies listed on Nasdaq may also want to consider vesting the nominating and corporate governance committee with this power. If a nominee approved by the nominating committee for inclusion on a company's proxy card (other than nominees who are executive officers or who are directors standing for reelection) was recommended by a third-party search firm, federal securities laws require the company to disclose this fact in its proxy statement.[521]

If the committee is granted this authority, it should bear in mind that there is no legal obligation to engage third-party advisors to assist in identifying director candidates. Third-party advisors will, in some instances, bring valuable capabilities that a firm may not possess internally. Directors should have full access to any consultants, and engaging and questioning advisors is often an important part of the process by which the board reaches a judgment after careful and informed deliberation. It is also important for the nominating and corporate governance committee to understand the nature and scope of any other services provided to the company by the third-party advisor in order to detect any actual or perceived conflicts of interest. Of course, a consultant's judgment should not be viewed as a substitute for the independent judgment of the committee and ultimately the board.

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[518] *Id. See also* Wachtell, Lipton, Rosen & Katz, *Section 220 as Pre-Complaint Discovery—Recent Developments* (December 14, 2020), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27184.20.pdf.
[519] Order, *Disney* v. *Walt Disney Co.*, No. 380, 2004 (Del. March 31, 2005).
[520] Commentary to NYSE Listed Company Manual, Rule 303A.04.
[521] Item 407(c)(2)(vii) of Regulation S-K. 17 C.F.R. § 229.407(c)(2)(vii).

XVII. Fiduciary Duties of Nominating and Corporate Governance Committee Members

A. The Business Judgment Rule

The decisions of the nominating and corporate governance committee ordinarily will be afforded the protection of the business judgment rule. The business judgment rule is a presumption that, in making a business decision, independent directors have 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.[522] A conscious decision to refrain from acting can also be an exercise of business judgment.[523] Unless a plaintiff can show that directors failed to act with loyalty or due care, the courts will generally defer to the business judgment of the board or committee. If a plaintiff is able to establish that the directors in question were conflicted or did not act with reasonable care, then the burden may shift to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the company and its shareholders.[524]

The business judgment rule focuses on process and is deferential to the substantive decisions reached by informed and disinterested directors. This deference reflects a fundamental principle of Delaware corporate law—that the business and affairs of a company are to be managed under the direction of the board of directors, rather than the courts.[525] The corporation laws of other states are generally at least as deferential to the decisions of informed and disinterested directors as those of Delaware, and in many cases more so; many states have constituency statutes that allow directors to consider the interests of all corporate stakeholders in making decisions, not only those of shareholders.

B. Fiduciary Duties Generally

Members of the nominating and corporate governance committee owe the company the same fiduciary duties in the performance of their committee assignments as they do in the performance of their activities as directors: a duty of care and a duty of loyalty.

1. The Duty of Care

The essence of a director's duty of care is the obligation to exercise informed business judgment. A business judgment is informed if, prior to making a decision, the director apprised himself or herself of all material information reasonably available,[526] including potential alternatives.[527] This process would generally include consultation with management and, in many cases, expert advisors, as well as receipt and review of such corporate records and information that the directors consider necessary and appropriate to make the decision in question.[528] A plaintiff alleging a breach of the duty of care must establish that the director's

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[522] *See, e.g.*, *Aronson* v. *Lewis*, 473 A.2d 805, 812 (Del. 1984).
[523] *Id.* at 813.
[524] *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006).
[525] *See* 8 *Del. C.* § 141(a).
[526] *Smith* v. *Van Gorkom*, 488 A.2d 858, 872 (Del. 1985).
[527] *Aronson* v. *Lewis*, 473 A.2d at 812; *Benihana of Tokyo, Inc.* v. *Benihana, Inc.*, 891 A.2d 150, 192 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006).
[528] *See* Section XVII.C for a discussion of reliance on corporate records and experts. *See also* 8 *Del. C.* § 141(e).

actions were grossly negligent.[529] Delaware Courts define gross negligence in this context as reckless indifference to, or a deliberate disregard of, the whole body of shareholders, or actions that are outside the bounds of reason.[530] Thus, a court will not find a breach of the duty of care simply because the directors' decisions were not flawless. In the landmark *Disney* case, the Delaware courts reaffirmed that informed directors acting in good faith will not be held liable for failure to comply with "the aspirational ideal of best practices" by "a reviewing court using perfect hindsight."[531]

2. The Duty of Loyalty

The duty of loyalty requires a director to consider the interests of the company and its shareholders rather than his or her personal interests or the interests of other persons or entities. The Delaware Supreme Court has explained that "[e]ssentially, the duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally."[532] Subsumed within the duty of loyalty is the duty to act in good faith.[533] A director fails to act in good faith if he or she acts with a purpose other than that of advancing the best interests of the corporation, acts with the intent to violate applicable positive law or fails to act in the face of a known duty to act, demonstrating a conscious disregard for his or her duties.[534]

3. Oversight Duties

Fiduciary duties apply not only to directors' active decisions but also in their capacity as overseers. A breach of the duty to oversee the affairs of the company is categorized as a breach of the duty of loyalty, because establishing such a claim requires a showing of bad faith.[535] These claims can expose directors to personal liability, as under Delaware law directors cannot be exculpated or indemnified for breaches of the duty of loyalty.

The seminal Delaware case drawing the contours of directors' oversight duties is the 1996 case *In re Caremark*.[536] In *Caremark*, the court rejected claims that the company's directors breached their fiduciary duties by failing to sufficiently monitor certain practices that allegedly violated the Anti-Referral Payments Law and resulted in substantial criminal fines. The court held that "only a sustained or systematic failure" of oversight would be sufficient to show the lack of good faith necessary to establish a breach of loyalty claim.[537] A plaintiff alleging a breach of fiduciary duty predicated on the directors' oversight function must establish either: (1) that the directors utterly failed to implement any reporting information systems or

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[529] *See Smith* v. *Van Gorkom*, 488 A.2d at 873.
[530] *Benihana of Tokyo, Inc.* v. *Benihana, Inc.*, 891 A.2d at 192.
[531] *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 697-98 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006).
[532] *Cede & Co.* v. *Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).
[533] *Stone ex rel. AmSouth Bancorporation* v. *Ritter*, 911 A.2d 362, 369-70 (Del. 2006).
[534] *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006).
[535] *Stone ex rel. AmSouth Bancorporation* v. *Ritter*, 911 A.2d at 370.
[536] *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).
[537] *Id.* at 971.

controls; or (2) that, having implemented such controls, the directors consciously failed to monitor or oversee their operations.[538]

The principles of *Caremark* were reaffirmed in the 2009 case *In re Citigroup*.[539] There, shareholders of Citigroup alleged that the bank's directors breached their fiduciary duties by ignoring "red flags" and failing to monitor risks from subprime mortgages and securities.[540] The Court dismissed these claims and emphasized the "extremely high burden" faced by claims seeking personal director liability for a failure to monitor business risk, making clear that "[o]versight duties under Delaware law are not designed to subject directors, even expert directors, to *personal liability* for failure to predict the future and to properly evaluate business risk."[541]

However, in recent years the risk of liability from director oversight failures has grown. In *Marchand* v. *Barnhill*, plaintiffs sued Blue Bell Creameries for losses arising from actions that the company undertook to avoid insolvency after it had recalled its products and suspended operations because of deaths caused by the company's distribution of ice cream tainted with listeria.[542] The Delaware Supreme Court held that the board's failure to establish a committee or process for overseeing food safety was sufficient to support a reasonable inference that the board had breached its duty of loyalty, in light of the fact that the company relied solely on one product (ice cream).[543]

Caremark claims spiked immediately and have continued to mount: 2022 set a record for lawsuits faulting boards of directors of failing to adequately oversee corporate operations (a third consecutive year of acceleration). And since *Marchand*, Delaware courts have sustained these claims far more frequently. *Caremark* claims previously survived a motion to dismiss only very rarely. Now, one out of three survive motions to dismiss—acquiring enormous settlement value, without regard to the ultimate merits of the claim or the difficulty of showing any damages to stockholders. As a result, any announcement of adverse corporate news or regulatory exposure should now be expected to trigger not only tort claims from victims, but *Caremark* claims by stockholders.[544]

Several recent cases are illustrative. In *In re Clovis Oncology, Inc. Derivative Litigation*, the Delaware Court of Chancery upheld claims against directors of a life sciences company for failing to ensure accurate reporting of drug trial results, after the company's stock price dropped sharply upon the disclosure of poor clinical trial results for the company's most promising experimental cancer drug.[545] The Court of Chancery reasoned that the company had a board "comprised of experts" and "operate[d] in a highly regulated industry," so the directors should

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[538] *Stone ex rel. AmSouth Bancorporation* v. *Ritter*, 911 A.2d at 370; *see also* Summary Order, *Central Laborers' Pension Fund and Steamfitters Local 449 Pension Fund* v. *Dimon*, No. 14-4516 (2d Cir. January 6, 2016).
[539] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009).
[540] *Id.* at 111.
[541] *Id.* at 125, 131.
[542] *Marchand* v. *Barnhill*, 212 A.3d 805 (Del. 2019). The case was recently settled for approximately $60 million.
[543] *Id.* at 809.
[544] Wachtell, Lipton, Rosen & Katz, *Caremark* Exposure—And What to Do About It (January 23, 2023), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.28256.23.pdf.
[545] *In re Clovis Oncology, Inc. Derivative Litig.*, C.A. No. 2017-0222-JRS, 2019 WL 4850188, at *1 (Del. Ch. October 1, 2019).

have understood the problem and intervened to fix it.[546] In *Hughes* v. *Hu*, the Delaware Court of Chancery accepted that directors of Chinese auto parts manufacturer Kandi Technologies may have failed to implement responsible auditing protocols notwithstanding clear red flags.[547] In *In re Boeing Company Derivative Litigation*, the Delaware Court of Chancery permitted a *Caremark* duty-of-oversight claim to proceed against the directors of the Boeing Company on the basis that the pleaded facts described a board that "complete[ly] fail[ed] to establish a reporting system for airplane safety" and determining that the board "turn[ed] a blind eye to a red flag representing airplane safety problems," citing allegations that the directors "treated the [first] crash as an 'anomaly,' a public relations problem, and a litigation risk, rather than investigating the safety of the aircraft."[548] And in a January 2023 decision, *In re McDonald's Corp. Shareholder Derivative Litigation*, the Delaware Court of Chancery held that corporate *officers*, not just directors, may be held liable for *Caremark* claims.[549] Never before had oversight claims been applied to officers rather than directors.

While *Marchard*, *Clovis*, *Hughes*, *Boeing*, and *McDonald's* all highlight that courts are looking for engaged board oversight over "mission critical" (or in the case of *McDonald's* other key risks which may include workplace harassment matters) corporate risks, these are cases where the facts, as alleged, were fairly extreme, and these cases do not change the well-established *Caremark* standard that for directors to have personal liability they must have utterly failed to implement any reporting information systems or controls or consciously failed to monitor or oversee their operation.[550] Nonetheless, it is essential not only that the board implement reporting information systems and oversee their operation, but also that these efforts are thoroughly documented to provide inspecting stockholders and reviewing courts a fair picture of the directors' oversight efforts. That way, when the plaintiffs come calling, the directors (and, post-*McDonald's*, officers) will have a robust record demonstrating their attention to foreseeable risks and supplying a pathway to early dismissal of the claim.

C. Reliance on Experts

Under Delaware law, directors and committee members are protected in relying in good faith upon the company's records and the information, opinions, reports or statements of the company's officers, employees or committees, or any other person as to matters the director reasonably believes are within such other person's professional or expert competence and who has been selected by or on behalf of the company with reasonable care.[551] This protection is

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[546] *Id.* at *1, *14.
[547] *Hughes* v. *Hu*, C.A. No. 2019-0112-JTL, 2020 WL 1987029, at *14-16 (Del. Ch. April 27, 2020).
[548] *In re Boeing Company Deriv. Litig.*, 2021 WL 4059934 (Del. Ch. September 7, 2021).
[549] *In re McDonald's Corp. S'holder Derivative Litig.*, C.A. No. 2021-0324-JTL (Del. Ch. January 25, 2023). At issue were allegations that McDonald's chief human resources officer was answerable in fiduciary breach for having failed to properly respond to evidence of sexual harassment at the company.
[550] *See* Wachtell, Lipton, Rosen & Katz, *The Delaware Supreme Court Refines the Rules of Risk Management* (June 24, 2019), https://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26467.19.pdf; Wachtell, Lipton, Rosen & Katz, *Delaware Court of Chancery Again Sustains Oversight Claims* (October 4, 2019), https://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26542.19.pdf; Wachtell, Lipton, Rosen & Katz, *Caremark* Exposure—And What to Do About It (January 23, 2023), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.28256.23.pdf.
[551] *See* 8 *Del. C.* § 141(e).

available even with respect to matters in which the directors themselves have expertise.[552] Thus, while consultation with experts will not always be necessary or appropriate, it is often an important component of satisfying directors' duty of care and protecting decisions against judicial second-guessing.

D. Exculpation and Indemnification

Delaware permits a company's certificate of incorporation to contain a provision eliminating or limiting the personal liability of a director for monetary damages for breaches of fiduciary duty, except liability for (1) breaches of the duty of loyalty, (2) acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, (3) the unlawful payment of a dividend or unlawful stock purchase or redemption by the company and (4) any transaction from which the director derived an improper personal benefit.[553]

Delaware law also permits a company to indemnify a director (among other persons) for expenses incurred in any action by reason of his or her service as a director, so long as the director acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, so long as the director had no cause to believe his or her conduct was illegal.[554] A company may also advance expenses incurred in such an action and purchase indemnification insurance for its directors. Unlike an exculpation provision, an indemnification provision may be placed in a company's bylaws instead of its certificate of incorporation. Indemnification may also be negotiated in a separate agreement between the company and a director. Importantly, because a breach of the duty of loyalty involves an act of bad faith, such breaches are not eligible for exculpation or indemnification.

In August 2022, Delaware adopted important amendments to Delaware's General Corporation Law that expand the right of a corporation to adopt an "exculpation" provision in its certificate of incorporation to cover not only directors (as has been allowed and widely adopted since 1986, following *Smith* v. *Van Gorkom*) but also corporate officers.[555] Such an exculpation provision is not self-effectuating. Implementation requires an amendment to the corporation's certificate of incorporation which, in turn, requires approval by the corporation's shareholders. According to its policies for 2023, ISS will generally vote for proposals providing for exculpation provisions in a company's charter to the extent permitted under applicable state law.[556] We believe that Delaware corporations should consider proposing amendments to their exculpation provisions to extend the protection to corporate officers and eliminate the unequal and unfair targeting of officers for negligence claims in stockholder litigation (while preserving avenues for officers to be held accountable in appropriate circumstances).[557]

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[552] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 127 n.63 (Del. Ch. 2009).
[553] 8 *Del. C.* § 102(b)(7).
[554] *See* 8 *Del. C.* § 145.
[555] 8 *Del. C.* § 102(b)(7). The amendments became effective August 1, 2022.
[556] ISS, *2023 U.S. Proxy Voting Guidelines* 20 (December 13, 2022).
[557] *See* Wachtell, Lipton, Rosen & Katz, *Delaware Approves Permitting Exculpation of Officers from Personal Liability in Corporate Charters* (August 3, 2022), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.28153.22.pdf.

