

# Corporate Governance Hot Topics

## Quarterly Update (March 12, 2018)

### 1. Corporate Governance, Surveys, Policies and Reports

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- **ISS Announces Launch of Environmental & Social QualityScore:** On February 5, 2018, Institutional Shareholder Services (ISS) announced the launch of its Environmental & Social QualityScore platform (E&S QualityScore), a data-driven approach to measuring the quality of corporate disclosures on environmental and social issues, including sustainability governance, and identifying key disclosure omissions. The E&S QualityScore includes more than 380 environmental and social factors under analysis.
- **ISS Analytics Update and Potential for Proposals Relating to Gun Control:** On February 28, 2018, ISS Analytics released preliminary estimates indicating that more than two-thirds of the 450 shareholder proposals filed at Russell 3000 companies for the 2018 proxy season related to social and environmental issues. Although key themes among these proposals have been consistent with last year (political spending, board and workplace diversity and climate and sustainability), this year has seen a number of policy-oriented proposals stemming from, for example, the Opioid Accountability campaign. Given this pattern and current events, we expect to see proponents also submit proposals relating to gun control during the remainder of 2018 and for 2019. Issuers seeking to exclude social and environmental proposals from their proxy statements on the basis of ordinary business (Rule 14a-8(i)(7)) will need to consider the interplay of the issue with the significant policy issue exception and the SEC's related guidance in SLB 14I.
- **EY Releases 2018 Proxy Season Preview:** In January 2018, the EY Center for Board Matters released its 2018 Proxy Season Preview. EY interviewed more than 60 institutional investors representing \$32 trillion in assets under management, including asset managers, public pension funds, labor pension funds, and faith-based and socially responsible investors, as well as investor associations and advisors. Based on its interviews, EY found that the top five priorities for companies in 2018 are: board composition, with a particular focus on diversity; board-level expertise that is more aligned with business goals; increased attention to climate risk and the environment; enhanced attention to talent and human capital management; and compensation that is more aligned with performance and strategy. The report is available [here](#).
- **State Street Evaluates S&P 500 Companies for Non-Compliance with Investor Stewardship Group Governance Principles:** On February 23, 2018, State Street Global Advisors (SSGA) sent letters to board chairs and lead directors at S&P 500 companies requesting that they evaluate and disclose their compliance with the principles outlined by the Investor Stewardship Group (ISG). Starting in February 2018, SSGA will review governance practices at the companies and seek to "proactively engage with companies to better understand the reasons for non-compliance." If SSGA believes that a company is not adequately explaining its governance approach, it may hold the board accountable by voting against the independent chair, lead independent director or most senior independent director up for election. SSGA will use a screening methodology that identifies voting guidelines encompassed in the six ISG Corporate Governance Principles. Companies that do not meet at least three of the 13 voting guidelines "will be targeted for further review and engagement." The ISG Principles emphasize certain governance practices, including annual elections, majority voting standards, proxy access, one-share one-vote, robust

independent board leadership through either an independent chair or independent lead director with clearly explained roles, board refreshment and diversity and pay-for-performance executive compensation programs. Based on 2017 proxy filings, SSGA found that 13% of the S&P 500 companies fail to adhere to three or more of the guidelines and 40% of the companies fully comply with the compliance screen. The most common issue causing non-compliance with the ISG Principles is lack of proxy access. Other issues include lack of annual elections, “inadequate” board refreshment practices and insufficient board independence. The form of letter can be found [here](#).

