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ANALYSIS

THE EVOLVING RESPONSE TO SHAREHOLDER ACTIVISM

by Paul L. Choi, Partner[1]

Shareholder activism with respect to public companies continued to grow last year, and there are few indications of this trend abating in the near future. Activists targeted more than 200 companies in 2014, compared to about 120 in 2010. Activist funds now have over $200 billion in assets under management, and as a class, they outperformed all other hedge fund strategies in 2014. Accompanying this strong financial performance has been a remarkable record of success in achieving their governance objectives. For example, activists last year enjoyed a 73% success rate in placing their director nominees on targeted company boards, either through full blown proxy contests or negotiated settlements. In total, activists won 197 board seats and were instrumental in replacing 19 CEOs in 2014. So far in 2015, the number of actual or threatened proxy contests is on track to exceed last year's pace, and with a 67% success rate, activists have continued to enjoy strong results.

As the level of activism has grown, and as the tactics employed have become increasingly sophisticated, we have seen an evolution in how companies should best prepare for, and respond to, the appearance of activists. This article summarizes some of these key lessons.

- **All activists are not the same.** There is, in fact, a broad diversity of shareholder activists. Some are principally concerned with governance or corporate social responsibility matters. Most of the attention, though, has been focused on "value" activists that seek to promote an M&A transaction (e.g., a sale of the company or a divestiture of a business unit), a greater return of capital to shareholders (through share buybacks or increased dividends) or business and operational improvements (including management changes).
- **Boards need to keep an open mind on activist proposals.** An activist critique of the company's financial or operating strategy could be constructive in nature. Because each activist situation should be individually evaluated, it may be unwise to establish detailed advance preparation playbooks that seem to suggest that the board will reject out of hand any overture by an activist.
- Any company could be targeted by an activist campaign. The experience of the last couple of years has taught that even the largest companies in the country can be vulnerable. In 2014, activists targeted 45 companies with a market capitalization of over $10 billion, including such blue chip companies as Apple, eBay, Microsoft and PepsiCo. This year, we witnessed the largest company to date battling a proxy contest

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Even very large companies, and companies with generally strong financial performance, can be vulnerable to activism.

—Trian Fund's ultimately unsuccessful fight against DuPont. Even companies with a generally strong record of financial performance can be targets if they are susceptible to criticism regarding inadequate return of capital to shareholders or the unwillingness to shed underperforming units.

- **Structural takeover defenses may have less value against an activist.** Structural takeover defenses—designed to address an inadequate or coercive hostile takeover attempt—have proven to be less useful against activists. To begin with, far fewer companies employ the two most potent structural defenses, the classified board and the shareholder rights plan. Moreover, while a rights plan may be an important and appropriate response to an activist that seeks to rapidly accumulate a control position in a company, it is not designed to deter a proxy contest and would not be meaningful in situations where the activist is content with holding less than the triggering threshold of the rights plan (such as 10% or 15%). Similarly, while the classified board is highly effective in slowing down an outright takeover of the board, a typical activist seeks no more than a one-third representation on the board.
- **Proactive and regular engagement with key shareholders has never been more important.** Institutional investors are increasingly vocal about how companies are governed and have encouraged companies to engage with them on a regular basis—and not only when an activist situation emerges. Regular communications with key shareholders (and understanding their areas of concern) have always been a good governance practice. It has become vital in an age of activism. One of the reasons why DuPont prevailed earlier this year against Trian Fund was apparently due to the support that management received from the long-term index fund holders.

Companies must engage with key shareholders on a regular basis—not only when an activist situation emerges.

- **Anticipate likely activist criticism.** Some of the most effective preparatory steps can involve engaging outside advisors to prepare a critique of the company through the eyes of a potential activist. One tactic employed by sophisticated activists is to publicly distribute a detailed "white paper" describing the company's strategic or financial missteps. Companies should be prepared to promptly answer the most likely activist criticisms and, on occasion, proactively adopt those responses.
- **Regular updates to the board remain a key component of preparedness.** Periodic updates to the board on activism should include a general reminder of how directors should respond to an activist, consistent with their fiduciary duties and governance best practices. More specifically, directors should also understand the degree to which the company is vulnerable to activist critiques and whether it would be appropriate to make any modifications to the company's strategy and operations in light of such weaknesses.