ANNEX A

Comparison of NYSE and Nasdaq Corporate Governance Standards

Standard	NYSE	Nasdaq
1. Independence	The NYSE standards require that a listed company's board be composed of a majority of independent directors.[558] The NYSE's standard for determining director independence is discussed in Section VII.C.1.	Nasdaq listing requirements likewise provide that a company's board must be composed of a majority of independent directors.[559] Nasdaq's standard for determining director independence is discussed in Section VII.C.1. If a company fails to comply with this requirement due to one vacancy or because one director ceases to be independent because of circumstances beyond the director's reasonable control, the company has until the earlier of its next annual shareholder meeting or one year from the occurrence of the event causing noncompliance. However, if the next annual shareholder meeting is no later than 180 days following the event that caused noncompliance, the company instead has 180 days from such event to regain compliance.[560] There is no analogous cure period provision in the NYSE corporate governance guidelines.
2. Committees	NYSE-listed companies are required to have a nominating and corporate governance committee, a compensation committee and an audit committee, each of which must be composed entirely of independent directors.[561] Each of these committees must have a charter entrusting the committee with certain responsibilities and providing for an annual evaluation of the committee.[562] Additionally, members of the compensation	Nasdaq-listed companies are also required to have an audit committee and a compensation committee composed entirely of independent directors.[565] Both of these committees must have a written charter vesting the committees with certain responsibilities.[566] For a more detailed discussion of these requirements, *see* Section XI.B. Nasdaq does not require listed companies to have a nominating and corporate governance

[558] NYSE Listed Company Manual, Rule 303A.01.
[559] Nasdaq Listing Rule 5605(b)(1).
[560] Nasdaq Listing Rule 5605(b)(1)(A).
[561] NYSE Listed Company Manual, Rules 303A.04, 303A.05 and 303A.06.
[562] NYSE Listed Company Manual, Rules 303A.04, 303A.05, 303A.06 and 303A.07.
[565] Nasdaq Listing Rules 5605(c)(2)(A) and 5605(d)(2)(A).
[566] Nasdaq Listing Rules 5605(c)(1) and 5605(d).

Standard	NYSE	Nasdaq
	committee[563] and members of the audit committee[564] must satisfy more stringent independence criteria than other directors.	committee. However, if a Nasdaq-listed company does not have a nominating and corporate governance committee comprised solely of independent directors, director nominees must be selected or recommended to the board by independent directors constituting a majority of the board's independent directors in a vote in which only independent directors participate.[567] For listed companies with a nominations committee of at least three directors, Nasdaq permits one non-independent director to be a committee member in exceptional and limited circumstances.[568] Non-independent directors serving under this exception may serve no longer than two years.[569] Additionally, each Nasdaq-listed company must certify that it has adopted a formal written charter or board resolution addressing the nominations process and such related matters as may be required under federal securities laws.[570] The SEC requires that all members of the audit committee be independent.[571] Under SEC rules, an audit committee member may be considered independent only if he or she has not (i) accepted any consulting, advisory or other compensatory fee from the issuer or any of its subsidiaries or (ii) been an affiliate of the issuer or any of its subsidiaries.[572] The SEC

[563] NYSE-listed companies must affirmatively determine that compensation committee members do not have any relationship to the listed company that is material to the director's ability to be independent from management in connection with the duties of compensation committee members by specifically considering (i) the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the listed company to such director (excluding standard compensation for board service) and (ii) whether the director is affiliated with the listed company, its subsidiaries, or any affiliates of the listed company. NYSE Listed Company Manual, Rule 303A.02(a)(ii). However, while the NYSE requires companies to broadly analyze any and all potentially relevant circumstances when determining independence, it does not consider ownership of a significant amount of company stock, by itself, as a bar to independence. Commentary to NYSE Listed Company Manual, Rule 303A.02(a)(ii).

[564] In addition to the generally applicable independence requirements for NYSE directors, audit committee members must, in the absence of an applicable exception, satisfy the independence requirements of Exchange Act Rule 10A-3. NYSE Listed Company Manual, Rule 303A.07(a).

[567] Nasdaq Listing Rule 5605(e)(1).

[568] Nasdaq Listing Rule 5605(e)(3).

[569] *Id*.

[570] Nasdaq Listing Rule 5605(e)(2).

[571] 17 C.F.R. § 240.10A-3(b)(1)(i).

[572] 17 C.F.R. § 240.10A-3(b)(1)(ii)

Standard	NYSE	Nasdaq
		also provides that national stock exchanges, which must ensure that listed companies have independent compensation committee members, must consider the same factors in assessing the independence of compensation committee members as the SEC uses to assess audit committee member independence.[573]
3. Corporate Governance Guidelines and Code of Conduct	As discussed in Section XV.B.1, NYSE-listed companies are required to adopt, post to their website and disclose in SEC filings corporate governance guidelines that address director qualification standards, director responsibilities, director access to management (and, as necessary and appropriate, independent advisors), director compensation, director orientation and continuing education, management succession and annual performance evaluations of the board.[574]	In contrast to the NYSE listing standards, Nasdaq listing standards do not address corporate governance guidelines.
	NYSE-listed companies are also required to adopt, post to their website and disclose in SEC filings a code of business conduct and ethics for directors, officers and employees. While companies may determine their own policies, NYSE-listed companies must have a code of conduct that addresses at a minimum conflicts of interest, corporate opportunities, confidentiality, fair dealing, the protection and proper use of the company's assets, compliance with laws, rules and regulations (including insider trading laws) and encouraging the reporting of any illegal or unethical behavior. A code of conduct must require that any waiver of the code for executive officers or directors be made only by the board or a board committee, and listed companies must promptly disclose any waivers of the code for directors or executive officers. To the	Nasdaq-listed companies are also required to adopt and make public a code of conduct applicable to all directors, officers and employees.[576] The code of conduct must include standards that promote: (i) honest and ethical conduct (including the ethical handling of conflicts of interest); (ii) full, fair, accurate, timely and understandable disclosure; (iii) compliance with applicable governmental laws, rules and regulations; (iv) prompt internal reporting of violations of the code; and (v) accountability for adherence to the code.[577] The code of conduct must also include an enforcement mechanism. Any waivers of the code for directors or executive officers must be approved by the board and disclosed to the public within four business days by filing a current report on Form 8-K with the SEC or, in cases where a Form 8-K is not required,

[573] 17 C.F.R. § 240.10C-1(a)-(b).
[574] NYSE Listed Company Manual, Rule 303A.09
[576] Nasdaq Listing Rule 5610.
[577] The requirements for a Nasdaq-listed company's Code of Ethics are derived from Section 406(c) of the Sarbanes-Oxley Act of 2002 and Item 406 of Regulation S-K promulgated thereunder. *Id.*; 17 C.F.R. § 229.406.

Standard	NYSE	Nasdaq
	extent that any such waiver is granted, the waiver must be disclosed to shareholders within four (4) business days via press release, website disclosure, or through a current report on Form 8-K filed with the SEC. Each code of business conduct must also contain compliance standards and procedures that will facilitate the effective operation of the code. Listed companies must disclose in their annual proxy statements or, if the company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC that its code of business conduct and ethics is available on or through its website and provide the website address.[575]	by distributing a press release. Alternatively, the company may disclose waivers on the company website in a manner that satisfies the requirements of Item 5.05(c) of Form 8-K.[578]

[575] NYSE Listed Company Manual, Rule 303A.10.
[578] Nasdaq Listing Rule 5610.

Standard	NYSE	Nasdaq
4. Executive Sessions	The NYSE requires that non-management directors meet at regularly scheduled executive sessions without management.[579] "Non-management" directors include all those who are not executive officers, and include such directors who are not independent by virtue of a material relationship, former status or family membership, or for any other reason. A company may instead choose to hold regular executive sessions of independent directors only. If a company chooses to include all non-management directors in its regular executive sessions, it should hold an executive session including only independent directors at least once a year. An independent director must preside over each executive session of independent directors, although it need not be the same director at each session.[580]	Nasdaq requires that a company hold regularly scheduled executive sessions at which only independent directors are present.[581] This is a more stringent requirement than the NYSE requirement, which allows regularly scheduled executive sessions to include all non-management directors (including non-independent directors). Commentary to this rule instructs that executive sessions should occur at least twice a year, and perhaps more frequently, in conjunction with regularly scheduled board meetings.[582] Unlike the NYSE guidelines, Nasdaq does not address who must lead executive sessions.
5. Shareholder Approval of Certain Matters	Acquisitions: The NYSE requires shareholder approval prior to the issuance of securities in connection with any transaction or series of related transactions if the common stock to be issued is or will be equal to or greater than 20 percent of the voting power or number of shares of common stock outstanding before the issuance (subject to certain exceptions).[583]	Acquisitions: Nasdaq requires shareholder approval prior to the issuance of securities in connection with the acquisition of the stock or assets of another company if the common stock to be issued is or will be equal to or greater than 20 percent of the voting power or number of shares of common stock outstanding before the issuance.[585] Changes in Control: Shareholder approval is required prior to the issuance of securities if such issuance or potential issuance will result in a change of control of the company.[586]

[579] NYSE Listed Company Manual, Rule 303A.03.

[580] Additionally, if one director is chosen to preside at all executive sessions, his or her name must be disclosed either on or through the company's website or in its annual proxy statement, or, if it does not file an annual proxy statement, in its annual report on Form 10-K. If the same director does not preside over every executive session, the company must publicly disclose the procedure by which a presiding director is chosen (for example, if the position rotates among the chairs of its board committees). Disclosure Requirements to NYSE Listed Company Manual, Rule 303A.03.

[581] Nasdaq Listing Rule 5605(b)(2).

[582] Nasdaq Listing Rule IM-5605-2.

[583] NYSE Listed Company Manual, Rule 312.03(c).

[585] Nasdaq Listing Rule 5635(a)(1).

[586] Nasdaq Listing Rule 5635(b).

Standard	NYSE	Nasdaq
	Changes in Control: Shareholder approval is required prior to an issuance that will result in a change of control of the company.[584]	
	Insider Transactions: Shareholder approval is required prior to the issuance of common stock to a director, officer or substantial security holder, or any of their affiliates, if the issuance exceeds one percent of the voting power or shares of common stock of the company.[587] Equity Compensation: Subject to certain exceptions, shareholders must be given the opportunity to vote on the establishment or material amendment of equity-compensation plans.[588]	Insider Transactions: Shareholder approval is required prior to the issuance of securities in connection with the acquisition of the stock or assets of another company if (A) any director, officer or substantial shareholder of the company has a five percent or greater interest (or if such persons have a 10 percent or greater interest, collectively) in the company or assets to be acquired or in the consideration to be paid in the transaction or series of related transactions, and (B) the present or potential issuance of common stock, or securities convertible into or exercisable for common stock could result in an increase in the company's voting power or outstanding common shares of five percent or more.[589] Equity Compensation: Subject to certain exceptions, shareholder approval is required prior to the issuance of securities when a stock option or purchase plan is to be established or materially amended or other equity compensation arrangement made or materially amended, pursuant to which stock may be acquired by officers, directors, employees, or consultants.[590]

[584] NYSE Listed Company Manual, Rule 312.03(d).
[587] NYSE Listed Company Manual, Rule 312.03(b).
[588] NYSE Listed Company Manual, Rule 303A.08.
[589] Nasdaq Listing Rule 5635(a)(2).
[590] Nasdaq Listing Rule 5635(c).

Standard	NYSE	Nasdaq
6. Exemptions	Limited Partnerships, Companies in Bankruptcy and Controlled Companies: Limited partnerships, companies in bankruptcy, and controlled companies (defined as a company in which more than 50 percent of the voting power for director elections is held by an individual, group or another company) are not required to have a majority-independent boards, compensation committee or nominating and corporate governance committee.[591] These companies are, however, subject to the remaining NYSE corporate governance standards under Section 303A of the NYSE Listed Company Manual. Foreign Private Issuers: Foreign private issuers listed on the NYSE are permitted to follow home country practice in lieu of the NYSE corporate governance standards, with the exception of the NYSE governance standards regarding audit committees and certification of compliance.[592] Foreign private issuers must disclose any significant ways in which their corporate governance practices differ from the NYSE listing standards. Commentary to the NYSE guidelines clarify that "what is required is a brief, general summary of the significant differences, not a cumbersome analysis."[593]	Controlled Companies: Controlled companies (defined as a company in which more than 50 percent of the voting power for director elections is held by an individual, group or another company) are not required to have majority-independent boards or compensation committees, or to meet Nasdaq's requirements regarding nominations by independent directors.[594] Controlled companies are, however, subject to the remaining Nasdaq corporate governance standards.[595] Limited Partnerships: Limited partnerships are not generally subject to Nasdaq corporate governance requirements. Limited partnerships must, however, maintain a corporate general partner or co-general partner with the authority to manage the day-to-day affairs of the company, which partner(s) must maintain a sufficient number of independent directors to satisfy Nasdaq's audit committee requirements.[596] Limited partnerships must also be audited by an independent public accounting firm, review related-party transactions and abide by Nasdaq's notification of non-compliance requirements. Limited partnerships are also subject to the shareholder approval requirements with respect to establishing or amending equity compensation arrangements. While Nasdaq does not require limited partnerships to hold annual meetings, if annual meetings are required by statute, regulation or the terms of the partnership's limited partnership agreement, Nasdaq imposes requirements regarding quorums and solicitation of proxies.[597] Foreign Private Issuers: Foreign private issuers listed on Nasdaq may follow the practices of their home countries in

[591] NYSE Listed Company Manual, Rule 303A.00.
[592] *Id.*
[594] Nasdaq Listing Rule 5615(c)(2).
[595] *Id*.
[596] Nasdaq Listing Rule 5615(a)(4)(B)-(C).

Standard	NYSE	Nasdaq
		lieu of Nasdaq corporate governance requirements, except that they must comply with Nasdaq requirements concerning audit committees, board diversity, the prohibition on certain alterations to common stock voting rights and notification of noncompliance.[598] A foreign private issuer electing to follow home country practices in lieu of Nasdaq governance requirements must disclose in its annual SEC reports each requirement that it does not follow and describe the home country practice it follows in lieu of that requirement. Such issuer must also submit to Nasdaq a written statement from an independent counsel from the company's home country certifying that the company's practices are not prohibited by the home country's laws.[599]
7. Phase-In Exceptions	Companies Listing in Conjunction with an Initial Public Offering: A company listing on the NYSE in conjunction with an initial public offering ("IPO") must have a majority-independent board within one year of its listing date. The company must have at least one independent member of its compensation and nominating and corporate governance committees by the earlier of the date its IPO closes or five business days from its listing date (typically, the date on which "when-issued" trading begins), a majority of independent members of these committees within 90 days of its listing date, and fully independent committees within one year of listing. The company must have at least one independent member of its audit committee by its listing date, a majority of independent members within 90 days of the effective date of	Companies Ceasing to Qualify as Controlled Companies and Companies Listing in Conjunction with an IPO or upon Emergence from Bankruptcy: A company that ceases to qualify as a controlled company, a company emerging from bankruptcy, or a company listing on Nasdaq in conjunction with an IPO must have a majority-independent board within one year of its listing date.[601] For each committee, the company must have one independent director as of its listing date, a majority of independent committee members within 90 days of listing and solely independent committee members within one year of listing.[602] Companies Transferring from Other Markets: Companies transferring to Nasdaq from other markets with a substantially similar requirement are afforded the balance of any grace

[596] Nasdaq Listing Rule 5615(a)(4)(B)-(C).
[597] Nasdaq Listing Rule 5615(a)(4)(D)-(J).
[598] Nasdaq Listing Rule 5615(a)(3).
[599] *Id.*; Nasdaq Listing Rule IM-5615-3.
[601] Nasdaq Listing Rules 5615(b)(1)-(2) and 5615(c)(3).
[602] *Id.* Companies may choose not to adopt a nomination committee and may instead rely upon a majority of the Independent Directors to discharge responsibilities under Rule 5605(b).

Standard	NYSE	Nasdaq
	its registration statement and a fully independent audit committee within one year of the effective date of its registration statement.[600]	period afforded by the other market. Companies transferring to Nasdaq from other listed markets that do not have a substantially similar requirement are afforded one year from the date of listing on Nasdaq.[603]
	Companies Listing in Conjunction with a Carve-Out or Spin-Off Transaction: A company listing on the NYSE in conjunction with a carve-out or spin-off transaction must have at least one independent member on its audit committee by the listing date, a majority independent audit committee within 90 days of the effective date of its registration statement and a fully independent audit committee within one year of the effective date of its registration statement. Further, the audit committee must have at least two members within 90 days of the listing date and at least three members within one year of the listing date. Additionally, carved-out and spun-off companies must have at least one independent member on each of its compensation and nominating and corporate governance committees by the date the transaction closes, a majority of independent members on each committee within 90 days thereafter and fully independent committees within one year.[604] The company must have a majority independent board within one year of its listing date. Companies Listing upon Emergence from Bankruptcy: A company listing on the NYSE upon emergence from bankruptcy must have a majority independent board within one year of the listing date. The company also must have at least one independent member on both its compensation and nominating and corporate governance committees by its listing date, a majority of independent members within 90 days after such date and fully independent committees within one year.	