- **BlackRock CEO’s Annual Letter Highlights Shareholder Engagement, Board Diversity and Companies’ Duty to Society:** On January 16, 2018, BlackRock Chairman and CEO Laurence Fink released his annual letter to CEOs of public companies. The letter links the prosperity of companies to their ability to deliver both financial performance and positive contributions to society. Entitled “A Sense of Purpose,” the letter highlighted BlackRock’s increasingly active approach to shareholder engagement, its view that boards are central in the oversight of companies’ long-term strategic direction and what Mr. Fink believes is a connection between companies’ management of environmental, social and governance (ESG) risk factors and long-term value creation. Fink says, “[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers and the communities in which they operate.” Fink points to the rise in index funds, which require asset managers to hold long-term positions in companies, as a driver of change in corporate governance. Companies should be able to articulate how external factors such as social impact, climate change and regulatory changes will affect their financial performance. Fink’s letter also addresses the role of board diversity in driving long-term growth. The letter is available [here](#).
- **The National Association of Corporate Directors Releases the Results of Its 2017-2018 Public Company Governance Survey:** On November 30, 2017, the NACD released the results of its 2017-2018 Public Company Governance Survey of over 1,000 directors and executives. The survey examined directors’ outlook for 2018 on key business trends and critical board priorities, the board’s role in overseeing the organization’s culture, the state of board risk oversight—especially cybersecurity risk—and the growing challenge of hedge fund activist investors. When asked about trends expected to have the greatest effect on their companies over the next year, 58% identified significant industry change, including technology disruption, industry consolidation and shifting regulations. Next, 46% of respondents identified each of business model disruption and changing global economic conditions as key trends, followed by cybersecurity threats (38%), competition for talent (36%) and the uncertain political environment in the United States (35%). Participants’ concerns relating to the impact of regulatory burdens dropped from 58% in 2016 to 29% in 2017. Environmental, social and governance concerns, while a significant issue for many institutional investors, were less of a priority: only 6% identified climate change as a top-five trend for 2018, while only 2% believe the changing role of business in society is a key trend.
- **Deloitte Releases Results of 2017 Board Diversity Survey:** Deloitte Chairman Mike Fucci commissioned a report to examine the current state of corporate boards and the need for boardrooms to become more diverse, not just demographically but in skillset, perspectives and experiences. Deloitte conducted a survey of over 300 directors. Ninety-five percent of respondents agreed that their boards need to seek more candidates with diverse skills and perspectives. Respondents saw diversity as going beyond basic demographics as nine out of 10 of those surveyed agreed that gender and racial diversity alone does not produce the diversity required for an organization to be innovative or disruptive. The full survey results are available [here](#).
- **Equilar Study Finds Recent Drop in Median CEO Tenure Rates:** On January 19, 2018, Equilar released a study finding that, in the past five years, CEO transitions have become more common than they

were in the preceding five years. As a result, median CEO tenure has fallen a full year since 2013. The median tenure for CEOs at large-cap (S&P 500) companies was five years at the end of 2017. Looking back historically at the companies included in the study, that figure has fallen from six in 2013. Average tenure, which is affected by long-standing CEOs with several decades of service, also dropped in that timeframe, but to a lesser degree—decreasing from 7.5 years in 2013 to 7.2 years in 2017.

## 2. Selected SEC Developments

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- **SEC Issues Expanded Interpretive Guidance on Cybersecurity Matters:** On February 20, 2018, the SEC issued interpretive guidance to further assist public companies in preparing disclosures and crafting policies and procedures for reporting, risk management, and preventing insider trading in relation to cybersecurity risks and incidents. The SEC highlighted the need for public companies to have appropriate disclosure controls and procedures for escalation of cybersecurity risks and incidents to disclosure decision-makers, as well as policies and procedures to prevent insider trading on, and selective disclosure of, cybersecurity information. The S&C memorandum discussing the expanded guidance is available [here](#).
- **SEC Approves New NYSE Rules For Non-IPO Listings:** On February 2, 2018, the SEC approved the New York Stock Exchange (NYSE) proposal to permit qualifying private companies to use “direct listings” to list their shares on the NYSE and become publicly traded without conducting an initial public offering so long as the direct listing is accompanied by a concurrent Securities Act resale registration statement. Direct listings may provide an alternative to a traditional IPO for private companies that do not need to raise public capital but desire to provide greater liquidity for existing shareholders and/or make their shares a more attractive currency for merger and acquisition activity. The S&C memorandum discussing the new rules is available [here](#).
- **SEC Provides Guidance on New Tax Reform Reporting:** On December 22, 2017, the SEC’s Division of Corporation Finance released Form 8-K [Compliance and Disclosure Interpretation 110.02](#) and its Office of the Chief Accountant published [Staff Accounting Bulletin No. 118](#), which provide guidance on reporting accounting impacts of the recently enacted tax reform legislation. The new C&DI clarifies that disclosure under Item 2.06 of Form 8-K (Material Impairments) is not triggered by the re-measurement of deferred tax assets due to a change in tax rates or tax laws. New SAB 118 provides guidance on reporting the income tax effects of U.S. tax reform for issuers that are not able to complete the accounting for certain tax effects by the time financial statements are issued covering the reporting period that includes the date of the enactment of the Tax Cuts and Jobs Act (December 22, 2017). The S&C memorandum discussing the new guidance is available [here](#).
- **SEC Approves Rules to Eliminate Requirement for NYSE-Listed Companies to Provide Hard Copies of Proxy Materials to NYSE:** On March 1, 2018, the SEC announced that NYSE-listed companies that file proxy materials under Schedule 14A on EDGAR will no longer be required to send hard copies to the NYSE. The release is available [here](#).