SEC AND PCAOB RENEWED FOCUS ON AUDIT COMMITTEES AND AUDIT COMMITTEE MEMBER CONDUCT

by Holly J. Gregory, Jack B. Jacobs and Thomas J. Kim[2]

Public company counsel and audit committee members should be aware of recent activity at the U.S. Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) that could lead to additional regulation of audit committee disclosure and to federal normative expectations for how audit committees and their members behave.

The SEC

On July 1, 2015, the SEC issued a concept release[3] soliciting public comment on the question of whether more information should be disclosed about the activities of public company

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3 SEC Release No. 33-9862, *Possible Revisions to Audit Committee Disclosures* (Jul. 1, 2015), available here.

audit committees. This new concept release is not a reaction to any particularly noteworthy development, nor is it responsive to a recent accounting scandal or a legislative directive. Rather, the SEC in its concept release notes:

- "the fact that a significant number of audit committees voluntarily provide information beyond the disclosures required by our current rules raises a question of whether there may be market demand for such information;" and
- "investors and other stakeholders have requested greater transparency about audit committee activities."

For these reasons, the SEC seeks public comment on whether its disclosure requirements should be amended to elicit additional information about what audit committees do, because this information could be valuable in two respects. First, it could provide "useful context for audit committee decisions." Second, it could "enable investors to differentiate between companies based on the quality of audit committee oversight, and determine whether such differences in quality of oversight may contribute to differences in performance or quality of financial reporting among companies."

The concept release focuses on three topics: the audit committee's oversight of the auditor, the audit committee's process for selecting the auditor, and the audit committee's consideration of the qualifications of the audit firm and certain members of the engagement team when selecting the audit firm. On their face, these topics are likely to be of interest to some investors. The difficulty for issuers and audit committees, however, is in the details. For example, the SEC asks whether there should be disclosure about how the audit committee:

- "dealt with disagreements between company management and the auditor;"
- "considered any deficiencies described in the PCAOB inspection report on the audit process;" and
- "evaluated the auditor's objectivity and professional skepticism, as well as the results of such an evaluation."

These potential areas of disclosure are qualitatively different from the disclosures required of audit committees to date in that they focus on the thought process of individual audit committee members in an open-ended context that leads to no definitive conclusion other than that the audit committee has decided that it has discharged its oversight duty. In other words, these disclosure requirements focus on the questions that the audit committee posed to the auditor, and the follow-up questions they asked in response to the answers they received.

We question whether quality of audit committee oversight can be evaluated in the abstract, based on responses to the hypothetical questions posed in the SEC's concept release.

The concept release acknowledges that a primary objective of these disclosures would be to "enable investors to differentiate between companies based on the quality of audit committee oversight, and determine whether such differences in quality of oversight may contribute to differences in performance or quality of financial reporting among companies." Disclosing information so that shareholders can compare the quality of oversight between and among public companies sounds like a valid objective. However, given the unique circumstances that each company faces, it will be challenging to compare the quality of audit committee oversight separate and apart from these circumstances, as well as the fact that oversight is—in many instances—about subjective human judgments. Indeed, we question whether "quality of oversight" can be measured or evaluated in the abstract, based on responses to the hypothetical questions posed in the SEC's concept release. Another concern relates to the "Heisenberg Principle" effect: in physics, this means that the act of observation will itself change the phenomenon that is being observed. Here, a requirement to disclose how the audit committee dealt with disagreements between company management and the auditor may change the way in which management and the auditor inform the audit committee of such disagreements, as well as the manner in which the audit

While requiring disclosure can be an effective way to change behavior, the potential for improvements in behavior must be balanced against the potential for unintended consequences, which could discourage candid discussion among management, the auditor and the audit committee.

committee deals with any such disagreements. For example, if this disclosure is required, management and the auditor may be tempted to redefine whether and how an issue is classified as a "disagreement," thereby potentially reducing audit committee insight into these issues. Should the audit committee recalibrate what constitutes a disagreement, this may lead to less rigorous discussions with the auditor and management. While requiring disclosure can be an effective way to change behavior, the potential for improvements in behavior must be balanced against the potential for unintended consequences, which could discourage candid discussion between and among management, the auditor and the audit committee. Without a compelling reason why this is necessary for public company audit committees, this risk alone should give the SEC reason to pause.