[600] NYSE Listed Company Manual, Rule 303A.00.
[603] Nasdaq Listing Rule 5615(b)(3).
[604] NYSE Listed Company Manual, Rule 303A.00.

Standard	NYSE	Nasdaq
	The company must comply with the NYSE requirements regarding audit committees, including, if applicable, the independence requirements, as of its listing date, unless an exemption is available.[605]	
	Companies Ceasing to Qualify as a Controlled Company: An NYSE company that ceases to qualify as a controlled company must have a majority-independent board and fully independent compensation and nominating and corporate governance committees within one year from its status change.[606] The company must also have at least one independent member on each of its compensation and nominating and corporate governance committees as of the date of its status change, and a majority of independent committee members within 90 days. Companies Ceasing to Qualify as a Foreign Private Issuer: An NYSE company that ceases to qualify as a foreign private issuer must have a majority independent board and fully independent audit, compensation and nominating and corporate governance committees within six months of the date it ceases to so qualify.[607] Additionally, such companies must comply with the shareholder approval of equity compensation plans requirement by the later of six months after losing foreign private issuer status or its first annual meeting after losing foreign private issuer status, but, in any event, within one year after loss of status.[608] Companies Transferring from Another National Securities Exchange: With regards to particular requirements of the NYSE's Corporate Governance Standards, companies transferring to the NYSE from another national securities exchange that has a substantially similar governance	

[605] *Id.*
[606] *Id.*
[607] *Id.*
[608] NYSE Listed Company Manual, Rule 303A.08.

Standard	NYSE	Nasdaq
	requirement are afforded the balance of any transition period afforded by the other exchange. Companies transferring to the NYSE from other national securities exchanges that do not have a substantially similar requirement are afforded one year from the date of listing on the NYSE.[609]	
8. Noncompliance	The CEO of a NYSE-listed company must certify to the NYSE each year that he or she is not aware of any violation by the company of the NYSE corporate governance standards, qualifying the certification to the extent necessary.[610] The CEO must promptly notify the NYSE in writing after any executive officer of the company becomes aware of any noncompliance with the NYSE corporate governance standards.	A company must provide Nasdaq with prompt notification after an executive officer of the company becomes aware of any noncompliance with Nasdaq's corporate governance rules.[611]

[609] NYSE Listed Company Manual, Rule 303A.00.
[610] NYSE Listed Company Manual, Rule 303A.12(a).
[611] Nasdaq Listing Rule 5625.

ANNEX B

Example of

Director Resignation Policy

This Director Resignation Policy ("Policy") of [COMPANY] (the "Company") applies to annual elections of directors in which the number of director nominees equals or is less than the number of board seats being filled, hereinafter referred to as uncontested elections of directors. All other elections of directors shall be governed by the Company's Certificate of Incorporation and Bylaws without giving effect to this Policy.

In an uncontested election of directors, any incumbent nominee who receives a greater number of votes "withheld" from his or her election than votes "for" his or her election will, [promptly] [within [five] days] following the certification of the stockholder vote, tender his or her resignation in writing to the Chairman of the Board for consideration by the Nominating and Governance Committee (the "Committee").

The Committee will consider any such tendered resignation and, within [90] days following the date of the stockholders' meeting at which the election occurred, will make a recommendation to the Board of Directors concerning the acceptance or rejection of such resignation. In determining its recommendation to the Board of Directors, the Committee will consider all factors deemed relevant by the members of the Committee including, without limitation, the reasons why stockholders who cast "withhold" votes for such director did so, if known, the qualifications of the director (including, for example, the impact the director's resignation would have on the Company's compliance with the requirements of the Securities and Exchange Commission and the [NASDAQ] [NYSE]), and whether the director's resignation from the Board of Directors would be in the best interests of the Company and its stockholders.

The Committee may also consider a range of possible alternatives concerning the director's tendered resignation as the members of the Committee deem appropriate, which may include, without limitation, acceptance of the resignation, rejection of the resignation or rejection of the resignation coupled with a commitment to seek to address and cure the underlying reasons reasonably believed by the Committee to have substantially resulted in the "withhold" votes.

The Board of Directors will take formal action on the Committee's recommendation within a reasonable period of time following the date of

the stockholders' meeting at which the election occurred. In considering the Committee's recommendation, the Board of Directors will consider the information, factors and alternatives considered by the Committee and such additional information, factors and alternatives as the Board of Directors deems relevant.

The Company, within four business days after such decision is made, will publicly disclose, in a Form 8-K filed with the Securities and Exchange Commission, the Board of Director's decision to accept or reject the resignation, together with [a full explanation of the process by which the decision was made and], if applicable, the reasons for rejecting the tendered resignation.

No director who, in accordance with this policy, is required to tender his or her resignation, shall participate in the Committee's deliberations or recommendation, or in the Board of Director's deliberations or determination, with respect to accepting or rejecting his/her resignation as a director. Any such director shall, however, otherwise continue to serve as a director during this period.

This Policy is effective commencing with the Company's [next] annual stockholders' meeting.

ANNEX C

Section [●] Advance Notice of Stockholder Business and Nominations.

(A) Annual Meeting of Stockholders. Without qualification or limitation, for any nominations or any other business to be properly brought before an annual meeting by a stockholder pursuant to Section [●] [*reference annual meeting bylaw*] of these By-laws, the stockholder must have given timely notice thereof in writing to the Secretary in proper form, and in accordance with this Section [●] or Section [●] [*reference proxy access bylaw, if applicable*], as applicable.

To be timely, a stockholder's notice shall be delivered to the Secretary at the principal executive offices of the Corporation not earlier than the Close of Business on the one hundred and twentieth (120th) day and not later than the Close of Business on the ninetieth (90th) day prior to the first anniversary of the preceding year's annual meeting;[*if the corporation is a newly public company*: (which first anniversary date shall, for the purposes of the Corporation's first annual meeting held after the shares of the Corporation are first publicly traded (the "First Annual Meeting"), be deemed to be [●] [*typically either the IPO date or de-SPAC date*]);] provided, however, that in the event that no annual meeting was held in the previous year [*if the corporation is a newly public company*: (other than in connection with the First Annual Meeting)] or the date of the annual meeting is more than thirty (30) days before or more than sixty (60) days after such anniversary date, notice by the stockholder must be so delivered not earlier than the Close of Business on the one hundred and twentieth (120th) day prior to the date of such annual meeting and not later than the Close of Business on the later of the ninetieth (90th) day prior to the date of such annual meeting or, if the first Public Announcement of the date of such annual meeting is less than one hundred (100) days prior to the date of such annual meeting, the tenth (10th) day following the day on which Public Announcement of the date of such meeting is first made by the Corporation. In no event shall any adjournment, recess, rescheduling or postponement of an annual meeting, or the Public Announcement thereof, commence a new time period for the giving of a stockholder's notice as described above. For the avoidance of doubt, a stockholder shall not be entitled to make additional or substitute nominations following the expiration of the time periods set forth in these By-laws.

Notwithstanding anything in the immediately preceding paragraph to the contrary, in the event that the number of directors to be elected to the Board of Directors is increased by the Board of Directors, and there is no Public Announcement by the Corporation naming all of the

nominees for director or specifying the size of the increased Board of Directors at least ten (10) days prior to the deadline for nominations that would otherwise be applicable under this subsection (A), a stockholder's notice required by this subsection (A) shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the Close of Business on the tenth (10th) day following the day on which such Public Announcement is first made by the Corporation.

(B) Special Meetings of Stockholders. [*If stockholders are permitted to call special meetings*: Without qualification or limitation, for any business to be properly requested to be brought before a special meeting by a stockholder pursuant to Section [●] [*reference stockholder special meetings bylaw, if applicable*] of these By-laws, the stockholder must have given timely notice thereof in writing to the Secretary in proper form and in accordance with this Section [●], and such business must otherwise be a proper matter for stockholder action.]

In the event a special meeting of stockholders is called pursuant to Section [●] [*reference stockholder special meetings bylaw, if applicable*], a purpose of which is the election of one or more directors to the Board of Directors, any stockholder may nominate an individual or individuals (as the case may be) for election to such position(s) as specified in the Corporation's notice of meeting; provided that the stockholder gives timely notice thereof. To be timely, a stockholder's notice shall be delivered to the Secretary at the principal executive offices of the Corporation not earlier than the Close of Business on the one hundred and twentieth (120th) day prior to the date of such special meeting and not later than the Close of Business on the later of the ninetieth (90th) day prior to the date of such special meeting or, if the first Public Announcement of the date of such special meeting is less than one hundred (100) days prior to the date of such special meeting, the tenth (10th) day following the day on which Public Announcement is first made of the date of the special meeting and [*if stockholders are permitted to call special meetings*: [●] [*reference stockholder special meeting bylaw, if applicable*], if applicable,] of the nominees proposed by the Board of Directors to be elected at such meeting. In no event shall any adjournment, recess, rescheduling or postponement of a special meeting of stockholders, or the Public Announcement thereof, commence a new time period for the giving of a stockholder's notice as described above. For the avoidance of doubt, a stockholder shall not be entitled to make additional or substitute nominations following the expiration of the time periods set forth in these By-laws.

Notwithstanding anything in the immediately preceding paragraph to the contrary, in the event that the number of directors to be

elected to the Board of Directors is increased by the Board of Directors, and there is no Public Announcement by the Corporation naming all of the nominees for director or specifying the size of the increased Board of Directors at least ten (10) days prior to the deadline for nominations that would otherwise be applicable under this Section [●], a stockholder's notice required by this subsection (B) shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the Close of Business on the tenth (10th) day following the day on which such Public Announcement is first made by the Corporation.

(C) Disclosure Requirements.

(1) To be in proper form, a stockholder's notice pursuant to [*if stockholders are permitted to call a special meeting*: Section [●] [*reference stockholder special meeting bylaw, if applicable*],] Section [●] [*reference special meeting bylaw*] or this Section [●] must include the following, as applicable:

(a) As to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination is made or business is brought, as applicable, a stockholder's notice must set forth: (i) the name and address of such stockholder, as they appear on the Corporation's books, of such beneficial owner, if any, and any persons that are acting in concert therewith; (ii) a representation that the stockholder giving the notice is a holder of record of Voting Stock entitled to vote at such meeting, will continue to be a stockholder of record of Voting Stock entitled to vote at such meeting through the date of such meeting and intends to appear in person or by proxy at the meeting to make such nomination or to propose such business; (iii) (A) the class or series and number of shares of the Corporation which are, directly or indirectly, owned of record and owned beneficially by such stockholder, such beneficial owner and their respective affiliates or associates, or others acting in concert therewith, (B) any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege or a settlement payment or mechanism at a price related to any security of the Corporation or with a value derived, in whole or in part, from the value of any security of the Corporation, or any derivative or synthetic arrangement having the characteristics of a long position in any security of the Corporation, or any contract, derivative, swap or other transaction or series of transactions designed to produce economic benefits and risks that correspond substantially to the ownership of any security of the Corporation, including due to the fact that the value of such contract, derivative, swap or other transaction or series of transactions is determined by reference to the price, value or volatility of any security of the Corporation, whether or not such instrument, contract or right shall be

subject to settlement in the underlying securities of the Corporation, through the delivery of cash or other property, or otherwise, and without regard to whether the stockholder of record, the beneficial owner, if any, or any of their respective affiliates or associates, or others acting in concert therewith, may have entered into transactions that hedge or mitigate the economic effect of such instrument, contract or right, or any other direct or indirect opportunity to profit or share in any profit derived from any increase or decrease in the value of securities of the Corporation (any of the foregoing, a "Derivative Instrument") directly or indirectly owned beneficially by such stockholder, the beneficial owner, if any, or any of their respective affiliates or associates, or others acting in concert therewith, (C) any proxy, contract, arrangement, understanding, or relationship pursuant to which such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith has or pursuant to any proxy, contract, understanding or relationship may acquire any right to vote any security of the Corporation, (D) any agreement, arrangement, understanding, relationship or otherwise, including any repurchase or similar so-called "stock borrowing" agreement or arrangement, involving such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, directly or indirectly, the intent, purpose or effect of which may be to mitigate loss to, transfer to or from any such person, in whole or in part, any of the economic consequences of ownership, or reduce the economic risk (of ownership or otherwise) of any security of the Corporation by, manage the risk of share price changes for, or increase or decrease the voting power of, such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, with respect to any security of the Corporation, or which provides, directly or indirectly, the opportunity to profit or share in any profit derived from any decrease in the price or value of any securities of the Corporation (any of the foregoing, a "Short Interest"); (E) any rights to dividends on the shares of the Corporation owned beneficially by such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, that are separated or separable from the underlying shares of the Corporation; (F) any proportionate interest in securities of the Corporation or Derivative Instruments held, directly or indirectly, by a general or limited partnership or similar entity in which such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, is a general partner or, directly or indirectly, beneficially owns an interest in a general partner or is the manager or managing member or, directly or indirectly, beneficially owns any interest in the manager or managing member of such general or limited partnership or similar entity; (G) any performance-related fees (other than an asset-based fee) that such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, is entitled to based on any

increase or decrease in the value of securities of the Corporation or Derivative Instruments or Short Interests, if any; (H) any direct or indirect interest, including significant equity interests or any Derivative Instruments or Short Interests in any principal competitor of the Corporation held by such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith; and (I) any direct or indirect interest of such stockholder, such beneficial owner and their respective affiliates or associates, or others acting in concert therewith, in any contract with, or any litigation involving, the Corporation, any affiliate of the Corporation or any principal competitor of the Corporation (including, in any such case, any employment agreement, collective bargaining agreement or consulting agreement); (iv) if any such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, intends to engage in a solicitation with respect to a nomination or other business pursuant to this Section [●] or Section [●] [*refer to proxy access bylaw, if applicable*], a statement disclosing the name of each participant in such solicitation (as defined in Item 4 of Schedule 14A under the Exchange Act) and if involving a nomination a representation that such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert, therewith intends to deliver a proxy statement and form of proxy to holders of at least sixty-seven percent (67%) of the Voting Stock; (v) a certification that each such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, has complied with all applicable federal, state and other legal requirements in connection with its acquisition of shares or other securities of the Corporation and such person's acts or omissions as a stockholder of the Corporation; (vi) the names and addresses of other shareholders (including beneficial owners) known by any such stockholder, such beneficial owner or any of their respective affiliates or associates, or others acting in concert therewith, to financially or otherwise materially support (it being understood, for example, that statement of an intent to vote for, or delivery of a revocable proxy to such proponent, does not require disclosure under this section, but solicitation of other stockholders by such supporting stockholder would require disclosure under this section) such nomination(s) or proposal(s), and to the extent known the class and number of all shares of the Corporation's capital stock owned beneficially or of record by, and any other information contemplated by clause (iii) of this Section [●] with respect to, such other stockholder(s) or other beneficial owner(s); (vii) all information that would be required to be set forth in a Schedule 13D filed pursuant to Rule 13d-1(a) or an amendment pursuant to Rule 13d-2(a) if such a statement were required to be filed under the Exchange Act and the rules and regulations promulgated thereunder by such stockholder, such beneficial owner and their respective affiliates or associates, or others acting in concert therewith, if any; and (viii) any other information relating

to such stockholder, such beneficial owner or any of their respective affiliates or associates or others acting in concert therewith, if any, that would be required to be disclosed in a proxy statement and form or proxy or other filings required to be made in connection with solicitations of proxies for, as applicable, the business proposal and/or for the election of directors in a contested election pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder;

(b) If the notice includes any business other than a nomination of a director or directors that the stockholder proposes to bring before the meeting, a stockholder's notice must, in addition to the matters set forth in paragraph (a) above, also set forth: (i) a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest of such stockholder, such beneficial owner and each of their respective affiliates or associates or others acting in concert therewith, if any, in such business; (ii) the text of the business proposal (including the text of any resolutions proposed for consideration and, in the event that such proposal includes a proposal to amend the By-laws of the Corporation, the text of the proposed amendment); and (iii) a description of all agreements, arrangements and understandings between such stockholder, such beneficial owner and each of their respective affiliates or associates or others acting in concert therewith, if any, on the one hand, and any other person or persons (including their names), on the other hand, in connection with the business proposal by such stockholder;