### 3. Other Regulatory Developments

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- **Issuance of Material News in Period Immediately After Official Closing Time for NYSE's Trading Session Takes Effect:** On December 4, 2017, the NYSE adopted an amendment to Section 202.06 of the NYSE Listed Company Manual to limit the issuance of material news by listed companies in the period immediately after the official closing time for the Exchange's trading session. Listed companies are prohibited from publishing material news after the official closing time for the NYSE's trading session until the earlier of 4:05 p.m. EST or the publication of the official closing price of the listed company's security. This rule is intended to alleviate confusion caused by price discrepancies between the NYSE closing price and trading prices on other markets after the NYSE official closing time and before the NYSE closing auction is completed, which can be after 4:00 p.m. EST. The S&C memorandum discussing the rule change is available [here](#).
- **Advance Notice of Dividend or Stock Distribution Announcements to NYSE Takes Effect:** On February 1, 2018, the NYSE proposed rule change to require listed companies to provide notice to the Exchange at least 10 minutes before making any public announcement with respect to a dividend or stock distribution, including when the notice is outside of NYSE trading hours, took effect. The S&C memorandum discussing the rule change is available [here](#).
- **Federal Trade Commission Announces Revised Hart-Scott-Rodino Thresholds:** On January 26, 2018, the Federal Trade Commission announced that the applicable thresholds under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 would be revised to reflect the change in the gross national product. The FTC is required to revise these thresholds each year. On February 28, 2018, the size-of-transaction threshold increased to \$84.4 million (up from \$80.8 million) and the size-of-person test now applies to transactions valued at \$337.6 million or less (up from \$323 million). For acquisitions that are subject to the size-of-person test, the "\$10 million" person must now be a \$16.9 million person and the "\$100 million" person must now be a \$168.8 million person. The revised thresholds apply to all transactions that close on or after February 28, 2018. The S&C memorandum discussing the new thresholds is available [here](#).
- **NASDAQ Proposes Changes to Shareholder Approval Requirements:** On January 30, 2018, Nasdaq Stock Market LLC filed notice with the SEC of a proposed rule change to Nasdaq Listing Rule 5635(d). This proposed change deletes the reference to book value in the threshold price of "less than the greater of book or market value" for the purposes of the shareholder approval required for issuances of common stock equal to 20% or more of the outstanding stock or voting power. The proposed rule change also changes the definition of "market value" from the closing bid price to "the lower of (i) the closing price (as reflected on Nasdaq.com) or (ii) the average closing price of the common stock (as reflected on Nasdaq.com) for the five trading days immediately preceding the signing of the binding agreement." The S&C memorandum discussing the new changes is available [here](#).
- **Federal Reserve Takes Significant Enforcement Action Against Wells Fargo:** On February 2, 2018, the Federal Reserve issued an enforcement action barring Wells Fargo from increasing its total assets and mandating substantial corporate governance and risk management actions. The Federal Reserve noted that Wells Fargo would replace three current board members by April 2018 and a fourth board member by the end of 2018. In addition, the Federal Reserve released three supervisory letters stating that Wells' board of directors, former Chairman and CEO John Stumpf and a past lead independent director did not meet supervisory expectations. These actions come shortly after significant actions already taken against Wells Fargo, including appointing a former Federal Reserve governor as independent Chairman and replacing a number of independent directors, as well as its General Counsel.