The potential chilling effect on audit committee decisions, deliberations and judgments will likely be a theme in the public comment that the SEC has invited. While this information may be of interest to investors who seek greater transparency into the committee room, it will also raise concerns that investors are being inundated with too much information—so much so that they often turn to third parties to digest the information and advise them on how to vote based on it. Should that be the result, then once in the hands of these third-party advisors, additional legitimate concerns arise regarding the one-size-fits-all nature of the policies the third-party advisors are likely to apply in making vote recommendations on related topics, including the election of audit committee members.

The PCAOB

Separately, in May 2015, the PCAOB issued its first Audit Committee Dialogue[4] which begins: "In our talks with audit committee members, we heard your request to provide insights from our oversight activities." In this dialogue—as it has elsewhere—the PCAOB offers up possible questions that it would like audit committee members to ask auditors. When a regulator suggests questions that an audit committee should ask of its auditor, such a suggestion is difficult to ignore. The PCAOB's suggested questions, combined with the requirements of the PCAOB's Auditing Standard No. 16, "Communications with Audit Committees," appear intended to influence the relationship of the audit committee and auditor and the dialogue between them. Auditing Standard No. 16 requires the auditor to communicate certain specific matters to the audit committee. In its "Potential Questions for Your Auditor," the PCAOB has now provided audit committees with a suggested script for the audit committee's side of that conversation.

Under state law, particularly that of Delaware, boards and board committees are free to discharge their fiduciary duties, including how they communicate among themselves and with auditors, without the oversight of courts or administrative regulators.

Since the enactment of Sarbanes-Oxley, public company audit committees have been subject to a high degree of regulation, in terms of heightened independence requirements for audit committee members and enhanced responsibilities for audit committees as set forth in their charters. The audit firms they oversee are also subject to a high degree of regulation, in terms of both PCAOB audit standards and the PCAOB's inspection process, which is annual for the largest audit firms. Given this existing federal regulatory regime, and the importance of respecting the traditional role of state law regulating the substance of director conduct and oversight, in our view, the case for more regulation—whether in the form of disclosure requirements or suggested questions for the audit committee to ask the auditor—has not yet been made. Under state law, particularly that of Delaware, boards and board committees are free to discharge their fiduciary duties, including how they communicate among themselves and with auditors, without the oversight of courts or administrative regulators.

The SEC's concept release and the PCAOB's audit committee dialogue suggest, both directly and indirectly, that an unprecedented layer of federal regulation of how audit committee members should carry out their state law fiduciary duties would be appropriate, without demonstrating any countervailing upside benefit or justification. Given the potential significance of these regulatory developments, we highly recommend that counsel to public

4 Public Company Accounting Oversight Board, *Audit Committee Dialogue* (May 2015), available here.

companies and audit committee members follow these developments closely and consider to what degree these efforts—even absent any definitive regulatory action—signal regulatory expectations about audit committee behavior.

PROXY ACCESS GAINING MOMENTUM

by Holly J. Gregory, Partner[5]

Through the collective efforts of large institutional investors, including public and private pension funds, shareholders at a significant number of companies are likely within the next several years to gain the power to nominate a portion of the board without undertaking the expense of a proxy solicitation. By obtaining proxy access—the ability to include shareholder nominees in the company's own proxy materials—activists and other shareholders will have an additional weapon in their arsenal to influence board decisions.

While proxy access has been the subject of shareholder proposals for several years, 2015 appears to be a turning point. Proxy access is taking hold this year, with a major initiative from public pension funds led by New York City Comptroller Scott M. Stringer. Major investors, such as TIAA-CREF, and the large institutional investor industry group the Council of Institutional Investors, are encouraging these efforts. Adding to the momentum is the SEC's removal for the 2015 proxy season of a key defense that has been traditionally used by companies. The SEC announced that, during the 2015 proxy season, it would no longer grant no-action relief in situations in which a company intends to put forward its own competing proposal. Proxy advisory firm policies that support proxy access and discourage efforts to defend against proxy access proposals add to the momentum.

Proxy access will likely follow the pattern of majority voting in uncontested director elections and become common among S&P 500 companies in the next several years, assuming that institutional investors continue to campaign through shareholder proposals and the threat of shareholder proposals.

The 2015 proxy season has seen a significant increase in the number of shareholder proxy access proposals and shareholder support for such proposals, as well as an increased frequency of negotiation and voluntary adoption of proxy access via board action or submission of a management proposal to a shareholder vote. As of July 31, 2015:

- 84 shareholder proxy access proposals had been voted on in 2015 with average support of more than 54% of votes cast and 49 proposals passing;
- of the 12 management proxy access proposals voted on in 2015, seven have passed; and
- 26 companies have adopted proxy access in 2015, and several additional companies have publicly committed to adopt proxy access later in 2015 or in 2016.

