

# Corporate Governance Hot Topics

## Quarterly Update (May 2019)

### 1. Selected Regulatory Developments

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- **SEC Issues C&DIs on Director Diversity Disclosure:** On February 6, 2019, the SEC released two CD&Is addressing the disclosure of self-identified diversity characteristics with respect to directors and nominees under Items 401 and 407 of Regulation S-K. The C&DIs call on issuers to provide details on how they consider self-identified diversity characteristics (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background) when making decisions regarding the composition of their boards. The updated list of C&DIs is available [here](#), and the Sullivan & Cromwell memorandum on the topic is available [here](#).
- **SEC to Consider Changes to Rules on Proxy Advisors and Shareholder Proposals:** On May 22, the SEC released its spring agenda for 2019, which includes plans to consider updates to its rules on proxy advisors and shareholder proposals. According to the agenda, the SEC is considering possible rule amendments to address proxy advisors' reliance on the proxy solicitation exemptions in Rule 14a-2(b) and the current thresholds for filing shareholder proposals under Rule 14a-8. The agenda indicates that the SEC expects to act on both of these items and release advanced notice of proposed rule-making by April 2020. The full SEC agenda is available [here](#).
- **SEC Continues to Adopt Disclosure Simplification Amendments:** On March 20, 2019, the SEC adopted amendments designed to "modernize and simplify" numerous disclosure requirements of Regulation S-K and the SEC rules. The amendments are intended to eliminate requirements that are redundant, duplicative or outdated without altering the total mix of information available for investors. These amendments follow an earlier round of disclosure simplification amendments adopted in August 2018. The SEC's final rule is available [here](#), and the Sullivan & Cromwell memorandum summarizing these amendments is available [here](#).
- **SEC Proposes Rules to Tailor Definitions of Accelerated and Large Accelerated Filers:** On May 9, 2019, the SEC proposed rules that would amend the definitions of accelerated filer and large accelerated filer by providing that smaller reporting companies with less than \$100 million in revenues would not be required to obtain an attestation of their internal controls over financial reporting from an independent outside auditor. The proposed amendments, if adopted, would reduce audit costs for certain lower-revenue companies but would not change other provisions of the Sarbanes-Oxley Act of 2002, such as independent audit committee requirements, CEO and CFO certifications of financial reports, or the requirement that companies continue to establish, maintain, and assess the effectiveness of their internal controls over financial reporting. The proposed rule amendments are available [here](#).
- **DOJ Issues Updated Guidance on the Evaluation of Corporate Compliance Programs:** On April 30, 2019, the Criminal Division of the U.S. Department of Justice released updated guidance to its attorneys on how to evaluate the design, implementation and effective operation of corporate compliance programs in determining whether, and to what extent, the DOJ considers a corporation's compliance program to have been effective at the time of the offense and to be effective at the time of a charging decision or resolution. The DOJ guidance is available [here](#), and the Sullivan & Cromwell memorandum on the topic is available [here](#).

- **DOJ Signals Renewed Focus on Officer and Director Interlocks:** In a speech on May 1, 2019, the Assistant Attorney General in charge of the DOJ's Antitrust Division announced that the DOJ is currently looking into Section 8 of the Clayton Act, which imposes limits on interlocking directorates, with a specific focus on "bringing it forward to account for modern corporate structures," including, for instance, limited liability companies. The Assistant Attorney General did not express a definitive view on the application of Section 8 to entities other than corporations, but simply noted that the DOJ was "thinking" about these issues. The full speech is available [here](#), and the Sullivan & Cromwell memorandum on this topic is available [here](#). This speech followed another recent [speech](#) by a senior leader in the DOJ, which stated that the DOJ was beginning to review common ownership and interlocking directorates "more closely," especially in concentrated markets where coordination may be easier.

## 2. Selected Legislative Developments

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- **Proposed Legislation Would Require Additional Diversity Disclosures:** On February 6, 2019, the same day the SEC released its C&DIs on director diversity disclosures, the "Improving Corporate Governance Through Diversity Act of 2019" was introduced in both houses. The bill seeks to require public companies to disclose in their annual proxy statements the gender, race, ethnicity and veteran status of not only their directors and nominees, but also their senior executive officers, and to disclose whether the board has a policy or strategy to promote racial, ethnic and gender diversity among directors, nominees and executive officers. The bill has been referred to subcommittees in the House and the Senate for review, and the full text of the bill is available [here](#). These regulatory and legislative developments come at a time when companies are increasingly disclosing the diversity of their directors voluntarily.
- **Proposed Legislation Seeks to Enhance Cybersecurity Risk Disclosures:** On February 28, 2019, Senators introduced a bipartisan bill seeking to promote transparency in the oversight of cybersecurity risks at publicly traded companies. The bill, titled "Cybersecurity Disclosure Act of 2019," would require issuers to disclose in their annual reports or proxy statements whether any member of their boards has expertise or experience in cybersecurity and, if not, to explain why they do not believe such expertise is necessary. The full text of the bill is available [here](#).
- **Senators Announce Plan to Introduce a Bill Imposing Limits on Corporate Buybacks:** On February 3, 2019, Senate Democratic leader Charles Schumer and Senator Bernie Sanders [announced](#) their plan to introduce legislation that would prevent companies from buying back their own shares unless they pay workers at least \$15 an hour and offer seven days of paid sick leave and other health benefits. Citing statistics that U.S. corporations repurchased more than \$1 trillion of their own stock in 2018, the Senators asserted that such buybacks are contributing to economic inequality and diverting resources away from workers.