(c) As to each individual, if any, whom the stockholder proposes to nominate for election or reelection to the Board of Directors, a stockholder's notice must, in addition to the matters set forth in paragraph (a) above, also set forth: (i) the name, age, business and residence address of such person; (ii) the principal occupation or employment of such person (present and for the past five (5) years); (iii) the completed and signed questionnaire, representation, agreement [and majority voting-related conditional resignation] required by Section [●] [*reference director qualification bylaw*] of these By-laws; (iv) all information relating to such individual that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors in a contested election pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder (including such individual's written consent to being named in a proxy statement as a nominee) and a written statement of intent to serve as a director for the full term if elected; and (v) a description of all direct and indirect compensation and other material monetary agreements, arrangements and understandings during the past three (3) years, and any other material relationships, between or among such stockholder and beneficial owner, if any, and their respective affiliates and associates, or others acting in concert therewith, on the one

hand, and each proposed nominee, and his or her respective affiliates and associates, or others acting in concert therewith, on the other hand, including, without limitation, all biographical and related party transaction and other information that would be required to be disclosed pursuant to Rule 404 promulgated under Regulation SK if the stockholder making the nomination and any beneficial owner on whose behalf the nomination is made, if any, or any affiliate or associate thereof or person acting in concert therewith, were the "registrant" for purposes of such rule and the nominee were a director or executive officer of such registrant;

(d) In addition, to be considered timely, a stockholder's notice shall further be updated and supplemented, if necessary, so that the information provided or required to be provided in such notice shall be true and correct as of the record date for determining the stockholders of record entitled to notice of the meeting (or any adjournment, recess, rescheduling or postponement thereof) and as of the date that is ten (10) days prior to the meeting (or any adjournment, recess, rescheduling or postponement thereof), and such update and supplement shall be delivered to the Secretary at the principal executive offices of the Corporation not later than (a) the later of (i) ten (10) days after the record date for determining the stockholders of record entitled to notice of the meeting (or any adjournment, recess, rescheduling or postponement thereof) or (ii) the first Public Announcement of the date of notice of such record date in the case of the update and supplement required to be made as of the record date, and (b) not later than [eight (8)] days prior to the date for the meeting (or any adjournment, recess, rescheduling or postponement thereof) in the case of the update and supplement required to be made as of ten (10) days prior to the meeting or any adjournment, recess, rescheduling or postponement thereof. The obligation to update and supplement as set forth in this paragraph or any other Section of these By-laws shall not limit the Corporation's rights with respect to any deficiencies in any notice provided by a stockholder, extend any applicable deadlines hereunder [*if stockholders are permitted to call special meetings or if proxy access is permitted*: or under any other provision of these By-laws] or enable or be deemed to permit a stockholder who has previously submitted notice hereunder [or under any other provision of these By-laws] to amend or update any nomination or business proposal or to submit any new nomination or business proposal, including by changing or adding nominees, matters, business and or resolutions proposed to be brought before a meeting of the stockholders. In addition, if the stockholder giving the notice has delivered to the Corporation a notice relating to the nomination of directors, the stockholder giving the notice shall deliver to the Corporation no later than five (5) business days prior to the date of the meeting or, if practicable, any adjournment, recess, rescheduling or postponement thereof (or, if not practicable, on the first practicable date prior to the date to which the meeting has been adjourned, recessed, rescheduled, or postponed)

reasonable evidence that it has complied with the requirements of Rule 14a-19 of the Exchange Act.

(e) The Corporation may also, as a condition to any such nomination or business being deemed properly brought before an annual or special meeting, require any stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or business proposal, as applicable, is made, or any proposed nominee to deliver to the Secretary, within five (5) business days of any such request, such other information as may reasonably be required by the Corporation or its Board of Directors, in its sole discretion, to determine (a) the eligibility of such proposed nominee to serve as a director of the Corporation, (b) whether such nominee qualifies as an "independent director" or "audit committee financial expert" under applicable law, securities exchange rule or regulation, or any publicly disclosed corporate governance guideline or committee charter of the Corporation or (c) such other information that the Board of Directors determines, in its sole discretion, could be material to a reasonable stockholder's understanding of the independence, or lack thereof, of such nominee. Notwithstanding anything to the contrary, only persons who are nominated in accordance with the procedures set forth in these By-laws, including, without limitation, Section [●] [*reference order of business bylaw*], this Section [●], Section [●] [*reference proxy access bylaw, if applicable*] and Section [●] [*reference director qualifications bylaw*] hereof, shall be eligible for election as directors; and

(f) Notwithstanding anything to the contrary in this Section [●], to the extent the stockholder of record giving the notice is acting solely at the direction of the beneficial owner and not also on its own behalf or in concert with a beneficial owner, and is not an affiliate or associate or such beneficial owner, information otherwise required by clauses (iii), (iv), (v) and (vi) of paragraph (a) shall not be required of or with respect to such stockholder of record.

(D) Notwithstanding the provisions of these By-laws, a stockholder giving the notice shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in this By-law; provided, however, that any references in these By-laws to the Exchange Act or the rules promulgated thereunder are not intended to and shall not limit the separate and additional requirements set forth in these By-laws with respect to nominations or proposals as to any other business to be considered.

(E) Only persons who are nominated by stockholders in accordance with the procedures set forth in Section [●] [*reference order of business bylaw*] and this Section [●] or Section [●] [*reference proxy access bylaw, if applicable*] shall be eligible to be elected at an annual or

special meeting of stockholders of the Corporation to serve as directors and only such business shall be conducted at a meeting of stockholders as shall have been brought before the meeting in accordance with the procedures set forth in Section [●] [*reference order of business bylaw*] and this Section [●] or Section [●] [*reference proxy access bylaw, if applicable*], as applicable. The procedures set forth in Section [●] [*reference order of business bylaw*] and this Section [●] or Section [●] [*reference proxy access bylaw, if applicable*] for nomination for the election of directors by stockholders are in addition to, and not in limitation of, any procedures now in effect or hereafter adopted by or at the direction of the Board of Directors or any committee thereof.

(F) Notwithstanding the foregoing provisions of Section [●] [*reference order of business bylaw*] and this Section [●], if the stockholder giving the notice (or a qualified representative thereof) does not appear at the annual or special meeting of stockholders of the Corporation to present a nomination or proposed business, such nomination shall be disregarded and such proposed business shall not be transacted, notwithstanding that proxies in respect of such vote may have been received by the Corporation.

(G) Except as otherwise provided by law, the Board of Directors or the chair of the meeting shall have the power (a) to determine whether a nomination or any business proposed to be brought before the meeting was made or proposed, as the case may be, in accordance with the procedures set forth in Section [●] [*reference order of business bylaw*] and this Section [●] (including whether the stockholder or beneficial owner, if any, on whose behalf the nomination or business proposal is made solicited (or is part of a group which solicited) or did not so solicit, as the case may be, proxies in support of such stockholder's nominee or business proposal in compliance with such stockholder's representation as required by clause (v) of paragraph (a) of this Section) and (b) if any proposed nomination or business was not made or proposed in compliance with Section [●] [*reference order of business bylaw*] and this Section [●], or if any of the information provided to the Company pursuant to Section [●] [*reference order of business* bylaw] or this Section [●] was inaccurate, to declare that such nomination shall be disregarded or that such proposed business shall not be transacted.

(H) Nothing in these By-laws shall be deemed to affect any rights: (a) of stockholders to request inclusion of business proposals in the Corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act; or (b) of the holders of any series of Preferred Stock if and to the extent provided for under law, the Certificate of Incorporation or these By-laws. Subject to Rule 14a-8 under the Exchange Act [*if proxy access is permitted*: and Section [●] [*reference proxy access bylaw, if applicable*] of these By-laws,] nothing in these By-laws shall be construed

to permit any stockholder, or give any stockholder the right, to include or have disseminated or described in the Corporation's proxy statement any nomination of director or directors or any other business proposal.

ANNEX D

Name: _____

[COMPANY]

DIRECTORS' AND OFFICERS' QUESTIONNAIRE

[COMPANY], a [STATE] corporation (the "Company"), is preparing its annual report on Form 10-K ("Form 10-K"), its annual report to stockholders and its proxy statement for its upcoming annual stockholders' meeting. Certain information about the Company's Directors, Executive Officers and key employees is needed to complete the Form 10-K, the annual report and the proxy statement. The purpose of this Questionnaire is to obtain that information so that the Company and its counsel can provide accurate and complete information, and verify the disclosures to be contained, in those documents.

Capitalized terms used in this Questionnaire are defined in the Glossary attached at the end of this Questionnaire.

Please complete, sign, date and return this Questionnaire to [NAME OF CONTACT PERSON AT THE COMPANY AND COMPANY ADDRESS] on or before [DATE]. This Questionnaire may also be returned by facsimile to [FAX NUMBER] or e-mailed to [E-MAIL ADDRESS].

If you have any questions regarding this Questionnaire, please contact [NAME OF CONTACT PERSON] at [TELEPHONE NUMBER], and [s]he will assist you.

[***Note**: Generally the contact person is someone in the legal department, such as the Corporate Secretary or a Deputy or Associate General Counsel. If the Company has asked its outside counsel to assist with the preparation, distribution and collection of the Questionnaires, an additional contact person at the outside law firm could be added.*]

General Instructions

1. Part I of this Questionnaire should be answered by all Executive Officers, Directors and Director nominees. Part II should only be answered by non-executive Directors and Director nominees. Part III should only be answered by those Directors and Director nominees who are members of or nominees for the Audit Committee.

2. If the answer to any question is "No," "None" or "Not Applicable," please indicate that as your response, but do not leave any answers blank.

3. If additional space is required to answer any question, please use the "Additional Information" page at the end of this Questionnaire. Please identify all questions answered there by their respective question numbers.

4. Information requested in this Questionnaire is to be provided as of the date you complete this Questionnaire, unless otherwise indicated. If, after submitting this Questionnaire, any events occur or information comes to your attention that would affect the accuracy of any of your responses herein, please notify [NAME OF CONTACT PERSON] at [TELEPHONE NUMBER] as soon as possible.

PART I – TO BE ANSWERED BY ALL EXECUTIVE OFFICERS, DIRECTORS AND DIRECTOR NOMINEES

1. Background Information. Please provide the following information:

[***Note**: This information is required by Item 7 of Schedule 14A, Item 401 of Regulation S-K.*]

(a) Name:_____

(b) Business address and telephone number:

_____

_____

Residential address and telephone number:

_____

_____

(c) Date of birth:_____

(d) Citizenship:_____

(e) Are you related by blood, marriage or adoption to any Executive Officer, Director or any nominee to become an Executive Officer or Director of the Company?

Yes ❑ No ❑

If yes, please name the Executive Officer, Director or the nominee and state the nature of the relationship:

_____

(f) Were you appointed to serve as an Executive Officer or Director of the Company, or were you nominated for such position, as a result of any arrangement or understanding between you and any other Person (except the Directors or Executive Officers of the Company acting solely in their capacity as such)? [***Note***: *This information is required by Item 7 of Schedule 14A, Items 401(a) and (b) of Regulation S-K.*]

Yes ❑ No ☐

If yes, please explain the arrangement or understanding below and name the other Party(ies) and attach a copy of any written arrangement or understanding to this Questionnaire:

_____

_____

_____

(g) Please review and update, if necessary, your personal information, which is attached as Appendix A. This information includes a description of your business experience, previous employment and charitable and professional affiliations for each of the past [five **OR** [NUMBER]] fiscal years, including:

- Principal occupations and employment;
- The name and principal business of any company or other organization in which these occupations and employment were carried on; and
- Whether such company or organization is a parent, subsidiary or other Affiliate of the Company.

This information should include all positions and offices, if any, that you currently hold with the Company or any of its subsidiaries, the period of time for which you have held each position or office and all positions and offices held with the Company or any of its subsidiaries at any time during the past [five **OR** [NUMBER]] fiscal years.

[***Note***: *Item 401(e) of Regulation S-K requires disclosure of only a five-year business experience biography of each officer, director and director*

nominee. However, a company must also describe the specific qualifications, skills and experiences of each director or director nominee that qualify him or her to serve as a director. Obtaining this additional information is primarily addressed in Question 1(h) below. However, it is possible that many directors and director nominees may be too busy or reluctant to complete this type of question, yet the company would still be obligated to provide this information. In that event, the company's legal department or outside counsel should be prepared to draft this discussion on their behalf, subject to review by the specific director(s) or director nominee(s). Obtaining a longer business experience biography, such as for at least 10 years instead of only five years, from each person can provide a good background for this drafting. It is a good idea to use a 10-year period, but a longer period may be more appropriate for more senior directors or director nominees. Some companies may find that five years is sufficient.]

If you are an Executive Officer and have been employed by the Company or one of its subsidiaries for less than five years, please ensure that this information includes a brief description of the nature of your responsibilities in prior positions.

If you are a Director or nominee for Director, this information should also list all other Directorships (and committee memberships) of public companies or investment companies registered under the Investment Company Act of 1940 that you currently hold or have held at any time during the past five fiscal years.

[***Note**: This information is required by Item 7 of Schedule 14A, Items 401(a), (b) and (e) of Regulation S-K.*]

Is the information in Appendix A complete and correct?

Yes ❑ No ☐

If no, please correct the information in Appendix A.

(h) If you are a Director or nominee for Director, please describe any specific qualifications or skills that you possess and/or any specific experience that you have had that you believe best address your qualifications to serve as a Director of the Company. Please note that this information can extend beyond the past five years and can include any specific past experience that could be useful to the Company, such as previous directorships or employment with other companies in the same industry as the Company or specific areas of expertise, such as accounting, finance, risk assessment skills or experience with compensation. Please

feel free to use the "Additional Information" page at the end of this Questionnaire for additional space to answer this question if necessary.

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[***Note**: This Question 1(h) addresses the requirement in Item 401(e) of Regulation S-K, in which a company must describe the specific qualifications, skills and experiences of each director or director nominee that qualify him or her to serve as a director.*]

(i) Do you, or have you at any time on or after the beginning of the Company's most recent completed fiscal year, served as either a director or an officer of any business other than the Company, including non-public businesses, that had (a) total liabilities and stockholders' equity (*i.e.*, net worth as shown on its balance sheet) in excess of $45,257,000 as of the end of that business's most recent completed fiscal year and (b) revenues of $4,525,700 or more attributable to business operations that could be viewed as competing with the Company because of the nature of the other business's business operations and the geographical markets in which the other business operates?

If yes, please provide the name of the business.

(j) Do you or any person with whom you are affiliated, or any officer or director of any entity with which you are affiliated, serve as an officer or director for any company that directly or indirectly competes with any company for which you serve as an officer or director. Without limiting the scope of this question and in order to avoid uncertainty, this question includes situations in which you have a relationship with or act as a representative of an entity, and another person that also has a relationship with or acts as a representative of the same entity or person serves as an officer or director of another company. For purposes of this question, "compete" includes situations in which products or services (1) may be considered by customers or by the relevant industry to be interchangeable or similar in terms of the market for such products or

services, (2) share similar production techniques or methods and are sold in similar geographic markets or to similar customers or (3) could be subject to potential action under U.S. antitrust laws.

If yes, please identify any affiliation, capacity and/or relationship below.

(k) During the past 10 years:

[***Note***: *This information is required by Item 7 of Schedule 14A, Item 401(f) of Regulation S-K.*]

(To determine the 10-year period for Questions 1(i) and 1(j), the date of a reportable event is considered to be the date on which the final order, judgment or decree was entered, or the date on which any rights of appeal from preliminary orders, judgments or decrees have lapsed. For bankruptcy petitions, this date is the date of filing for uncontested petitions or the date on which approval of a contested petition became final.)

(i) Has a petition under the federal bankruptcy laws or any state insolvency law been filed by or against you, or has a receiver, fiscal agent or similar officer been appointed by a court for the business or property of (A) you, (B) any partnership in which you were a general partner at, or within two years before, the time of such filing or (C) any company or business association of which you were an Executive Officer at, or within two years before, the time of such filing?

Yes ❑ No □

(ii) Have you been convicted of fraud in a civil or criminal proceeding (that was not overturned or expunged)?