As companies are considering whether and when to adopt proxy access, they should:

- follow developments in this area and keep the board of directors and the nominating and corporate governance committee generally apprised;
- know the preferences of their shareholder base (as evidenced in proxy voting policies and voting history on proxy access proposals) and engage with shareholders with respect to proxy access;
- stay current on proxy advisory firm policies and guidance relating to proxy access;
- keep apprised of the terms upon which companies are adopting proxy access (e.g., ownership threshold, holding period, limits on the number of seats at issue, limits on the number of shareholders who can combine to meet the threshold, nominee requirements and shareholder and nominee disclosure requirements), which, in some cases, appear to be settling in on a market standard as described in the Sidley update linked below; and
- review the advance notice and director qualification provisions in the bylaws and consider how such provisions may be aligned with a proxy access bylaw if adopted.

For more information, see our Sidley update on proxy access developments available here.

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NEWS[6]

JUDICIAL DEVELOPMENTS

Peppercorn of Consideration No Longer Sufficient to Support an M&A Settlement

Modifications to certain deal protections and supplemental disclosures were not sufficiently beneficial to the class to warrant an "intergalactic release" of claims for the defendants.

In *Acevedo v. Aeroflex Holding Corp.* (Del. Ch. Jul. 8, 2015), the Delaware Court of Chancery intentionally departed from the long-developing trend of M&A litigation settlements based only on merger agreement modifications and/or supplemental disclosures. The case related to the acquisition by Cobham plc of Aeroflex Holding Corp. Vice Chancellor Laster declined to approve a proposed settlement in a class action lawsuit, finding that modifications to certain deal protections (e.g., reduction in break-up fee and change in matching rights period) and supplemental disclosures were not sufficiently beneficial to the class to warrant an "intergalactic release" of claims for the defendants.

The transcript of the settlement hearing is fascinating reading, particularly for M&A practitioners who are accustomed to the customary series of steps that occur following the announcement of nearly every public company merger. Following announcement, plaintiffs typically file one or more class action lawsuits asserting breaches of fiduciary duty, and then, after a short discovery period, the parties enter into a court-approved settlement that includes a global release from the certified class. To be clear, this is not the case with all M&A class action lawsuits, particularly if the entire fairness standard is at issue. But it happens in the vast majority of public company M&A transactions. The plaintiffs' attorneys benefit because they receive a fee, and the parties to the proposed merger benefit because the global release from the class provides significant protection and closure to stockholder litigation prior to the closing of the M&A transaction.

What is interesting about the *Aeroflex* settlement hearing was the detailed analysis by the Vice Chancellor of whether the plaintiffs (not just their attorney) actually benefitted from any of the merger agreement changes or the supplemental disclosures. For example, even though the termination fee was reduced by $14 million (a 40% reduction) and the matching rights period was reduced from four days to three, Vice Chancellor Laster noted that neither change addressed the real reason why the most likely competing bidder did not try to make a topping bid. In this case, the issue was that the competing bidder needed an NDA waiver so that it could try to find a buyer for the portion of Aeroflex's business that it did not want to buy. Furthermore, Aeroflex's 73% stockholder was receiving the same terms as the other stockholders and was supportive of the transaction. Vice Chancellor Laster explained that fixing the termination fee and the matching rights did not increase the likelihood of a topping bid if the NDA was not waived:

Vice Chancellor Laster: The trend of settling M&A class action lawsuits for a "peppercorn and a fee" has the effect of "undercut[ting] Delaware's credibility as an honest broker in the legal realm."

> [I]f I am telling you that my car won't drive and we agree that it's because of the transmission—and you've agreed that it was because of the NDA; that was very helpful—then the fact that you have changed my oil and given me a new air filter has not increased the chances that my car will drive.

In denying approval of the settlement, Vice Chancellor Laster noted that the trend of settling M&A class action lawsuits for a "peppercorn and a fee" has the effect of "undercut[ting] the credibility of the litigation process" and "undercut[ting] Delaware's credibility as an honest broker in the legal realm." In addition to raising the possibility of a dismissal motion, the Vice Chancellor did leave the door open for the parties to come back with a more limited release, tied only to the breach of fiduciary duty claims, or for plaintiffs to seek a "mootness" fee based on the supplemental disclosures.

