Corporate Governance Hot Topics

Quarterly Update (June 27, 2018)

1. Corporate Governance, Surveys, Policies and Reports

- **Lazard Report Finds Increased Shareholder Activism in Q1 2018**: Lazard's Quarterly Review of Shareholder Activism for Q1 of 2018 found increased activism by shareholders in terms of number of campaigns initiated, board seats won and capital deployed. Seventy-three new campaigns were initiated in Q1 2018, compared to 67 in Q1 2017 and 62 in Q1 2016. Sixty-five board seats were won in Q1 2018, compared to 41 in Q1 2017 and 100 for the entirety of 2017. $25 billion in capital was deployed in new campaigns for Q1 2018, the most in any single quarter on record. The full report is available here.
- **Equilar Publishes Study on CEO Pay Ratio:** On May 22, 2018, Equliar published a study on CEO pay ratios based on over 2,000 data points available as of May 10, 2018. The study found that the median pay ratio was 70:1 for all Russell 3000 companies and 166:1 for all Equilar 500 companies. Companies with larger market caps had higher ratios—the median ratio for companies with a market cap above $25 billion was 213:1, compared to 32:1 for those with a market cap below $1 billion. The full study is available here.
- **ISS Analytics Report Shows Increase in Virtual-Only Meetings for 2018 Proxy Season:** From January to May 2018, 127 virtual-only shareholder meetings were held in the U.S., compared to 99 virtual-only meetings during the same period last year.
- **Banco Santander and Broadridge Complete First Practical Use of Blockchain for Investor Voting:** Santander and Broadridge, in collaboration with J.P. Morgan and Northern Trust as custodian banks, conducted the test pilot on March 23, 2018 for Banco Santander's annual general meeting (AGM). The pilot was run in parallel to Santander's AGM, with blockchain used to produce a "shadow" digital register of the proxy voting taking place using the conventional voting model.
- **Investors Pressuring Corporations to Act on Gun Violence:** Based on a CNBC report, nearly 150 professional investors, largely from faith-based organizations, "strongly urg[ed]" gun retailers, distributors and manufacturers, as well as companies financing the gun industry, to take action on gun violence. Collectively, the group represents $634 billion in assets and includes faith-based organizations as well as asset managers in the U.S. and Europe. Signing onto a statement issued by the Interfaith Center on Corporate Responsibility, the investors asked these companies "to review their operations, supply chains and policies and take meaningful action on this public safety concern." They also provided steps that gun manufacturers, distributors and retailers, financial institutions and other companies can adopt to reduce the risk of gun violence.
- **EY Releases Report on Independent Directors of 2017:** In May 2018, the EY Center for Board Matters published a report analyzing independent directors elected by shareholders to the board of a Fortune 100 company for the first time in 2017. EY reviewed proxy statements of companies on the 2017 Fortune 100 list and the same 83 companies' class of 2016. The report found that over half of the companies reviewed added at least one independent director. The newly elected directors were 40 percent female, were primarily assigned to audit committees and included more non-CEOs. Corporate finance and accounting were the most common director qualifications. The report is available here.