Yes □ No □

(j) During the past 10 years:

[***Note***: *This information is required by Item 7 of Schedule 14A, Item 401(f) of Regulation S-K.*]

(i) Have you been convicted in a criminal proceeding or named the subject of a pending criminal proceeding, excluding traffic violations and other minor offenses?

Yes □ No □

(ii) Have you been the subject of any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court, permanently or temporarily enjoining or limiting you from any of the following:

(A) acting as futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator, floor broker, leverage transaction merchant, any other Person regulated by the Commodity Futures Trading Commission, or an associated Person of any of the foregoing, or as an investment advisor, underwriter, broker or dealer in securities, or as an affiliated Person, Director or employee of any investment company, bank, savings and loan association or insurance company, or engaging in or continuing any conduct or practice in connection with such activity;

(B) engaging in any type of business practice; or

(C) engaging in any activity in connection with the purchase or sale of any security or commodity or in connection with any violation of federal or state securities laws or federal commodities laws?

Yes ❑ No ☐

(iii) Have you been the subject of any order, judgment or decree, not subsequently reversed, suspended or vacated, of any federal or state authority barring, suspending or otherwise limiting for more than 60 days your right to engage in any activity described in subsection (ii)(A) above or to be associated with Persons engaged in any such activity?

Yes ☐ No ☐

(iv) Have you been found by a court of competent jurisdiction in a civil action or by the Securities and Exchange Commission (the "SEC") to have violated any federal or state securities law, and the judgment in such civil action or finding by the SEC has not been subsequently reversed, suspended or vacated?

Yes ☐ No ☐

(v) Have you been found by a court in a civil action or by the Commodity Futures Trading Commission to have violated any federal commodities law, and the judgment in such civil action or

finding by the Commodity Futures Trading Commission has not been subsequently reversed, suspended or vacated?

Yes ❑ No ☐

(vi) Have you been the subject of any order, judgment, decree or finding, not subsequently reversed, suspended or vacated, of any federal or state court or administrative agency relating to an alleged violation of any of the following:

(A) any federal or state securities or commodities law or regulation;

(B) any law or regulation relating to financial institutions or insurance companies (including any temporary or permanent injunctions, orders of disgorgement or restitution, civil money penalties, temporary or permanent cease-and-desist orders or removal or prohibition orders); or

(C) any law or regulation prohibiting mail or wire fraud or fraud relating to any business entity?

Yes ☐ No ☐

(vii) Have you been the subject of any sanction or order, not subsequently reversed, suspended or vacated, of any national securities exchange, registered securities association, registered clearing agency, registered commodities or derivatives exchange, registered derivatives transaction execution facility or registered derivatives clearing organization or any similar exchange, association, entity or organization with disciplinary authority over its members?

Yes ☐ No ☐

If you answered yes to any of the foregoing questions in (i) and (j), please describe each such event on the "Additional Information" page at the end of this Questionnaire.

(l) Relationships with Government Officials.

(i) Do you currently hold a position as a Government Official or have you been a Government Official within the past three years?

Yes ☐ No ☐

(ii) Do you have a familial relationship with a Government Official?

Yes ❑ No ☐

If you answered yes to either (k)(i) or (k)(ii), please provide details regarding your position as a Government Official or your familial relationship with a Government Official, as applicable:

_____

_____

_____

_____

_____

_____

(m) Sarbanes-Oxley. [***Note**: This information is required by 15 U.S.C. § 7215(c)(7)(B) (Sarbanes-Oxley Act § 105(c)(7)(B)).*]

Have you ever been: (i) suspended or barred from being associated with an issuer or public accounting firm; or (ii) suspended or barred from appearing or practicing before the SEC?

Yes ☐ No ☐

If you answered yes, please provide details regarding your suspension or disbarment:

_____

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_____

(n) Dodd-Frank. [***Note:*** *This information is required by Rule 506(d)(1) of Regulation D if the Company anticipates relying on it.*]

(i) Have you been convicted within the past ten years of any felony or misdemeanor:

(A) in connection with the purchase or sale of any security;

(B) involving the making of any false filing with the SEC; or

(C) arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities?

Yes ❑ No ❑

(ii) Are you subject to any order, judgment or decree of any court, entered within the past five years, that restrains or enjoins you from engaging or continuing to engage in any conduct or practice:

(A) in connection with the purchase or sale of any security;

(B) involving the making of any false filing with the SEC; or

(C) arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities?

Yes ❑ No ❑

(iii) Are you subject to any final order of any state securities commission or agency, state authority that supervises or examines banks, savings associations or credit unions, state insurance commission or agency, federal banking agency, the CFTC, or the National Credit Union Administration that bars you from:

(A) association with an entity regulated by such commission, authority, agency or officer;

(B) engaging in the business of securities, insurance or banking; or

(C) engaging in savings association or credit union activities?

Yes ❑ No ❑

(iv) Are you subject to any final order, entered within the past ten years, of any state securities commission or agency, state authority that supervises or examines banks, savings associations or credit unions, state insurance commission or agency, federal banking agency, the CFTC, or the National Credit Union Administration that is based on a violation of any law or regulation prohibiting fraudulent, manipulative or deceptive conduct?

Yes ❑ No ❑

(v) Are you subject to any SEC disciplinary order that:

(A) suspends or revokes your registration as a broker, dealer, municipal securities dealer or investment adviser;

(B) limits your activities, functions or operations as a broker, dealer, municipal securities dealer or investment adviser;

(C) bars you from being associated with any entity; or

(D) bars you from participating in any penny stock offering?

Yes ❑ No ❑

(vi) Are you subject to any SEC cease-and-desist order, entered within the past five years, that directs you to cease and desist from committing or causing a violation or future violation of:

(A) any anti-fraud provisions of the federal securities laws; or

(B) any provision of Section 5 of the Securities Act of 1933.

(Anti-fraud provisions of the federal securities laws include Section 17(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, Section 15(c)(1) of the Securities Exchange Act of 1934 and Section 206(a) of the Investment Advisers Act of 1940.)

Yes ❑ No ❑

(vii) Have you been suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade?

Yes ❑ No ❑

(viii) Regulation A

(i) Are you the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued in connection with any registration statement or Regulation A offering statement filed with the SEC, or have; or

(ii) Have you filed (as a registrant or issuer), or were or were named as an underwriter in, any registration statement or Regulation A offering statement filed with the SEC that, within the past five years, was the subject of a refusal order, stop order, or order suspending the Regulation A exemption?

Yes ❑ No ❑

(ix) Are you subject to any US Postal Service false representation order entered within the past five years?

Yes ❑ No ❑

(x) Are you subject to any temporary restraining order or preliminary injunction relating to conduct alleged by the US Postal Service that constitutes a scheme or device for obtaining money or property through the mail by means of false representations?

Yes ❑ No ❑

If you answered yes to any of the foregoing questions, please describe each event below.

_____

_____

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[2. Stock Ownership.

[***Note***: *Use this version of Question 2 if the Company has the information necessary to complete the security ownership table in Appendix B for each director, officer and director nominee. Complete an Appendix B on behalf of each person who is sent a Questionnaire before distributing the Questionnaires.*]

(a) Do you know of any Person(s) or group(s) that Beneficially Own(s) more than five percent of any class of the Company's voting securities (other than [NAMES OF KNOWN five percent OR MORE STOCKHOLDERS])? [***Note***: *This information is required by Item 6(d) of Schedule 14A, Item 403(a) of Regulation S-K.*]

Yes ❑ No ☐

If yes, please provide the names and addresses of the Person(s) or group(s) below:

_____

_____

_____

(b) Please review and update, if necessary, the table in Appendix B, which provides information regarding your security ownership, including the number of shares of each class of equity securities of the Company (or any of its parents or subsidiaries) that you "Beneficially Owned" on [DATE]. [***Note***: *Insert the most recent date possible, which should be after the end of the company's fiscal year.*] Appendix B also describes the nature and terms of any of your rights to acquire Beneficial Ownership, whether you share voting or investment power over any shares you own with any other Person and whether you disclaim Beneficial Ownership of any of the shares. [***Note***: *This information is required by Item 6(d) of Schedule 14A, Item 403(b) of Regulation S-K.*] Is the information in Appendix B accurate and complete?

Yes ❑ No □

If no, please correct the information in Appendix B.

(c) Have you pledged as security any shares of any class of equity securities that you beneficially own as set forth in Appendix B, including any securities held in margin accounts?

Yes □ No □

If yes, please list the number and class of equity securities below:

_____

_____

_____

(d) Have you or any of your Immediate Family Members or anyone else on your behalf, currently or since [DATE AT LEAST 12 MONTHS PRIOR TO QUESTIONNAIRE DISTRIBUTION], purchased or sold any financial instruments (*e.g.*, prepaid variable forward contracts, equity swaps and cash-settled total return swaps, collars or exchange-traded puts or calls) that are designed to hedge or offset any decrease in the market value of Company Securities (i) granted to you by [COMPANY] as part of your compensation as a director or officer of [COMPANY] or (ii) otherwise beneficially owned by you?

Yes □ No □

If yes, please provide details, including the number and type(s) of securities and the date(s) on which the underlying transaction occurred:

_____

_____

_____]

[2. Stock Ownership.

[***Note***: *Use this version of Question 2 if the Company does not have all of the information necessary to complete the security ownership table in Appendix B for each director, officer and director nominee. This version of Question 2 eliminates the use of a completed Appendix B and requires each person completing this Questionnaire to provide the information on his or her own behalf in this Questionnaire.*]

(a) Do you know of any Person(s) or group(s) that Beneficially Own(s) more than five percent of any class of the Company's voting securities (other than [NAMES OF KNOWN five percent OR MORE STOCKHOLDERS])? [***Note**: This information is required by Item 6(d) of Schedule 14A, Item 403(a) of Regulation S-K.*]

Yes ❑ No ☐

If yes, please provide the names and addresses of the Person(s) or group(s) below:

_____

_____

_____

(b) Please complete the information below regarding the equity securities of the Company (or any of its parents or subsidiaries) that you "Beneficially Owned" on [DATE]. [***Note**: Insert the most recent date possible.*] [***Note**: This information is required by Item 6(d) of Schedule 14A, Item 403(b) of Regulation S-K.*]

Please be sure that the table includes all of the following:

(i) Company securities owned solely by you through one or more brokerage accounts (*i.e.*, shares held in street name for your account);

(ii) Company securities owned jointly with your spouse or others;

(iii) Company securities owned by you as trustee of a trust;

(iv) Company securities owned by you as executor or administrator of an estate;

(v) Company securities owned by you as custodian for a minor or as a legal guardian for a minor; and

(vi) Company securities owned directly by others (such as a corporation or foundation) over which you share voting power and/or investment power.

Number of shares of common stock owned (includes vested restricted stock awards)	
Number of vested options owned	
Number of unvested options owned (please include vesting schedule)	
Number of shares of unvested restricted stock (please include vesting schedule)	
Any other equity securities owned (please describe and include any applicable vesting schedule)	
Any equity securities in which ownership, voting power or investment power is shared (please describe and include any applicable vesting schedule)	
Any derivative instruments or hedging arrangements involving or related to common stock	

If you need additional space to complete this table, please include the information on the "Additional Information" page at the end of this Questionnaire.

(c) If you share the voting or investment power over any security, please identify the Persons with whom you share such power and the relationship that gives rise to sharing such power:

_____

_____

(d) Describe the nature and terms of any rights to acquire Beneficial Ownership of any equity securities of the Company identified in Question 2(b):

(e) If you disclaim Beneficial Ownership of any shares listed in Question 2(b), please describe the shares and why you disclaim Beneficial Ownership:

(f) Have you pledged as security any shares of any class of equity securities that you beneficially own as set forth in the table above, including any securities held in margin accounts?

Yes ❑ No ☐

If yes, please list the number and class of equity securities below:

(g) Have you or any of your Immediate Family Members or anyone else on your behalf, currently or since [DATE AT LEAST 12 MONTHS PRIOR TO QUESTIONNAIRE DISTRIBUTION], purchased or sold any financial instruments (*e.g.*, prepaid variable forward contracts, equity swaps and cash-settled total return swaps, collars or exchange-traded puts or calls) that are designed to hedge or offset any decrease in the market value of Company securities (i) granted to you by [COMPANY] as part of your compensation as a director or officer of [COMPANY] or (ii) otherwise beneficially owned by you?

Yes ☐ No ☐

If yes, please describe the financial instrument(s) or other transaction(s), including the number and type(s) of securities and the date(s) on which the underlying transaction(s) occurred.

_____

_____

_____]

[3. Section 16 Reporting Compliance. Attached as Appendix C are copies of the Section 16 filings that the Company made on your behalf during the Company's last fiscal year. Based on a review of these filings and all your transactions in the Company's securities, please answer the following questions:

*[**Note**: Use this version of Question 3 if the Company filed the Section 16 reports on behalf of the directors and officers and if copies of these filings on behalf of each director and officer will be attached to his or her respective Questionnaire. If this is done for each officer and director, make sure that copies of every filing made on behalf of the respective officer or director have been attached and that no filings have been omitted. Attaching the filings will increase the size of this Questionnaire, which may make distribution more difficult or costly.]*

(a) Were any of your Section 16 filings (Forms 3, 4 and/or 5) filed after the date on which they were due to be filed, or did you engage in any transaction in the Company's securities for which you failed to file a required form? For reference, the due dates for Section 16 filings are as follows: A Form 3 must be filed within 10 days after the event by which you became a reporting person; a Form 4 must be filed by the end of the second business day following the reportable transaction; and a Form 5 must be filed within 45 days after the end of the Company's fiscal year.

Yes ❑ No ☐

If yes, please indicate the number of late filings, the number of transactions that were not reported on a timely basis and any known failure to file a required form:

_____

_____

(b) Have you engaged in any transactions in the Company's securities that have not yet been reported in the most recently filed Form 4 or Form 5?

Yes ❑ No □

If yes, please briefly describe the transaction(s):

(c) Is the information contained in Appendix C otherwise accurate and complete?

Yes □ No □

If no, please explain below:

(d) Are you required to file a Form 5 with the SEC for the past fiscal year? (A Form 5 is required to be filed with the SEC within 45 days after the end of the Company's fiscal year that reflects (a) any transaction in the Company's securities that you completed during the past fiscal year that was not required to be reported on Form 4 and that you did not so report; (b) any transaction in the Company's securities that you should have reported during the past fiscal year but did not; and (c) your aggregate ownership of the Company's securities as of the date that you file the Form 5. However, you do not need to file a Form 5 if (i) you have not engaged in any transaction in the Company's securities during the past fiscal year that is required to be reported on Form 5 or (ii) (x) each such transaction was previously reported during the past fiscal year on a Form 4 and (y) you do not have any other holding or transaction which otherwise was required to be reported during the past fiscal year and which was not so reported to the SEC.) By answering "No," you are representing to the Company that no Form 5 filing is required.

[***Note**: Include this clause (d) and the following clause (e) only if the company has not made a Form 5 filing on behalf of the individual director or officer and the Form 5 is not attached to Appendix C.*]

Yes □ No □

(e) If you answered "Yes" to question 3(d) above, have you filed a Form 5 or was one filed on your behalf, or will you be able to file a Form 5 (or have the form filed on your behalf) by [DATE]? [***Note**: Insert the date that is 45 days after the end of the Company's fiscal year.*]

Yes ❑ No □

If no, please explain why below:

_____

_____

_____]

*[**Note**: The Form 5 is due within 45 days after the end of the fiscal year, but, depending on the size of the company, the Form 10-K is due within 60 to 90 days after the end of the fiscal year. If the director or officer answers "Yes" to subparagraph (e) of this version of Question 3, confirm with the director or officer that his or her Form 5 was, in fact, filed on time. If "Yes" was answered, but the Form 5 is not filed on time, this version of Question 3 must be updated.]*

[3. Section 16 Reporting Compliance. Based on a review of all your transactions in the Company's securities and all filings you made with the SEC during the last fiscal year, please answer the following questions:

[***Note**: Use this version of Question 3 if copies of the filings of each director and officer will not be attached to his or her respective Questionnaire.*]

(a) Were any of your Section 16 filings (Forms 3, 4 and/or 5) filed after the date on which they were due to be filed, or did you engage in any transaction in the Company's securities for which you failed to file a required form? For reference, the due dates for Section 16 filings are as follows: A Form 3 must be filed within 10 days after the event by which you became a reporting person; a Form 4 must be filed by the end of the second business day following the reportable transaction; and a Form 5 must be filed within 45 days after the end of the Company's fiscal year.