The facts that were stipulated by the plaintiffs, after discovery, were compelling in favor of the defendants. Therefore, it will be interesting to see if this result is a fact-specific blip in the

6 The following attorneys contributed to the research and writing of the pieces in this section: Beth E. Flaming, Jack B. Jacobs, John P. Kelsh, J. Mark Metts and Hille R. Sheppard. We appreciate their contributions.

trend of M&A settlements or instead the start of a new trend. If it is a new trend, it could have a chilling effect on suits with fact patterns that do not raise enhanced scrutiny issues.

But the ruling does underscore that care should be given in structuring settlements to make clear that any merger agreement changes address the particular transaction dynamics of the deal at hand and that any supplemental disclosures fix material disclosure deficiencies that have caused harm to the stockholders. Finally, consideration should be given to the scope of the release, with attention to whether the claims that are being released are sufficiently connected to the claims that were or could reasonably have been asserted in the litigation.

Enhanced Protection for Independent Directors

In re Cornerstone Therapeutics Inc. Stockholder Litigation (Del. May 14, 2015) is a welcome development for independent directors who approve M&A transactions, adopt takeover defenses or approve transactions with controlling stockholders. In this decision, the Delaware Supreme Court held that, regardless of the underlying standard of review for the board's conduct—business judgment rule, entire fairness, *Unocal*, etc.—a suit for monetary damages against a director who is protected by a Section 102(b)(7) exculpatory charter provision will be dismissed unless the plaintiff pleads facts suggesting that the director engaged in non-exculpated conduct (e.g., breached the duty of loyalty or acted in bad faith). This case also serves as a reminder of two fundamental tenets of Delaware law: (i) where directors face claims for damages in a suit challenging board action, each director is considered individually and (ii) independent directors are presumed to have acted in accordance with their fiduciary duties.

In Cornerstone*, the Delaware Supreme Court held that a suit for monetary damages against a director who is protected by a Section 102(b)(7) exculpatory charter provision will be dismissed unless the plaintiff pleads facts suggesting that the director engaged in non-exculpated conduct (e.g., breached the duty of loyalty or acted in bad faith).*

This decision helps to ensure that independent directors do not have an incentive to reject transactions or a disincentive to serve as special committee members, simply because of the risk of protracted litigation. In addition, this decision may result in lower settlement values with respect to such actions. However, directors should bear in mind the following:

- The holding is limited to suits for monetary damages. If equitable relief is a viable remedy (as is typically the case in pre-closing M&A litigation), the exculpatory charter provision may not lead to the same result of dismissal.
- Following the dismissal of a suit against a director defendant on a motion to dismiss, plaintiffs may amend their complaints if they subsequently obtain sufficient evidence to plead non-exculpated claims against that director defendant.
- Even if independent directors are not subject to suit for monetary damages, they will still be subject to discovery in fiduciary duty litigation, including in connection with ongoing suits against non-independent directors and in connection with the determination as to the appropriate standard of review and which party bears the burden of proof (e.g., in an entire fairness case).

Third Circuit Clarifies Application of Rule 14a-8's "Ordinary Business" Exclusion

In Trinity Wall Street v. Wal-Mart Stores, Inc. (3d Cir. Jul. 6, 2015), the U.S. Court of Appeals for the Third Circuit held that Wal-Mart could properly exclude a shareholder proposal under Rule 14a-8(i)(7) because the decision to sell assault rifles relates to Wal-Mart's ordinary business operations. Trinity's proposal asked Wal-Mart's board to develop and implement standards for management to use in deciding whether to sell a product that (i) "especially endangers public safety; (ii) "has the substantial potential to impair the reputation of Wal-Mart"; and/or (iii) "would reasonably be considered by many offensive to the family and community values integral to the Company's promotion of its brand." Under Rule 14a-8(i)(7), a company may exclude a shareholder proposal from its proxy materials if the proposal deals with a matter relating to the company's ordinary business operations. The Court found that the subject matter of Trinity's proposal relates to Wal-Mart's ordinary business operations because "a retailer's approach to its product offerings is the bread and butter of its business."