## 4. Selected Case Law Developments

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- **Supreme Court Issues Ruling on Dodd-Frank Whistleblower Provision:** On February 21, 2018, in *Digital Realty Trust, Inc. v. Somers*, the Supreme Court held that the Dodd-Frank Act's definition of a "whistleblower" is "unambiguous" and "unequivocal": it means "any individual who provides . . . information relating to a violation of the securities laws to the Commission." The Court held, in accordance with that definition, that the Dodd-Frank Act's anti-retaliation provision—which prohibits employers from retaliating against "whistleblowers" for each of three types of "lawful act[s]"—provides a private cause of action only for persons who report suspected wrongdoing directly to the SEC, and not for persons who report exclusively to their employers. The decision resolved a conflict in the courts of appeals, which had split over the question of whether the portion of the anti-retaliation provision, which protects "whistleblowers" who made "disclosures that are required or protected under . . . any . . . law, rule or regulation subject to the jurisdiction of the Commission," also protected individuals who made internal complaints about possible violations of securities laws. As a result of this decision, individuals who do not report to the SEC may not bring claims under Dodd-Frank; however, they may well have claims under the Sarbanes-Oxley Act, which explicitly protects individuals who report concerns internally from retaliation for having done so. The S&C memorandum discussing the decision is available [here](#).
- **Delaware Court Applies Entire Fairness Standard in Reviewing Challenges to Shareholder-Approved Discretion-Based Director Compensation:** On December 13, 2017, in *In re Investors Bancorp, Inc. Stockholder Litigation*, Case No. 169, the Delaware Supreme Court held that, except under limited circumstances, the court will not apply the deferential "business judgment rule" in reviewing challenges to director compensation awards granted pursuant to stockholder-approved equity plans. Instead, such awards are subject to an "entire fairness" standard of review.
- **Delaware Court Issues Ruling Relating to Dual-Class Structure and Controlling Shareholders:** On December 11, 2017, the Delaware Court of Chancery issued a decision that may be important for companies looking to implement measures to extend or make changes to dual-class voting structures and for companies with controlling stockholders. The decision addressed stockholder fiduciary duty challenges to a recapitalization undertaken by NRG Yield, Inc., which, prior to the recapitalization, had a dual-class stock structure and a controlling stockholder. The court found that the transaction was conflicted because it was specifically designed to benefit the controlling stockholder. Despite this conflict, the court dismissed the litigation because the court found that NRG Yield, in adopting the recapitalization, properly followed the "MFW" framework, named after the 2014 Delaware Supreme Court decision in *Kahn v. M&F Worldwide Corp.*, which provides a roadmap for avoiding the entire fairness standard of review in certain types of controlling stockholder transactions.

- **Delaware Court Enforces Oral Proxy Contest Settlement Agreement:** On December 8, 2017, in *Sarissa Capital Domestic Fund LP v. Innoviva Inc.*, the Delaware Chancery Court held that an oral agreement to settle a proxy contest was binding and enforceable and ordered pharmaceutical company Innoviva to add two nominees from Sarissa to its board. In February 2017, Sarissa launched a proxy contest to replace three of Innoviva's seven directors at the company's annual meeting in April. A day before the annual meeting, the parties reached an oral agreement to settle the proxy contest in exchange for the appointment of two Sarissa nominees to the board. Later that day, Innoviva rescinded the oral agreement after learning that a large stockholder planned to vote for the board's directors, ensuring a win for the board nominees. In ordering specific performance of the oral agreement, the court found that Innoviva had entered into a binding agreement to settle a proxy contest launched by Sarissa and that Innoviva's attempts to renege on that agreement when it later learned it would win the proxy contest was "nothing but misguided opportunism."

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