Yes □ No □

If yes, please indicate the number of late filings, the number of transactions that were not reported on a timely basis and any known failure to file a required form:

_____

_____

(b) Have you engaged in any transactions in the Company's securities that have not yet been reported in the most recently filed Form 4 or Form 5?

Yes ❑ No □

If yes, please briefly describe the transaction(s):

_____

(c) Are you required to file a Form 5 with the SEC for the past fiscal year? (A Form 5 is required to be filed with the SEC within 45 days after the end of the Company's fiscal year that reflects (a) any transaction in the Company's securities that you completed during the past fiscal year that was not required to be reported on Form 4 and that you did not so report; (b) any transaction in the Company's securities that you should have reported during the past fiscal year but did not; and (c) your aggregate ownership of the Company's securities as of the date that you file the Form 5. However, you do not need to file a Form 5 if (i) you have not engaged in any transaction in the Company's securities during the past fiscal year that is required to be reported on Form 5 or (ii) (x) each such transaction was previously reported during the past fiscal year on a Form 4 and (y) you do not have any other holding or transaction which otherwise was required to be reported during the past fiscal year and which was not so reported to the SEC.) By answering "No," you are representing to the Company that no Form 5 filing is required.

Yes □ No □

(d) If you answered "Yes" to 3(c) above, have you filed a Form 5 or was one filed on your behalf, or will you be able to file a Form 5 (or have the form filed on your behalf) by [DATE]? [***Note**: Insert the date that is 45 days after the end of the Company's fiscal year.*]

Yes □ No □

If no, please explain why below:

_____

_____

_____]

*[**Note**: The Form 5 is due within 45 days after the end of the fiscal year, but, depending on the size of the company, the Form 10-K is due within 60 to 90 days after the end of the fiscal year. If the director or officer*

answers "Yes" to subparagraph (d) of this version of Question 3, follow up with the director or officer to confirm that his or her Form 5 was, in fact, filed on time. If "Yes" was answered, but the Form 5 is not filed on time, this version of Question 3 must be updated.]

4. Payments for Personal Benefit. During the last fiscal year, did you or any Immediate Family Member receive, or are you or any Immediate Family Member to receive, directly or indirectly, any perquisite or other benefit which was not (or will not be) directly related to the performance of your job or the satisfaction of your obligations to the Company, from (a) the Company or any of its parents or subsidiaries (examples would be the payment of personal expenses, personal use of the Company's property, such as automobiles, and use of the corporate staff for personal purposes) or (b) third parties as a result of or in connection with your employment by or relationship or association with the Company or any of its parents or subsidiaries? [***Note**: This information is required by Item 8 of Schedule 14A, Item 402 of Regulation S-K.*]

Yes ❑ No □

If yes, please describe the benefit and list its dollar value (or any other value ascribed to it).

_____

_____

Are there any agreements, arrangements or understandings between you and any person or entity (other than the Company) relating to compensation or other payment (including non-cash payment) in connection with your candidacy or service as a director? [***Note**: This question is based on Rule 5250(b)(3) of the NASDAQ Listing Rules.*]

Yes □ No □

If yes, please describe all material terms of the agreement, arrangement or understanding and name the other person(s) that are parties to this agreement, arrangement or understanding.

_____

_____

_____

5. Transactions with Related Persons. Since the beginning of the Company's last fiscal year, have you or any Immediate Family Member

engaged in any transaction in which the Company or any of its subsidiaries was or is to be a participant and which the dollar amount involved exceeds $120,000? Does any proposed transaction exist in which the Company or any of its subsidiaries was or is to be a participant and in which the dollar amount involved exceeds $120,000 and in which you or your Immediate Family Member will have a direct or indirect interest? For the purposes of these questions, a "transaction" includes, but is not limited to, any financial transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships. [***Note**: This information is required by Item 7 of Schedule 14A, Item 404(a) of Regulation S-K.*]

Yes ❑ No □

If yes, please briefly describe the transaction or series of similar transactions, including: (a) the name of such Person and the Person's relationship to the Company and/or the Company's subsidiaries; (b) the nature of such Person's interest in the transaction (including the Person's position or relationship with, or ownership in, a firm, corporation or other entity that is a party to, or has an interest in, the transaction); (c) the approximate dollar value of such transaction; (d) the approximate dollar value of such Person's interest in the transaction; and (e) any other information regarding the transaction or the Person in the context of the transaction that could be considered Material.

In the case of indebtedness, disclosure of the amount involved in the transaction must include (a) the largest aggregate amount of principal outstanding during the period for which disclosure is provided, (b) the amount outstanding as of the most recent date, (c) the amount of principal paid during the period for which disclosure is provided, (d) the amount of interest paid during the period for which disclosure is provided and (e) the interest rate or amount payable on the indebtedness.

_____

_____

_____

6. Financial or Economic Interests in Certain Entities with Relationships with [COMPANY]. Do you or any of your Immediate Family Members or any other person living in your home, have a direct or indirect financial or economic interest in or relationship with another business entity, vendor, sponsor or contractor with which [COMPANY] (or any of its subsidiaries) has done business since [DATE AT LEAST

THREE YEARS PRIOR TO QUESTIONNAIRE DISTRIBUTION] or which is a competitor of [COMPANY] (or any of its subsidiaries)?

Yes ❑ No ☐

If yes, please provide the information requested below.

(i) Name of the person having the interest or relationship and such person's relationship to [COMPANY] or any of its subsidiaries.

_____

_____

(ii) Name and nature of business entity, vendor, sponsor, contractor or competitor.

_____

_____

(iii) Description of the financial or economic interest in the business entity, vendor, sponsor, contractor or competitor.

_____

_____

(iv) Brief description of any transactions or series of similar transactions between [COMPANY] (or any of its subsidiaries) and the other business entity, vendor, sponsor, or contractor, including the dollar amount involved.

_____

_____

7. Five Percent or Greater Ownership in Any Entities. Do you or any of your Immediate Family Members, either alone or in the aggregate, have a direct or indirect ownership interest of five percent or more of the equity of any entity?

Yes ☐ No ☐

If yes, please provide the information requested below.

(i) Name of the person having the interest or relationship and such person's relationship to [COMPANY] or its subsidiaries.

_____

_____

(ii) Name and nature of the business entity.

_____

_____

(iii) Description of the financial or economic interest in the business entity.

_____

_____

8. Change in Control. Do you know of any arrangement, including any pledge of securities of the Company, which resulted in a change in control of the Company in the last fiscal year, or may result in the future in a change in control of the Company? [***Note**: This information is required by Item 6 of Schedule 14A, Item 403(c) of Regulation S-K.*]

Yes ❑ No □

If yes, please briefly describe any such arrangement:

_____

_____

_____

9. Adverse Interest in Legal Proceedings. Do you know of any pending legal proceedings in which either you or any Director, Officer or Affiliate of the Company or any owner of more than five percent of any class of voting securities of the Company, or any Associate of any such Director, Officer, Affiliate or security holder, is a party adverse to the Company or any of its subsidiaries, or has a material interest adverse to the Company or any of its subsidiaries? [***Note**: This information is required by Item 7 of Schedule 14A, Item 103(c)(2) of Regulation S-K.*]

Yes □ No □

If yes, please briefly describe any such proceedings:

_____

_____

10. Compensation Committee or Similar Committee.

(a) During the last fiscal year, have you been a member of the compensation committee or similar committee of a company other than the Company or, in the absence of such a committee, a member of the board of directors of a company other than the Company that was involved in making decisions regarding compensation policy? [***Note**: This information is required by Item 8 of Schedule 14A, Item 407(e)(4) of Regulation S-K.*]

Yes ❑ No □

If yes, please indicate which company(ies) below:

_____

_____

_____

(b) As a director or director nominee of the Company, during the last three fiscal years, were you, or was an Immediate Family Member, an Executive Officer or employee of any partnership, joint venture, corporation, trust, limited liability company, company or business entity, or other organization, whether for profit or not-for-profit, of which any executive of the Company was a director?

Yes □ No □

If yes, please describe such relationship, stating particularly the name of the Company executive who is or was a director, whether such person is or was on the compensation committee (or other committee performing equivalent functions) of such partnership, joint venture, corporation, trust, limited liability company, company or business entity, or other organization, whether for profit or not-for-profit (please note if such partnership, joint venture, corporation, trust, limited liability company, company or business entity, or other organization, whether for profit or not-for-profit did not have a compensation or equivalent committee), or otherwise participates or participated in any deliberation of Executive Officer or other employee compensation:

_____

_____

_____

(c) As a current or former officer of the Company or any of its subsidiaries or other Affiliates, did you also serve, at any time during the last three fiscal years, as a member of the compensation committee (or other committee performing equivalent functions), or as a director, of another partnership, joint venture, corporation, trust, limited liability company, company or business entity, or other organization, whether for profit or not-for-profit, where an Executive Officer or employee of such other partnership, joint venture, corporation, trust, limited liability company, company or business entity, or other organization, whether for profit or not-for-profit, has served or currently serves on the Company's board of directors?

Yes ❑ No □

If the answer to question 10(c) is "Yes," did any other Executive Officers of the Company or any of its subsidiaries or other Affiliates serve at the same time on the compensation committee (or other committee performing equivalent functions) of that partnership, joint venture, corporation, trust, limited liability company, company or business entity, or other organization, whether for profit or not-for-profit?

_____

_____

_____

[***Note**: Item 8 of Schedule 14A (Item 402 of Regulation S-K) requires detailed information on the compensation of executive officers and directors. However, this Questionnaire does not include any questions requesting an itemized response of the elements of executive compensation or director compensation because it is typically easier and more efficient to obtain executive compensation information from the Company's compensation or human resources department and director compensation information from the Company's Corporate Secretary. As a result, some directors and officers may not complete such a question.*]

11. Related Parties - PCAOB AS 2410.

*[**Note**: These inquiries are to assist the company's auditor in fulfilling the requirements of Public Company Accounting Oversight Board's Auditing*

Standard No. 2410. The company should coordinate these inquiries with its auditor, or substitute the auditor's preferred inquiries for PCAOB AS No. 2410 in their place.]

(a) List all entities that you directly or indirectly have control over. For purposes of this question, "control" is the possession, direct or indirect, of the power to direct or cause the direction of management and policies of an entity through ownership, by contract, or otherwise. If you control an entity, which in turn controls another entity, both entities would be considered controlled by you and therefore should be listed below. If you do not control any entities, please confirm this below.

Entities

☐ I do not control any entities.

(b) List all entities that you directly or indirectly, including through other entities, can significantly influence the management or operating policies of to the extent that the entity might be prevented from fully pursuing its own separate interests. All such entities should be listed below. If you do not exert this level of influence over any entities, please confirm this below.

Entities

☐ I have no such influence over any entities.

(c) List any and all family members[612] who might control or influence you, or who might be controlled or influenced by you, because of your family relationship. For each, list any affiliations with entities that they control or can significantly influence to the extent that the entity might be prevented from fully pursuing its own separate interests.

Family Member	Affiliations

(d) List any and all transactions, if not otherwise disclosed elsewhere in this questionnaire, involving the Company and you, any of your family members or any entity or affiliation identified above.

_____

_____

_____

_____

_____

[612] For U.S. GAAP SEC filers, the AS 2410 concept of "related parties" is defined in the Financial Accounting Standards Board's Accounting Standards Codification Topic 850, *Related Party Disclosures*. "Related parties" include immediate family members of principal owners or members of management and "immediate family" is defined as "family members who might control or influence a principal owner or a member of management, or who might be controlled or influenced by a principal owner or a member of management, because of the family relationship." In most cases, we would expect the definition of "immediate family" to include your spouse, children and other family members living in the same household as you. Further, it may include a parent, stepparent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, sister-in-law or other relatives, if, in your judgment, any of these individuals are in a position to have control or influence on you, or to be controlled or influenced by you (for example, a parent for whom you provide significant monetary support).

12. Iran-related Activities. During the last fiscal year:

[***Note***: *The following questions are based on the Iran Threat Reduction and Syria Human Rights Act of 2012. Section 219 of the Act amended Section 13 of the Exchange Act to add subsection (r), which requires an issuer to file Exchange Act periodic reports to provide disclosure in its periodic report if during the reporting period it or any of its affiliates has knowingly engaged in certain specified activities involving contacts with or support for Iran or other identified persons involved in terrorism or the creation of weapons of mass destruction.*]

(a) Have you or any of your Affiliates knowingly engaged in any activities or transactions relating or contributing to Iran's petroleum or petroleum products industries or Iran's ability to acquire or develop weapons of mass destruction, conventional weapons or other military capabilities?

Yes ❑ No ☐

If yes, please describe such activities:

_____

_____

_____

(b) Have you or any of your Affiliates knowingly engaged in: any activities or transactions that finance or facilitate the Iranian government's acquisition or development of weapons of mass destruction or that may support or facilitate terrorism; any transactions with an Iranian financial institution to finance or otherwise support Iran's ability to acquire or develop weapons of destruction or international terrorism; or any activities or transactions with or that finance or otherwise benefit Iran's Islamic Revolutionary Guard Corps?

Yes ☐ No ☐

If yes, please describe such activities:

_____

_____

_____

(c) Have you or any of your Affiliates knowingly engaged in: any transfers of products or technology or provision of services to Iran that are likely to be used by the Iranian government for human rights abuses against the Iranian people; or any transfers of technology that could be used by the Iranian government to restrict the free flow of unbiased information in Iran or disrupt, monitor or otherwise restrict speech of the Iranian people?

Yes ❑ No ☐

If yes, please describe such transfers:

_____

_____

_____

(d) Have you or any of your Affiliates knowingly engaged in or conducted any transactions with the Iranian government or any political subdivision or agency or any entity owned or controlled by the Iranian government without specific authorization from a US federal department or agency or with any persons or entities whose assets are frozen pursuant to executive orders for their involvement with weapons of mass destruction or terrorism?

Yes ☐ No ☐

If yes, please describe such transactions:

_____

_____

_____

PART II – TO BE ANSWERED BY NON-EXECUTIVE DIRECTORS AND DIRECTOR NOMINEES ONLY

[***Note***: *For companies that use the Wachtell, Lipton, Rosen & Katz form model bylaws (or a similar form), the representations and agreement attached as Appendix D should be completed along with this Questionnaire for all nominees for election or reelection as directors.*]

[13. Independence.