The Third Circuit held that Wal-Mart could properly exclude Trinity's shareholder proposal as relating to Wal-Mart's ordinary business operations under Exchange Act Rule 14a-8(i)(7) because "a retailer's approach to its product offerings is the bread and butter of its business."

The SEC Staff has declared that a shareholder proposal generally will not be excludable under Rule 14a-8(i)(7) when "a proposal's underlying subject matter transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote." The Court determined that Trinity's proposal raises a sufficiently significant policy issue, but not an issue that "transcends" Wal-Mart's ordinary business operations. To meet that standard in this case, the Court stated that the policy issue "must target something more than the choosing of one among tens of thousands of products it sells." Finally, the Court recommended that the SEC issue new interpretive guidance to address the increasing number of shareholder proposals that relate simultaneously to an ordinary business matter and a significant social policy issue.

Disclosure of Actual (Not Approximate) Annual Meeting Date Required to Trigger Notice Period Under Certain Advance Notice Bylaws

In *Hill International v. Opportunity Partners, L.P.* (Del. Jul. 2, 2015), the Delaware Supreme Court considered the deadline under Hill's bylaws for notices of stockholder proposals or nominations to be considered at Hill's 2015 annual meeting. Hill's bylaws provided that the window for notices of stockholder proposals and nominations was generally between 60 and 90 days prior to the annual meeting but that if "less than seventy (70) days notice or prior public disclosure of the date of the annual meeting is given or made to stockholders," the deadline for notices of stockholder proposals and nominations would be the tenth day following the date of public disclosure of the annual meeting date. The Supreme Court rejected the company's argument that it had publicly disclosed the date of the 2015 annual meeting in its 2014 proxy statement, which stated that the company "anticipate[d]" holding its 2015 annual meeting "on or about June 10, 2015," since it consisted of disclosure of an anticipated range of meeting dates, rather than disclosure of the *actual* meeting date. The Supreme Court then affirmed the Court of Chancery's judgment in favor of the activist stockholder, holding that the activist's notice of proposals and nominations was timely delivered (because it had been delivered within ten days following first public disclosure of the annual meeting date) and ordering a 21-day adjournment of the annual meeting to enable the stockholders to consider and vote upon the plaintiff's proposals and board nominees.

The decision provides four important takeaways for the corporate bar, including board advisors:

- Deadlines in advance notice bylaw provisions should be keyed off of the actual meeting date or the anniversary of the date of the prior annual meeting, not the date of public announcement of the annual meeting date.
- Delaware courts will be vigilant to ensure that stockholders seeking to nominate a dissident slate of directors receive clear instructions, so it is important to draft advance notice bylaws with clarity.
- Delaware courts will resolve disputes over the meaning of advance notice bylaw language under ordinary contract interpretation principles. As the Supreme Court stated: "…if the bylaw's language is ambiguous…the bylaw is construed as it is written, and the language, if simple and unambiguous, is given the force and effect required. If charter or bylaw provisions are unclear, we resolve any doubt in favor of the stockholder's electoral rights."
- Where the circumstances require, the Delaware courts will resolve disputes affecting the stockholder franchise on a highly expedited basis. In *Hill*, the Supreme Court issued its formal written opinion only seven weeks after the initial filing of the Court of Chancery action.

Consider Asking Shareholders to Approve Meaningful Limits on Director Equity Compensation

Calma v. Templeton (Del. Ch. Apr. 30, 2015), which involved Citrix Systems, Inc., is the second significant Delaware Court of Chancery opinion in recent years to deal with equity compensation paid to directors. *Seinfeld v. Slager* (Del. Ch. Jun. 29, 2012), decided in 2012, was the first. In both *Calma* and *Seinfeld*, the Court denied the defendant's motion to dismiss. In each case the denial turned to some extent on the absence from the relevant company's equity plan of a meaningful limit on the number of shares that directors could receive as compensation. At least one similar case—relating to director compensation at the Goldman Sachs Group—has been filed in Delaware since the opinion in *Calma* was issued. As a result of these cases, companies putting new plans to a shareholder vote would be well advised to consider adding to those plans a meaningful limit on director equity compensation. See our Sidley update here for more information.

LEGISLATIVE DEVELOPMENTS

DGCL Amendments Endorsing Forum Selection and Prohibiting Fee-Shifting Take Effect

Effective August 1, 2015, the Delaware General Corporation Law (DGCL) has been amended to:

- authorize forum selection clauses in the charters or bylaws of Delaware corporations specifying Delaware as an exclusive forum for litigating internal corporate claims;
- prohibit clauses designating only courts outside of Delaware as the exclusive forum for internal corporate claims; and
- invalidate provisions in the charters or bylaws of Delaware stock corporations that shift fees for internal corporate claims.