- **PwC Releases Study of S&P 500 Directors Aged 50 and Under:** In April 2018, PwC released a report examining the population of directors aged 50 or under ("Younger Directors") who are currently serving on S&P 500 boards. These Younger Directors make up only 6% of all board seats in the S&P 500. Only 43% of the S&P 500 has at least one Younger Director. At 50 of those companies, the CEO is a Younger Director. According to the report, S&P 500 companies with younger CEOs are much more likely to have independent Younger Directors. 60% of companies with a CEO aged 50 or under have at least one independent Younger Director on the board—as compared to just 42% of companies that have a CEO over the age of 50. Women comprise a much larger percentage (31%) of Younger Directors than S&P 500 directors overall (22%). Among the independent Younger Directors, the percentage of women is even higher (37%). The full report is available here.
- **New York State Pension Fund to Oppose All-Male Boards:** On March 21, 2018, the New York State Common Retirement Fund pledged to oppose re-election of directors at hundreds of U.S. public companies that do not have any women on their boards. As of the end of 2017, women held 16.5% of directorships at Russell 3000 companies, up from 15.1% in 2016, according to Equilar. Equilar predicts that Russell 3000 boards will not achieve gender parity until 2048. "We need to speed up that time frame," said Thomas DiNapoli, New York state comptroller. In 2017, the New York pension fund owned shares in more than 400 U.S. public companies that did not have any female directors.
- **Equilar Index Shows Four in Five Russell 3000 Boards Have at Least One Woman Director:** Equilar released its Gender Diversity Index (GDI) for Q1 2018, which reported an increase in the number of women on Russell 3000 boards from 16.5% in Q4 2017 to 16.9% in Q1 2018. The GDI showed that nearly one-third (32%) of all new Russell 3000 company board seats in Q1 2018 went to women. The percentage of all-male boards on the index dipped below 20% for the first time ever—decreasing from 22.5% in Q1 2017 to 19.5% in Q1 2018. A summary of the index is available here.
- **T. Rowe Price Makes Clear Activists Do Not Act at Its Request:** In June 2018, T. Rowe Price published a memo on its role in activist campaigns. The memo made clear that in almost all cases T. Rowe Price does not believe its role is to initiate activist campaigns. Instead, it judges each campaign on its merits and backs the party most likely to deliver "sustainable, long-term performance." Some have argued recently that at the outset of a new campaign, activists often enjoy the tacit support of institutional investors and may even have been invited by them into the stock. In the memo, T. Rowe Price emphasized that it has "adopted internal policies prohibiting [its] investment personnel from attempting to initiate an activism campaign indirectly, such as by discussing or pitching ideas to activist investors or other outside parties." It made clear that any activist or any other investor claims representing T. Rowe Price's view on any investment or voting matter should be disregarded.
- **Association Groups Launch New Investor Coalition Against ESG-Focused Investments:** On May 23, 2018, a group of national financial, retirement and manufacturing associations launched the Main Street Investor Coalition to reverse the trend of institutional investors using retail investors' funds to advance social and political objectives rather than focusing on improving business performance and financial returns. The Coalition's key priorities include ensuring that retail investors who own passive funds through 401(k)s have a say in how their shares are voted; forcing third-party proxy-advisory firms to be more transparent about potential conflicts of interest; and insisting that public pension funds meet the same basic regulatory and reporting standards as private pension funds. The release is available here.

2. Selected SEC Developments

- **SEC Updates Compliance & Disclosure Interpretations on Proxy Rules:** On May 11, 2018, the SEC's Division of Corporation Finance issued Compliance and Disclosure Interpretations (CDIs) on the proxy rules and related Schedules 14A/C. The C&DIs made clarifications and addressed a number of issues, including proxy disclosures needed to allow proxy holders to exercise their discretionary authority, matters requiring filing of a preliminary proxy statement or disclosure of financial information, and disclosures in the New Plan Benefits Table and about incumbent directors.
- **SEC Announces Highest Whistleblower Awards Ever:** On March 19, 2018, the SEC announced its largest-ever Dodd-Frank whistleblower awards, with two whistleblowers sharing nearly $50 million and a third whistleblower receiving almost $33 million. The awards surpass the previous record of $30 million granted in 2014. The identities of the whistleblowers were kept confidential. The SEC has awarded more than $262 million to 53 whistleblowers since 2012.
- **Altaba (Yahoo) Enters into Settlement with SEC to Pay $35 Million for Cybersecurity Breach Claim:** On April 24, 2018, Altaba, formerly known as Yahoo, entered into a settlement with the SEC, agreeing to pay $35 million amid allegations that Yahoo misled investors by failing to disclose its knowledge of the massive 2014 data breach that exposed personal data of over 500 million users. According to the SEC order, Yahoo's senior management became aware of the hack days after the incident, but failed to properly investigate the breach or consider whether it should be disclosed to investors. The breach was disclosed in September 2016, when Verizon was closing its acquisition of Yahoo's operating business. The SEC order also found that Yahoo kept the breach secret from external auditors and failed to maintain disclosure controls and procedures. This is the first time the SEC charged a public company for failure to disclose a cybersecurity breach. The updated Framework for Improving Critical Infrastructure Cybersecurity released on April 16, 2018 by the U.S. Commerce Department's National Institute of Standards and Technology could provide pertinent guidance on cybersecurity, including authentication, risk assessment, and management of cybersecurity within the supply chain and vulnerability disclosure. While the Framework originally targeted critical infrastructure industries such as banking, energy and communications, it has since been widely adopted by companies of all sizes as well as all levels of government. The updated Framework is available here, and the SEC order is available here.