[***Note**: Under Item 407(a) of Regulation S-K, a company must identify its independent directors in its proxy statement. This version of Question 13 incorporates the NYSE's independence standards and is applicable only to reporting companies listed on the NYSE. If the company is listed on NASDAQ, delete this version of Question 13 and use the following version. In addition, this Question 13 should be modified to include any additional independence standards adopted by the company.*]

(a) Are you currently, or at any time during the last three years were you, an employee of the Company or of any parent or subsidiary of the Company, or is any Immediate Family Member currently, or at any time during the last three years was an Immediate Family Member, an Executive Officer of the Company or of any parent or subsidiary of the Company? [***Note**: This question is based on Section 303A.02(b)(i) of the NYSE Listed Company Manual.*]

Yes ❑ No □

If yes, please briefly describe:

_____

_____

_____

(b) Did you or any of your Immediate Family Members receive, during any 12-month period within the last three years, more than $120,000 in direct compensation from the Company or from any parent or subsidiary of the Company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), or do you or any of your Immediate Family Members plan to accept such payments in the current fiscal year? [***Note**: This question is based on Section 303A.02(b)(ii) of the NYSE Listed Company Manual.*]

Yes □ No □

If yes, please briefly describe:

_____

_____

_____

(c) Are you, or is any Immediate Family Member, a current partner of [NAME OF THE COMPANY'S AUDITORS]; are you a current employee of [NAME OF AUDITORS]; is any Immediate Family Member a current employee of [NAME OF AUDITORS] who personally works on the audit of the Company; or were you, or was any Immediate Family Member, a partner or employee of [NAME OF AUDITORS] who personally worked on the audit of the Company or any parent or subsidiary of the Company within the last three years (but not currently)? [***Note***: *This question is based on Section 303A.02(b)(iii) of the NYSE Listed Company Manual.*]

Yes ❑ No □

If yes, please indicate the entity and describe your or your Immediate Family Member(s)' role with the entity:

_____

_____

(d) Are you or are any of your Immediate Family Members currently employed, or have you or any of your Immediate Family Members been employed within the last three years, as an executive officer of another entity where any of the Executive Officers of the Company or any parent or subsidiary of the Company at the same time serves or served on that entity's compensation committee? [***Note***: *This question is based on Section 303A.02(b)(iv) of the NYSE Listed Company Manual.*]

Yes □ No □

If yes, please indicate the entity and describe your or your Immediate Family Member(s)' role with the entity:

_____

_____

_____

(e) Are you a current employee, or is an Immediate Family Member a current executive officer, of a company that has made payments to, or received payments from, the Company or any parent or subsidiary of the Company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of $1 million, or two percent of such other company's consolidated gross revenues during any of the last

three fiscal years? [***Note**: This question is based on Section 303A.02(b)(v) of the NYSE Listed Company Manual.*]

Yes ❑ No ☐

If yes, please indicate the organization and describe the payments and your role with the organization:

_____

_____

_____

(f) Are you an executive officer of a charitable or other tax-exempt organization which received contributions from the Company or from any parent or subsidiary of the Company in any of the three preceding years in an amount which exceeds the greater of $1 million, or two percent of the organization's consolidated gross revenues? [***Note**: This question is based on Section 303A.02(b)(v) of the NYSE Listed Company Manual.*]

Yes ☐ No ☐

If yes, please indicate the organization and describe the payments and your role with the organization:

_____

_____

_____

(g) Do you have any other relationship with the Company or any parent or subsidiary of the Company, either directly or as a partner, stockholder or officer of an organization that has a relationship with the Company or any parent or subsidiary of the Company? [***Note**: This question is based on Section 303A.02(a) of the NYSE Listed Company Manual.*]

Yes ☐ No ☐

If yes, please describe the relationship:

_____

_____

_____]

[13. Independence.

[***Note**: Under Item 407(a) of Regulation S-K, a company must identify its independent directors in its proxy statement. This version of Question 13 incorporates NASDAQ's independence standards and is applicable only to reporting companies listed on NASDAQ. If the company is listed on the NYSE, delete this version of Question 13 and use the preceding version. In addition, this Question 13 should be modified to include any additional independence standards adopted by the company.*]

(a) Are you currently, or were you at any time during the past three years, an employee of the Company or of any parent or subsidiary of the Company? [***Note**: This question is based on Rule 5605(a)(2)(A) of the NASDAQ Listing Rules.*]

Yes ❑ No ☐

If yes, please briefly describe:

_____

_____

_____

(b) During any 12 consecutive months within the last three years, did you, or did any of your Family Members, accept any compensation from the Company or from any parent or subsidiary of the Company in excess of $120,000 (other than: (i) compensation for board or board committee service, (ii) compensation paid to a Family Member who is a non-executive employee of the Company or any parent or subsidiary of the Company, or (iii) benefits under a tax-qualified retirement plan or non-discretionary compensation)? For purposes of this Question 13, the term "Family Member" means a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person's home. Additionally, "compensation" refers to both direct and indirect compensation including, among other things, consulting or personal service contracts between the Company and a director or Family Member of the director and political contributions to the campaign of a director or a Family Member of the director.

[***Note**: This question is based on Rule 5605(a)(2)(B) of the NASDAQ Listing Rules. Under NASDAQ Marketplace Rule IM-5605, a director can be deemed to be independent regardless of:*

- *non-preferential payments made in the ordinary course of providing business services (such as payments of interest or proceeds related to banking services or loans by an issuer that is a financial institution or payment of claims on a policy by an issuer that is an insurance company);*

- *payments arising solely from investments in the company's securities; or*

- *loans permitted under Section 13(k) of the Exchange Act,*

as long as the payments are not considered compensation. However, depending on the circumstances, a loan or payment could be compensatory if, for example, it is not on terms generally available to the public.]

Yes ❑ No □

If yes, please briefly describe:

_____

_____

_____

(c) Are any of your Family Members currently serving as an Executive Officer of the Company or any parent or subsidiary of the Company, or were any of your Family Members serving in such capacity at any time during the past three years? [***Note**: This question is based on Rule 5605(a)(2)(C) of the NASDAQ Listing Rules.*]

Yes □ No □

If yes, please briefly describe:

_____

_____

_____

(d) Are you, or are any of your Family Members, a partner in, or a controlling stockholder or an executive officer of, any organization to which the Company made, or from which the Company received, payments for property or services in the current or any of the past three fiscal years that exceeded five percent of the recipient's consolidated gross revenues for that year, or $200,000, whichever is more (other than: (i) payments arising solely from investments in the Company's securities or (ii) payments under non-discretionary charitable contribution matching programs)? [***Note**: This question is based on Rule 5605(a)(2)(D) of the NASDAQ Listing Rules.*]

Yes ❑ No ☐

If yes, please briefly describe:

_____

_____

_____

(e) Are you, or are any of your Family Members, employed as an Executive Officer of another entity where at any time during the past three years any of the Company's executive officers served on the compensation committee of the other entity? [***Note**: This question is based on Rule 5605(a)(2)(E) of the NASDAQ Listing Rules.*]

Yes ☐ No ☐

If yes, please briefly describe:

_____

_____

_____

(f) Are you, or are any of your Family Members, a partner of [NAME OF THE COMPANY'S AUDITORS], or have you or any of your Family Members been a partner or employee of [NAME OF AUDITORS] who worked on the Company's audit at any time during any of the past three years? [***Note**: This question is based on Rule 5605(a)(2)(F) of the NASDAQ Listing Rules.*]

Yes ☐ No ☐

If yes, please briefly describe:

_____

_____

_____

(g) Do you have any other relationships (*i.e.*, being a partner, stockholder or officer of an organization that has any commercial, industrial, banking, consulting, legal, accounting, charitable, familial or any other relationships with the Company or any of its subsidiaries) that could interfere with your exercise of independent judgment in carrying out the responsibilities as a director of the Company? [***Note**: This question is based on Rule 5605(a)(2) of the NASDAQ Listing Rules*.]

Yes ❑ No ☐

If yes, please briefly describe:

_____

_____]

14. Diversity and Skills Matrix Information.

[***Note**: If the company includes a diversity and/or skills matrix in its annual proxy statement, or otherwise makes such information available to shareholders, include inquiries for the required information here. Note that in 2021, Nasdaq adopted a "comply or disclose" diversity framework to advance board diversity and enhance transparency of board diversity statistics. Nasdaq Listing Rule 5606 sets forth its "board diversity matrix," pursuant to which, and in substantially similar format, certain Nasdaq-listed companies are required to annually disclose aggregated statistic information about their board's voluntary self-identified gender and racial characteristics and LGBTQ+ status. This matrix could inform inquiries and statistical presentation by non-Nasdaq listed companies as well. See Nasdaq Listing Rule 5606, https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series. We have included below an example question to solicit voluntary responses for such diversity-related disclosures.*]

[14. Diversity Information. The Company is planning to include director diversity disclosures in its proxy statement. If you are willing to provide this information, please answer the following questions. Please note that, in addition to including this information in our proxy statement, we may also publicly disclose the information in other public media, including on our website [and our corporate responsibility report] and in response to inquiries from surveys, analysts, shareholders or journalists.

*[**Note:** Most companies present this information on an aggregated basis (i.e., "our board includes three women…") rather than identifying diversity characteristic by individual (i.e., "Jane is a woman"). If the Company is contemplating presenting the information on an individualized basis, additional language identifying that possibility should be included in this introductory paragraph.]*

(a) Do you self-identify as any of the following? Please indicate 'yes' to any one or more that apply to you. [***Note**: The below categories reflect the diversity categories provided by Nasdaq. See Nasdaq Listing Rule 5606. Disclosures required by various states (e.g., California) may require presentation ordered in slightly different categories.*]

Female	❑ Yes
Male	☐ Yes
Non-Binary	☐ Yes
African American or Black	☐ Yes
Alaskan Native or American Indian	☐ Yes
Asian	☐ Yes
Hispanic or Latinx	☐ Yes
Native Hawaiian or Pacific Islander	☐ Yes
White	☐ Yes
Two or More Races or Ethnicities	☐ Yes
LGBTQ+	☐ Yes
Prefer not to disclose	☐ Yes

(b) Please list any other diversity characteristics you wish to identify (*e.g.*, military service, disability, religion, nationality):

_____

_____

_____

(c) I consent to public disclosure of the above information [on an anonymous, aggregated basis], including (but not limited to) in the Company's proxy statement, its website, [its corporate responsibility

report,] or in response to inquiries from analysts, shareholders, proxy advisors, the media or other market participants.

Yes ❑ No □]

PART III – TO BE ANSWERED ONLY BY DIRECTORS WHO ARE MEMBERS OF OR NOMINEES FOR THE AUDIT COMMITTEE

15. Audit Committee Independence. As a member of or nominee for the Company's audit committee:

(a) Do you currently or do you plan to, in the current fiscal year, accept directly or indirectly any consulting, advisory, or other compensatory fee from the Company or from any of its subsidiaries, other than in your capacity as a member of the audit committee, the board of directors or any other board committee or the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the Company or its subsidiaries, provided that such compensation is not contingent in any way on continued service? For purposes of this Question 15(a), "indirect" includes acceptance of such a fee by a spouse, a minor child or stepchild or a child or stepchild sharing a home with you or by an entity in which you are a partner, member, an officer such as a managing director occupying a comparable position or Executive Officer, or occupying a similar position (except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and who provides accounting, consulting, legal, investment banking or financial advisory services to the Company or any of its subsidiaries. [***Note***: *This question is based on Rule 10A-3(b)(1)(ii)(A) under the Exchange Act.*]

Yes □ No □

If yes, please describe the nature of the services that are to be provided and the fee that is to be obtained:

_____

_____

_____

(b) Other than in your capacity as a member of the audit committee, the board of directors or any other committee of the board of directors, are you an "affiliated person" of the Company or of any of the Company's subsidiaries? For purposes of this Question 15(b), an

"affiliated person" is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the Company or a subsidiary of the Company. You are not deemed to control the Company or any of the Company's subsidiaries if you are not the beneficial owner, directly or indirectly, of more than 10 percent of any class of voting equity securities of the Company or its subsidiaries and you are not an executive officer of the Company or any of its subsidiaries. [***Note**: This question is based on Rule 10A-3(b)(1)(ii)(B) under the Exchange Act.*]

Yes ❑ No ☐

If yes, please describe your affiliation:

_____

_____

_____

(c) Do you believe that you qualify as an "audit committee financial expert"? For purposes of this Question 15(c), an "audit committee financial expert" means a person who has the following attributes: (i) an understanding of generally accepted accounting principles and financial statements; (ii) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves; (iii) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities; (iv) an understanding of internal control over financial reporting; and (v) an understanding of audit committee functions. Such attributes must be acquired through the following: (1) education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions; (2) experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions; (3) experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or (4) other relevant experience. [***Note**: This information is required by Item 7 of Schedule 14A, Item 407(d)(5) of Regulation S-K.*]

Yes ❑ No □

If yes, please describe your relevant education and experience:

_____

_____

_____

[16. Other Audit Committee Criteria.

[***Note***: *This version of Question 16 is applicable only to reporting companies listed on the NYSE. If the company is listed on NASDAQ, delete this version of Question 16 and use the following version.*]

(a) Do you believe that you are "financially literate" (as it would be interpreted by the Company's board of directors in its business judgment) or, if not, can become so within a reasonable period of time of your appointment to the Audit Committee? [***Note***: *This question is based on Section 303A.07(a) of the NYSE Listed Company Manual.*]

Yes □ No □

(b) Do you have accounting or related financial management expertise (as it would be interpreted by the Company's board of directors in its business judgment)? [***Note***: *This question is based on Section 303A.07(a) of the NYSE Listed Company Manual.*]

Yes □ No □

(c) On how many other audit committees of public companies do you serve? [***Note***: *This question is based on Section 303A.07(a) of the NYSE Listed Company Manual.*]

0 □ 1 □ 2 □ 3 □ 4 □ 5 □]

[16. Other Audit Committee Criteria.

[***Note***: *This version of Question 16 is applicable only to reporting companies listed on NASDAQ. If the company is listed on the NYSE, delete this version of Question 16 and use the preceding version*.]

(a) Have you participated in the preparation of the financial statements of the Company or any of its current subsidiaries at any time during the past three years? [***Note***: *This question is based on Rule 5605(c)(2)(A)(iii) of the NASDAQ Listing Rules.*]

Yes ❑ No □

If yes, please describe the extent of your participation:

_____

_____

_____

(b) Are you able to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement? [***Note**: This question is based on Rule 5605(c)(2)(A)(iv) of the NASDAQ Listing Rules.*]

Yes □ No □

(c) Do you have past employment experience in finance or accounting, requisite professional certification in accounting or any other comparable experience or background which results in your financial sophistication? [***Note**: This question is based on Rule 5605(c)(2)(A) of the NASDAQ Listing Rules.*]

Yes □ No □

If yes, please describe your relevant education and experience:

_____

_____

_____

(d) Are you or have you been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities? [***Note**: This question is based on Rule 5605(c)(2)(A) of the NASDAQ Listing Rules.*]

Yes □ No □

If yes, please describe your relevant experience:

_____

_____

_____]

PART IV – TO BE ANSWERED ONLY BY DIRECTORS WHO ARE MEMBERS OF OR NOMINEES FOR THE COMPENSATION COMMITTEE OR DIRECTORS OR EXECUTIVE OFFICERS OTHERWISE RESPONSIBLE FOR ADMINISTERING EXECUTIVE COMPENSATION

17. Independence Under Certain Federal Tax Laws. [***Note**: This question is based on Treasury Regulation § 1.162-27(e)(3) of the Internal Revenue Code.*]

(a) Are you currently, or have you ever been, an officer of the Company or of any of the Company's subsidiaries or Affiliates?

Yes ❑ No ☐

(b) Are you currently, or have you ever been, an employee of the Company or of any of the Company's subsidiaries or Affiliates?

Yes ☐ No ☐

If yes, please briefly describe any compensation you received from the Company or such subsidiary or Affiliate in respect of your services as an employee (other than benefits under a tax-qualified retirement plan) in the last year or expect to receive in the future:

_____

_____

_____

(c) Do you or any associated entity, directly or indirectly, currently receive or expect to receive, or during the last year have you or any associated entity received, any payments (or been party to a contract in respect of any payments) in exchange for goods or services from the Company or any of the Company's subsidiaries or Affiliates (other than for services as a director of the Company)? For purposes of this Question 14(c), the term "associated entity" means an organization that is a sole proprietorship, trust, estate, partnership or corporation (and any affiliate thereof) of which you have a beneficial ownership of at least five percent or by which you are employed.

Yes ☐ No ☐

If yes, please briefly describe such payments, including their amount, and, if applicable, your relationship to the entity receiving such payments:

_____

_____

_____

18. Compensation Committee Independence. As a member of or nominee for the Company's compensation committee:

(a) Do you have any business or personal relationship with any compensation consultant, legal counsel or other advisor that is currently retained by the compensation committee or that you expect to be retained by the compensation committee? [***Note**: This question is based on Item 407(e)(3) of Regulation S-K.*]

Yes ❑ No ☐

If yes, please describe such relationship:

_____

_____

_____

(b) Do you serve on the board of directors of any company (other than the Company) that retains [the same compensation consultant as the Company] an advisor on executive compensation or other matters? [***Note**: This question is based on Reg. S-K 407(e)(3).*]

Yes ☐ No ☐

If yes, please name the company(ies) and briefly describe the services that [the same compensation consultant as the Company] provides and lists who at [the consultant] advises the company (as applicable):

_____

_____

I hereby acknowledge that the answers to the foregoing questions are correct and complete to the best of my knowledge. If any changes in the information provided occur prior to the date of the proxy statement for the annual stockholders' meeting, I will notify the Company and its counsel of such changes. I hereby consent to being named as a Director or Executive Officer of the Company in the Form 10-K, annual report and the proxy statement, including any supplements or amendments to such documents.