Delaware corporations should seriously consider adopting a forum selection clause specifying that lawsuits asserting "internal corporate claims" be brought solely and exclusively in the Delaware courts.

The Governor of Delaware signed the amendments into law on June 24, 2015. What to do in light of the amendments:

- Consider adopting a Delaware forum selection clause (if not previously adopted) because multiple forum litigation is expensive, distracting and frequently the result of jockeying among plaintiffs' lawyers to obtain a "seat at the table" in lawsuits challenging mergers. Note that Delaware corporations that have unilaterally adopted forum selection clauses in recent years generally have not faced significant adverse reaction from ISS or large institutional investors. However, under its current policies, Glass Lewis will consider recommending against the governance committee chair where the board adopted a forum selection bylaw in the past year without shareholder approval (and explicitly will recommend voting against the governance committee chair at companies that completed an IPO within the past year if the board unilaterally adopted a forum selection clause in the charter or bylaws prior to the IPO).
- If a Delaware corporation has adopted a forum selection clause that would prohibit litigation of internal corporate claims in the Delaware courts, it should amend the clause to make clear that such claims may be brought in Delaware in addition to, or instead of, the forum currently specified.
- If a Delaware stock corporation has adopted a fee-shifting provision with respect to internal corporate claims, it should consider amending its charter and/or bylaws, as applicable, to remove such provision because it will no longer be enforceable.

See our Sidley update here for more information.

DGCL Amendment Permits Non-Directors to Make Restricted Stock Grants

Because of the restrictions imposed by Section 157(c) of the DGCL, it has long been understood by practitioners that a board or compensation committee may confer on an officer the ability to award "rights or options" relating to the company's equity to other employees, but that it was not possible to confer such authority with regard to the award of actual shares of stock. In a development that has seemingly not received a lot of press, the DGCL has now been modified, effective as of August 1, 2015, to permit such delegation. As a result, it is now possible for boards and compensation committees to authorize officers to award all forms of equity compensation, provided that the board or compensation committee must in all instances approve an overall limit on the number of shares that may be awarded by the officer.

SEC & REGULATORY DEVELOPMENTS

SEC Proposes Compensation Clawback Rules

With the proposal of the clawback rules, the SEC has now proposed or adopted rules to implement all of the Dodd-Frank Act provisions relating to executive compensation.

On July 1, 2015, the SEC proposed long-awaited rules mandated by the Dodd-Frank Act that would direct the securities exchanges to establish listing standards that would require any company to adopt, disclose and comply with a compensation clawback policy as a condition to listing its securities on an exchange. Each clawback policy must provide that, if the company is required to restate its financial statements because of material noncompliance with any financial reporting requirement under the securities laws, the company would recover excess compensation from any current or former executive officers who received incentive-based compensation during the preceding three-year period based on the erroneous data. The excess compensation would be any compensation in excess of what would have been paid under the accounting restatement. The proposed rules would also require the clawback policy to be filed as an exhibit to its annual report on Form 10-K and would require proxy statement disclosure in XBRL format of certain actions taken pursuant to the clawback policy. Our Sidley update summarizing the proposed rules and their implications is available here.

Update on SEC Staff Review of Rule 14a-8(i)(9)

In January 2015, SEC Chair White announced that, “Due to questions that have arisen about the proper scope and application of Rule 14a-8(i)(9), I have directed the staff to review the rule and report to the Commission on its review.” The SEC’s Division of Corporation Finance in turn announced that, effective for the 2015 proxy season, it would not grant no-action relief under Rule 14a-8(i)(9) on the grounds that a shareholder proposal directly conflicts with a management proposal.

In June 2015, five large law firms that together handle a significant volume of shareholder proposal work on behalf of corporate clients, including Sidley, sent a joint letter to the SEC urging it to continue its long-standing practice of permitting companies to exclude shareholder proposals that directly conflict with management proposals on the basis of Rule 14a-8(i)(9).

In a speech in late June 2015, SEC Chair White noted that, notwithstanding concerns that shareholders would be confused by two competing proposals, “shareholders were able to sort it all out and express their views.” She also expressed her hope that the Staff’s review of Rule 14a-8(i)(9) will be completed prior to the 2016 proxy season.