## 3. Selected Litigation Developments

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- **Delaware Supreme Court Clarifies When Emails Should Be Produced Under a § 220 Demand:** On January 29, 2019, in *KT4 Partners LLC v. Palantir Technologies, Inc.*, the Delaware Supreme Court provided guidance on when a stockholder's demand for books and records under Section 220 of the Delaware General Corporation Law will require a company to produce personal emails or other electronic communications. According to the court, "if a company observes traditional formalities, such as documenting its actions through board minutes, resolutions, and official letters, it will likely be able to satisfy a § 220 petitioner's needs solely by producing those books and records." However, "if a company instead decides to conduct formal corporate business largely through informal electronic

communications,” production of those electronic communications will likely be required. The full text of the opinion is available [here](#).

- **Delaware Chancery Court Finds Controlling Stockholder Impliedly Consented to Jurisdiction Based on Board’s Adoption of Forum Selection Bylaw:** On March 15, 2019, in *In re Pilgrim’s Pride Corp. Derivative Litigation*, the Delaware Court of Chancery held that a non-U.S. controlling stockholder had impliedly consented to personal jurisdiction in Delaware after the controlling stockholder’s board designees approved a bylaw designating the Court of Chancery as the exclusive forum for fiduciary duty litigation concurrently with their approval of an interested transaction involving the controlling stockholder. According to the court, because the controlling stockholder had designated a majority of the company’s board and held a super-majority of the company’s voting power, it had “consented implicitly to the existence of personal jurisdiction in Delaware when its representatives on the Board participated in the vote to adopt the Forum-Selection Bylaw.” The full text of the opinion is available [here](#).
- **Cornerstone Releases Review of 2018 Accounting Class Action Filings and Settlements:** On April 17, 2019, Cornerstone Research issued a report analyzing accounting class action filings and settlements. According to the report, there were 143 securities class actions involving accounting allegations during 2018 (down 13% from 2017, but still 86% higher than the historical average), including 79 M&A-related cases alleging failure to reconcile a non-GAAP measure to a GAAP measure. Additionally, while the number of accounting case settlements declined 16% in 2018 (from 49 to 41), total settlement value increased by more than five times to almost \$4.5 billion (compared to \$883 million in 2017), largely due to a handful of large settlements. The full report is available [here](#).

#### 4. Proxy Advisory and Institutional Investor Updates

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- **BlackRock and State Street CEO Letters Focus on Corporate Purpose and Culture:** On January 17, 2019, BlackRock Chairman and CEO Larry Fink released his annual letter to CEOs of public companies, expanding on the theme of corporate purpose raised in last year’s letter. The letter, titled “Purpose & Profit,” highlights “the inextricable link between purpose and profits” and calls on companies to become leaders in addressing societal issues, particularly retirement, infrastructure and job preparation. The letter also notes that BlackRock’s engagement focus in 2019 will be on board diversity, corporate strategy and capital allocation, compensation that promotes long-termism, environmental risks and opportunities, and human capital management, and that companies should be prepared to discuss how their corporate purpose informs their strategy and culture to underpin sustainable financial performance. The full text of the letter is available [here](#). The letter was released two days after State Street Global Advisors’ CEO Cyrus Taraporevala [released](#) his annual letter to portfolio companies in which he announced that State Street will focus on corporate culture in 2019.
- **Vanguard Releases Updated Proxy Voting Guidelines:** On April 12, 2019, Vanguard released its updated proxy voting guidelines, applicable to all United States company meetings held on or after April 1, 2019. The policy updates focus on areas such as independent chairs, overboarded directors and board diversity. The new voting policy is available [here](#). Following the release of its updated proxy voting guidelines, Vanguard [announced](#) its decision to grant proxy voting powers for its externally managed funds to those funds’ external managers, with the transitions expected to be complete by the end of 2019.
- **BlackRock Announces 2019 Proxy Voting Updates:** On January 17, 2019, BlackRock released its updated 2019 proxy voting guidelines for U.S. securities. Notable updates include amending its definition of “non-independent” directors, expanding its policy on board diversity to take into account both personal and professional factors, and stating that, at certain companies, it expects the whole board to demonstrate fluency in how climate risk affects the business and how management assesses, adapts to and mitigates climate risk. The new voting policy is available [here](#).