Date: [DATE]

_____
Signature

_____
Please type or print your name

ADDITIONAL INFORMATION

(Attach additional sheets as necessary.)

Question	Answer

GLOSSARY

DEFINITION OF CERTAIN TERMS

The terms below that are used in this Questionnaire have the following meanings:

Affiliate: An "Affiliate" of the Company or a Person "affiliated" with the Company refers to any Person that directly or indirectly Controls, or is Controlled by, or is under common Control with, the Company, and includes any of the following Persons:

- Any Director or Officer of the Company.
- Any Person performing general management or advisory services for the Company.
- [Any Beneficial Owner, directly or indirectly, of 10 percent or more of any class of voting equity securities of the Company.]
- Any "Associate" of the foregoing Persons.

Associate: An "Associate" of, or a Person "associated" with, a Person means: (i) any relative or spouse of such Person or any relative of such spouse, (ii) any corporation or organization (other than the Company or its subsidiaries) of which such Person is an Officer or partner or directly or indirectly the beneficial owner of 10 percent or more of any class of equity securities and (iii) any trust or estate in which such Person has a substantial beneficial interest or as to which such Person serves as a trustee, executor or in a similar fiduciary capacity.

Beneficially Owned: A "Beneficial Owner" of a security includes any Person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise has or shares (i) voting power, including the power to vote or to direct the voting of such security, or (ii) investment power, including the power to dispose of, or direct the disposition of, such security. In addition, a Person is deemed to have "Beneficial Ownership" of a security if such Person has the right to acquire beneficial ownership of that security at any time within 60 days, including, but not limited to: (i) through the exercise of any option, warrant or right, (ii) through the conversion of any security, or (iii) pursuant to the power to revoke, or the automatic termination of, a trust, discretionary account or similar arrangement.

It is possible that a security may have more than one "Beneficial Owner," such as a trust, with two co-trustees sharing voting power, and the settlor or another third party having investment power, in which case each of the

three would be the "Beneficial Owner" of the securities in the trust. The power to vote or direct the voting, or to invest or dispose of, or direct the investment or disposition of, a security may be indirect and arise from legal, economic, contractual or other rights, and the determination of beneficial ownership depends upon who ultimately possesses or shares the power to direct the voting or the disposition of the security.

The final determination of beneficial ownership depends upon the facts of each case. You may, if you believe it is appropriate, disclaim beneficial ownership of securities that might otherwise be considered "Beneficially Owned" by you.

Control: "Control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

Director: A "Director" means any Director of a corporation, trustee of a trust, general partner of a partnership, or any Person who performs for an organization functions similar to those performed by the foregoing Persons.

Executive Officer: An "Executive Officer" means a president, a principal financial officer, a principal accounting officer (or, if there is no such accounting officer, the controller), any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function and any other Person performing similar policy-making functions. Executive officers of the Company's subsidiaries may be deemed executive officers of the Company if they perform such policy-making functions for the Company.

Government Official: A "Government Official" includes: any elected or appointed government officials; any employee or person acting for or on behalf of a government official, agency, or enterprise performing a governmental function; any political party officer, employee or person acting for or on behalf of a political party or candidate for public office; or an employee or person acting for or on behalf of a public international organization.

Immediate Family Member: An "Immediate Family Member" of a person means the person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than a tenant or domestic employee) who shares such person's home.

Material: "Material," when used to qualify a requirement for providing information on any subject, unless otherwise indicated, limits the information required to those matters as to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the Company's securities.

Officer: An "Officer" refers to a president, vice president, secretary, treasurer or principal financial officer, controller or principal accounting officer, and any person that performs similar functions for any organization whether incorporated or unincorporated.

Person: A "Person" means an individual, corporation, partnership, limited liability company, association, joint stock company, trust, unincorporated organization or other entity, or a government or political subdivision thereof.

APPENDIX A

*[**Note**: Appendix A should contain biographic information for the relevant director or executive officer from the prior year's Form 10-K or proxy statement, as applicable, including the following items:*

- *The person's name and age, any positions and offices with the Company held by such person, the term of office as director or officer and the period during which he or she has served as such. [**Note**: This information is required by Item 7(b) of Schedule 14A, Items 401(a)-(c) of Regulation S-K.]*

- *Business experience of the person during the past five years, including: (1) the person's principal occupations and employment during the past five years, (2) the name and principal business of any corporation or other organization in which such occupations and employment were carried on and (3) whether such corporation or organization is a parent, subsidiary or other affiliate of the Company. [**Note**: This information is required by Item 7(b) of Schedule 14A, Item 401(e) of Regulation S-K.]*

- *All positions and offices currently held by the person with the Company or any of its subsidiaries and the period of time during which such person has held each such position or office. If the person is not currently employed by the Company or any of its subsidiaries, Appendix A should include information as to whether such person has been employed by the Company at any time during the past five fiscal years. [**Note**: This information is required by Item 7 of Schedule 14A, Items 401(a) and (b) of Regulation S-K.]*

When an executive officer or other person has been employed by the Company or a subsidiary of the Company for less than five years, Appendix A should include a brief description of the nature of the responsibility undertaken by the individual in prior positions to provide adequate disclosure of his or her prior business experience.

*For directors, this information should also include all directorships held by the person in public companies and U.S.-registered investment companies, including any board committees on which such individual serves. [**Note**: This information is required by Item 7(b) of Schedule 14A, Item 401(e) of Regulation S-K.]*

For director nominees, Appendix A should contain a draft biography regarding each nominee, including the following items:

- *The person's name and age. [**Note**: This information is required by Item 7(b) of Schedule 14A, Item 401(a) of Regulation S-K.]*

- *Business experience of the person during the past five years, including: (1) the person's principal occupations and employment during the past five years, (2) the name and principal business of any corporation or other organization in which such occupations and employment were carried on and (3) whether such corporation or organization is a parent, subsidiary or other affiliate of the Company. [**Note**: This information is required by Item 7(b) of Schedule 14A, Item 401(e) of Regulation S-K.]*

- *All positions and offices currently held by the person with the Company or any of its subsidiaries and the period of time during which such person has held each such position or office. If the person is not currently employed by the Company or any of its subsidiaries, Appendix A should include information as to whether such person has been employed by the Company at any time during the past five fiscal years. [**Note**: This information is required by Item 7 of Schedule 14A, Items 401(a) and (b) of Regulation S-K.]]*

APPENDIX B

[***Note**: If the version of Question 2 that requires completion of an Appendix B for each person who will be sent a Questionnaire is being used, Appendix B should contain security ownership information as of the most recent date possible for the relevant director or executive officer, as required by Item 6(d) of Schedule 14A and Item 403(b) of Regulation S-K. The following is an example of a table that should be included in Appendix B, to be verified by the individual.*

Number of shares of common stock owned (Includes vested restricted stock awards)	
Number of vested options owned	
Number of unvested options owned (Please include vesting schedule)	
Number of shares of unvested restricted stock (Please include vesting schedule)	
Any other equity securities owned (Please describe and include any applicable vesting schedule)	
Any equity securities in which ownership, voting power or investment power is shared (Please describe and include any applicable vesting schedule)	

In addition to confirming security ownership, Appendix B should also describe the nature and terms of any of the individual's rights to acquire beneficial ownership and whether the individual disclaims beneficial ownership of any of the securities listed.

If the information to complete this table cannot be obtained (for a director nominee or because the company does not have sufficient records), use the version of Question 2 that requires each person completing this Questionnaire to complete the table.]

APPENDIX C

[***Note**: Appendix C, if it is being included, should include all Form 3, Form 4 and Form 5 filings made by the Company on behalf of the Director or Executive Officer during the last fiscal year.*]

APPENDIX D

[***Note**: For companies that use the Wachtell, Lipton, Rosen & Katz model bylaws (or a similar form specifying director qualification), the following Director Nominee Representation and Agreement can be used to fulfill the requirement in Section 2.10 of the model bylaws. This form should be completed by all nominees for election and reelection as directors of the Company.*]

[COMPANY]

DIRECTOR NOMINEE REPRESENTATION AND AGREEMENT

THIS DIRECTOR NOMINEE REPRESENTATION AND AGREEMENT (this "Representation and Agreement") is delivered as of _____, to [COMPANY], a [STATE] corporation (the "Company"), by the undersigned nominee for election as a director of the Company (the "Nominee").

WHEREAS, the Nominee has been nominated for election as a director of the Company (the "Nomination") pursuant to [Article II] of the Bylaws of the Company (the "Bylaws"); and

WHEREAS, [Section 2.9] of the Bylaws provides that, in order to be eligible to be a nominee for election as a director of the Company, the Nominee must complete and deliver to the Secretary of the Company at the principal offices of the Company a written representation and agreement as to certain specified matters.

NOW, THEREFORE, the Nominee hereby represents and warrants to the Company and agrees as follows:

1. The Nominee:

(a) is not and will not become a party to:

(i) any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how the Nominee, if elected as a director of the Company, will act or vote on any issue or question (a "Voting Commitment") that has not been disclosed to the Company; or

(ii) any Voting Commitment that could limit or interfere with the Nominee's ability to comply, if elected as a director of the Company, with his or her fiduciary duties under applicable law;

(b) is not and will not become a party to any agreement, arrangement or understanding with any person or entity other than the

Company with respect to any direct or indirect compensation, reimbursement, or indemnification in connection with service or action as a director that has not been disclosed to the Company; [and]

(c) both in his or her individual capacity and on behalf of any person or entity on whose behalf the Nomination is being made, would be in compliance, if elected as a director of the Company, and will comply with all applicable publicly disclosed corporate governance, conflict of interest, confidentiality, and stock ownership and trading policies and guidelines of the Company; [and]

[(d) [*for companies that have share ownership requirements for directors*] beneficially owns, or agrees to purchase within 90 days if elected as a director of the Company, not less than [ ] common shares of the Company ("Qualifying Shares") (subject to adjustment for any stock splits or stock dividends occurring after the date of such representation or agreement), will not dispose of such minimum number of shares so long as the Nominee is a director, and has disclosed to the Company whether all or any portion of the Qualifying Shares were purchased with any financial assistance provided by any other person and whether any other person has any interest in the Qualifying Shares;] [and]

[(e) [*for companies with majority voting*] will abide by the requirements of [Section 2.10] of the Bylaws.]

2. The Nominee acknowledges and agrees that:

(a) the representations, warranties and agreements of the Nominee in this Representation and Agreement will be relied upon by the Company and that the Nominee will provide prompt written notice to the Company upon any change, event, transaction or condition affecting the accuracy or continued validity of the representations and warranties of the Nominee or of any breach by the Nominee of any agreement made herein; and

(b) in the event (i) any representation or warranty of the Nominee in this Representation and Agreement is inaccurate in any material respect or (ii) the Nominee is in breach of any agreement of the Nominee in this Representation and Agreement, such representation, warranty or agreement shall be deemed not to have been provided in accordance with [Section 2.9] of the Bylaws and the Nomination shall be deemed invalid.

3. Any notice required or permitted by this Representation and Agreement shall be in writing and shall be delivered as follows with notice deemed given as indicated: (i) by personal delivery upon delivery; (ii) by overnight courier upon written verification of receipt; (iii) by

facsimile transmission upon acknowledgment of receipt of electronic transmission; or (iv) by certified or registered mail, return receipt requested, upon verification of receipt. Any notice to be made to the Company hereunder shall be sent to the following:

[COMPANY]
Attn: Corporate Secretary
[ADDRESS 1]
[ADDRESS 2]
[FACSIMILE]

4. This Representation and Agreement shall be governed in all respects by the laws of [STATE], without regard to the conflicts of laws provisions therein, and it shall be enforced or challenged only in federal or state courts located in [STATE].

5. Should any provisions of this Representation and Agreement be held by a court of law to be illegal, invalid or unenforceable, the legality, validity and enforceability of the remaining provisions of this Representation and Agreement shall not be affected or impaired thereby.

[*Remainder of Page Intentionally Left Blank*]

IN WITNESS WHEREOF, the Nominee has delivered this Representation and Agreement as of the date first written above.

NOMINEE

_____

Signature

Name:_____

Address:_____

_____

_____

_____

_____

Facsimile:_____

ANNEX E

EXAMPLE OF NOMINATING & CORPORATE GOVERNANCE COMMITTEE CHARTER[613]

Purpose

The Nominating & Corporate Governance Committee (the "Committee") is appointed by the Board of Directors (the "Board") of **[**COMPANY**]** (the "Company") (1) to assist the Board by identifying individuals qualified to become Board members, consistent with criteria approved by the Board, and to recommend to the Board the director nominees for the next annual meeting of stockholders and the individuals to fill vacancies occurring between annual meetings of stockholders; (2) to develop and recommend to the Board matters of corporate governance, including the Corporate Governance Guidelines applicable to the Company; (3) to lead the Board in its annual review of the Board and management's performance; and (4) to recommend to the Board director nominees for each committee.

Committee Membership

The size of the Committee shall be determined by the Board in its sole discretion, provided that, in no event, shall it consist of fewer than [●][614] member(s).

The members of the Committee shall be appointed annually by the Board and will serve at the Board's discretion. Committee members may be removed from the Committee by the Board at any time, with or without cause and any vacancies will be filled through appointment by the Board.

The Board shall appoint one member of the Committee as its Chairperson.

All members of the Committee shall meet the independence requirements of the [New York Stock Exchange/Nasdaq] and any other applicable laws or regulations.

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[613] This is a generic, minimalist example of a Charter. Given the breadth of issues that Nominating and Corporate Governance Committees oversee, and the different and evolving emphases they may have (for example at different times a Board may prioritize diversity, experience, specific expertise, refreshment, etc.), the Charter should be reviewed on a regular basis to ensure that it reflects the Board's current priorities.

[614] Minimum number to be set in a manner consistent with governing state law and the Company's charter and bylaws.

Meetings

The Committee shall meet as often as necessary to carry out its responsibilities, but not less than [●] each year. The Committee Chairperson shall preside at each meeting. In the event the Committee Chairperson is not present at a meeting, the Committee members present at that meeting shall designate one of its members as the acting chair of such meeting.

Committee Authority and Responsibilities

1. The Committee shall have the resources and authority to discharge its responsibilities, including the sole authority (i) to retain and terminate any search firm to be used to identify director candidates and (ii) to approve the search firm's fees and other retention terms. The Committee shall also have authority to obtain advice and assistance from internal or external legal, accounting or other advisors.

2. The Committee shall actively seek individuals qualified to become directors for recommendation to the Board, consistent with criteria identified by the Board.

3. The Committee shall seek to complete customary vetting procedures and background checks with respect to individuals suggested for potential Board membership by stockholders of the Company or other sources.

4. The Committee shall monitor and evaluate the orientation and training needs of directors and make recommendations to the Board where appropriate.

5. The Committee shall assist the Board in determining and monitoring whether or not each director and prospective director is "independent" within the meaning of any rules and laws applicable to the Company.

6. The Committee shall annually review and make recommendations to the Board with respect to the compensation and benefits of directors, including under any incentive compensation plans and equity-based compensation plans.

7. The Committee shall receive comments from all directors and report annually to the Board with an assessment of the Board's performance, to be discussed with the full Board following the end of each fiscal year.

8. The Committee shall annually, or more frequently as it deems appropriate, review and reassess the adequacy of the Corporate Governance Guidelines of the Company and recommend any proposed changes to the Board for approval.

9. The Committee shall review and recommend to the Board proposed changes to the Company's Certificate of Incorporation and Bylaws.

10. The Committee shall review stockholder proposals relating to corporate governance and other matters and recommend to the Board the Company's response to such proposals.

11. The Committee shall periodically review the Company's policies, practices and disclosures with respect to sustainability and environmental, social and governance factors.

12. The Committee shall annually, or more frequently as it deems appropriate, review the succession planning for the Company's senior executive officers, including but not limited to the Chief Executive Officer and [may] [will] do so in concert with the Compensation Committee.

13. The Committee shall make regular reports to the Board.

14. The Committee shall review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.

15. The Committee shall annually review its own performance.

16. The Committee may form and delegate authority to subcommittees when appropriate.