On July 16, 2015, Jonathan Ingram, Deputy Chief Counsel of the SEC, provided an update on the Staff’s review of Rule 14a-8(i)(9) at a meeting of the SEC’s Investor Advisory Committee. He indicated that the Staff’s research on the subject is complete and that he expects the Staff to recommend various alternatives for changes to the rule and/or its application. It has not been determined whether any changes would be implemented through SEC rulemaking versus interpretive guidance.

SEC to Consider Adoption of Final Pay Ratio Rules on August 5

The SEC has announced that, on August 5, it will meet to consider adopting final rules regarding CEO pay ratio disclosure. The SEC proposed these rules in September 2013. As proposed, the rules would require public companies to disclose the CEO’s annual total compensation in relation to the median annual total compensation of all other employees of the company, including foreign, part-time and temporary employees. It is not yet known what the final rules will require. We will circulate a Sidley update analyzing the new rules when they are available.

It seems likely that—whatever form the final rules take—litigation will be brought challenging them. Several SEC rulemakings in recent years have been invalidated through litigation, often on the basis that the SEC has not undertaken sufficient economic analysis of their impact. That the SEC is mindful of this with respect to these rules is evidenced by its publication, on each of June 4 and June 30, of an analysis conducted by the Division of Economic and Risk Analysis regarding the impact of excluding various percentages of employees from the pay ratio calculation.

SIDLEY EVENTS AND SPEAKERS

Sidley will host its annual West Coast General Counsel Roundtable in Menlo Park on September 17, 2015. Any General Counsel who is interested in attending should contact Elpidio Benitag at ebenitag@sidley.com or (415) 772-7409.

The ABA Business Law Section Annual Meeting will take place in Chicago from September 17-19, 2015. Tom Kim, a partner in our Washington, D.C. office, will participate in a panel entitled *New Opportunities for Unregistered Securities Offerings—Today and Tomorrow* on September 18. Also on September 18, Holly Gregory, a partner in our New York office and the Chair of the ABA Business Law Section's Corporate Governance Committee, will chair a meeting of that committee. Rebecca Grapsas, counsel in our New York/Sydney offices, will participate in a panel entitled *International Developments with Respect to Shareholder Rights and Implications for U.S. Companies* on September 19. Sidley's Chicago office will host a cocktail reception in conjunction with the Annual Meeting from 5:00–7:00 p.m. on September 18. For more information, please contact Kayla Sierra at ksierra@sidley.com.

Jennifer Fitchen, a partner in our Palo Alto office, will participate in a webinar on September 29, 2015 entitled *Private Company Mergers & Acquisitions: A Potpourri of Practical Pointers* sponsored by the ABA Business Law Section. Click here to register and find more information.

Sidley will host its annual Corporate College in Chicago and New York from November 3-5, 2015. Sidley's Corporate College is a program intended to expose participants to a broad spectrum of topics likely to be encountered by a transactional lawyer. Sidley clients interested in attending should contact Brooke Farrell at bfarrell@sidley.com or (312) 456-4049.

SIDLEY RESOURCES

The Sidley Best Practices Calendar for Corporate Boards and Committees, as most recently updated in June 2015, is available here. The calendar outlines how the board of a public company may wish to organize its activities during a calendar year taking into account applicable SEC rules, listing standards and general governance principles.

An article entitled *Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective* by Jack Jacobs, senior counsel in our Wilmington office who served on the Delaware Supreme Court from 2003 to 2014, was published in the Summer 2015 issue of the Harvard Business Law Review.

An article entitled *Hot Topics for Compensation Committees* by Holly Gregory, a partner in our New York office, was published in the July/August 2015 edition of Practical Law's *The Governance Counselor.*

An article entitled *Integration Clauses & Letters of Intent* by Sharon Flanagan, a partner in our San Francisco/Palo Alto offices, Jack Jacobs, senior counsel in our Wilmington office, and John Fisher, counsel in our Palo Alto office, was published in the July/August 2015 edition of Deal Lawyers. The article was based on a Sidley update they authored earlier this year.

On July 13, 2015, Bill Blumenthal, a partner in our Washington, D.C. office, was interviewed by the hosts of the *Legal Face-Off* program on WGN Radio about antitrust implications in M&A transactions. A link to the podcast containing the interview is available here.