- **Institutional Investors Seek Limits on Dual-Class Structures:** On March 14, 2019, a group of institutional investors with \$3.2 trillion in assets sent a letter to Lyft calling on it to eliminate its dual class share structure, noting that the structure “imposes a significant gap between those who exercise control over the company and those who have significant exposure to the consequences of that control.” The full text of the letter is available [here](#). These efforts continue a general push by investors to impose limits on dual-class voting structures, including by putting pressure on regulators and exchanges. For example, in October 2018, the Council of Institutional Investors filed petitions with the New York Stock Exchange and NASDAQ Inc., calling on them to limit listings of companies with dual-class share structures – a move that was supported by BlackRock and T. Rowe Price Group Inc. The press release announcing these petitions is available [here](#).
- **State Street Announces Proprietary ESG Scoring System, R-Factor:** In May 2019, State Street announced the launch of its R-Factor scoring methodology to score companies on ESG issues. R-Factor is powered by ESG data from four different service providers, and State Street has indicated that companies’ R-Factor scores will power their investment and client reporting capabilities, and be fully integrated into its stewardship program. R-Factor leverages certain portions of the Sustainability Accounting Standards Board (SASB) standards published in the fall of 2018, which provide standards for sustainability metric reporting in 11 sectors and 77 industries. For environmental and social factors, R-Factor relies upon the sustainability metrics deemed relevant for the specified industries by the SASB standards, and focuses on these metrics as material because these metrics are deemed to be those that most impact financial performance. For governance factors, R-Factor relies on State Street’s internal stewardship principles and an outside data provider. The SASB standards were created by the SASB, a non-profit organization dedicated to identifying, managing and reporting on the sustainability topics that matter most to investors. In addition to use by State Street, ISS now includes an issuer’s SASB industry codifications in its reports with respect to issuers’ annual shareholder meetings.

## 5. Corporate Governance Surveys, Policies and Reports

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- **The Conference Board Releases 2019 Study on Corporate Board Practices in the S&P 500 and Russell 3000:** On April 24, 2019, the Conference Board released a study tracking corporate governance trends and developments in SEC filings for Russell 3000 and S&P 500 companies. The report found that progress towards board gender diversity has been slow, with 20% of Russell 3000 companies still having no female representatives on their board, and that the main reasons for this include high average director tenure (at 10+ years), low director turnover (with 50% of Russell 3000 and 43% of S&P 500 companies disclosing no change in the composition of their boards in 2018), and the fact that when board seats do become vacant, they are typically taken by a seasoned director rather than a newcomer with no prior board experience. A summary of the study is available [here](#).
- **Brunswick Group Releases Survey on Communicating with the Investment Community in the Digital Age:** On January 30, 2019, Brunswick Group LLC released a survey analyzing digital media use by buy-side investors and sell-side analysts globally. According to the survey, in 2018, investor use of digital media to make investment decisions hit the highest levels recorded, with 88% of the investors reporting that they make investment decisions or recommendations based on something they learned from digital media – up from 70% in 2017 and 41% in 2015. However, the most notable finding of the survey was the rapid increase in the number of investors who want to hear directly from CEOs and other senior executives via digital media (49% compared to 28% in 2017). This increase is especially significant among sell-side analysts, 59% of whom say that they now use digital media to stay connected with CEOs. The full report is available [here](#).
- **Diligent Institute Releases Report Analyzing ESG Oversight Practices:** On February 6, 2019, the Diligent Institute released a report analyzing how directors and boards globally are engaging with

environmental sustainability issues. While the report found that board-level discussions of environmental sustainability issues have become increasingly common, 48% of those surveyed stated that their boards still do not have established governance policies or practices related to these issues (such as a policy linking executive compensation to sustainability performance metrics). The report also found little unanimity on structural best practices for ESG oversight, but noted that formal ESG oversight was most commonly delegated to a board committee. The full report is available [here](#).

- **ISS Releases Report on U.S. Director Pay:** On May 6, 2019, ISS released a report analyzing trends in U.S. director compensation. The report found a reasonable increase in total director compensation across all market segments in 2018, but noted that the increased demands on directors justified these increases. Additionally, equity remained a significant component in total director compensation, with most directors receiving more than 60% of their compensation in stock. The report is available [here](#).

For an analysis of shareholder activism in 2018, please see S&C's [Review and Analysis of 2018 U.S. Shareholder Activism](#). S&C will also be releasing its annual review of the 2019 proxy season in the summer of 2019.