3. Other Regulatory Developments

- **Department of Labor Issues Guidance on ESG Considerations:** On April 23, 2018, the DOL published Field Assistance Bulletin No. 2018-01, which provides guidance on the considerations of ESG factors by ERISA plan fiduciaries. While investor focus on ESG factors continues to grow, the FAB cautions ERISA fiduciaries from readily treating ESG factors as economically relevant. It also notes that plan fiduciaries may not sacrifice investment return or take on additional investment risk to promote collateral social policy goals. Instead, the DOL calls on ERISA fiduciaries to prioritize the economic interests of the plan and focus on economic factors that have a material effect on risk and return, unless the ultimately chosen investment would be equal or superior to alternative investments based solely on economic value. The S&C memorandum discussing the guidance is available here.

- **Congress Pressures Proxy Advisory Firms for Enhanced Transparency:** On May 9, 2018, six Senators on the Banking, Housing and Urban Affairs Committee sent letters to ISS and Glass Lewis, following two Government Accountability Office investigations of the proxy advisory industry. The letters sought responses by May 30 to questions regarding the eligibility of their voting systems for exemption from SEC proxy rules, report accuracy and disclosures of conflicts of interest. The Senators' questions echo the concerns discussed in the Corporate Governance Reform and Transparency Act of 2017 passed in the House of Representatives last December, which would require registration of proxy advisory firms with the SEC, disclosure of proxy firms' potential conflicts of interest and codes of ethics, and disclosure of methodologies for formulating proxy recommendations.

4. Selected Case Law Developments

- **Delaware Court Finds Reasonably Conceivable a Minority Stakeholder Can Be Controlling Stockholder:** On March 28, 2018, in *In re Tesla Motors Inc. Stockholder Litigation*, the Delaware Court of Chancery denied the defendants' motion to dismiss, finding it reasonably conceivable that Elon Musk as a 22.1 percent stockholder of Tesla was a controlling stockholder. As a result, Tesla's 2016 acquisition of SolarCity would be subject to a stringent entire fairness standard. Delaware courts seldom find stockholders with "relatively low" ownership levels to be controlling, but the Court considered Musk's ability to rally other stockholders, role as the company's visionary and chairman of the board, strong personal business connections with directors and influence over the company in public filings to reflect virtual control. Companies contemplating transactions with influential stockholders might not be able to rely on a shareholder vote to prevent an entire fairness review of the transaction. Such transactions may require approval of an independent special committee and the uncoerced, informed vote of a majority of the minority stockholders.
- **New York State Court Issues Decision Blocking Proposed Xerox Business Combination:** On April 27, 2018, the New York State Supreme Court issued a significant decision temporarily blocking a proposed business combination between Xerox Corporation ("Xerox") and Fuji Xerox Co., Ltd. ("Fuji Xerox"), the long-standing joint venture between Xerox and Fujifilm Holdings Corporation ("Fuji"). The crux of the Court's decision to block the transaction turned on the conduct of Xerox's "massively conflicted" CEO Jeff Jacobson in negotiating the transaction, and the Board's "acquiescence" to such conduct. The Court found that upon Jacobson learning that Carl Icahn, the largest shareholder, and the board of directors of Xerox (the "Board") were seeking to replace him as CEO, he "abandoned the Board's request to obtain a value-maximizing all-cash transaction and engineered the framework for a one-sided deal" with Fuji that would result in him retaining the CEO position with the combined company. In addition to blocking the transaction, the Court enjoined Xerox from enforcing its nomination deadline for its 2018 annual meeting of shareholders.