Corporate Governance 2021

Contributing editor
Holly J Gregory
Sidley Austin LLP

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Published by
Law Business Research Ltd
Meridian House, 34-35 Farringdon Street
London, EC4A 4HL, UK

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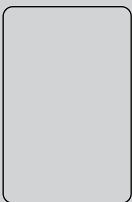
© Law Business Research Ltd 2021
No photocopying without a CLA licence.
First published 2002
Twentieth edition
ISBN 978-1-83862-640-2

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



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Lexology Getting The Deal Through is delighted to publish the twentieth edition of *Corporate Governance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes a new chapter on Australia.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Holly J Gregory, for her continued assistance with this volume.

London
May 2021

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This article was first published in June 2021
For further information please contact editorial@gettingthedealthrough.com

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

In the United States, there are two primary sources of law and regulation relating to corporate governance.

State corporate laws

State corporate law – both statutory and judicial – governs the formation of privately held and publicly traded corporations and the fiduciary duties of directors. Delaware is the most common state of incorporation. Because Delaware law and interpretation are influential in other states, the Delaware General Corporation Law (DGCL) is used in this chapter as the reference point for all state law discussion. Shareholder suits are the primary enforcement mechanism of state corporate law.

Federal securities laws

On the federal level, the primary sources are the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act), each as amended. The Securities Act regulates all offerings and sales of securities, whether by public or private companies. The Exchange Act addresses many issues, including the organisation of the financial marketplace generally, the activities of brokers, dealers and other financial market participants and, as to corporate governance, specific requirements relating to the periodic disclosure of information by publicly held, or 'reporting', companies. A company becomes a reporting company under the Exchange Act when its securities are listed on a national securities exchange or when it has total assets exceeding US$10 million and a class of securities held of record by more than 2,000 persons or a maximum of 500 persons who are not sophisticated ('accredited') (with some exclusions). Both the Securities Act and the Exchange Act have addressed questions of corporate governance primarily by mandating disclosure, rather than through normative regulation.

The Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act) was enacted in July 2002 in response to the corporate failures of 2001 and 2002. The Sarbanes–Oxley Act, which applies to all reporting companies (whether organised in the United States or elsewhere) with US-registered equity or debt securities, amends various provisions of the Exchange Act (and certain other federal statutes) to provide direct federal regulation of many matters that traditionally had been left to state corporate law or addressed by federal law through disclosure requirements. Under the Sarbanes–Oxley Act, many aspects of corporate governance that were previously addressed, if at all, through stock market listing requirements, best practice standards or policy statements from the Securities and Exchange Commission (SEC) are now subjects of direct binding law. Since 2002, the Securities and Exchange Commission (SEC) has promulgated a number of rules that implement provisions of the Sarbanes–Oxley Act.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd–Frank Act) was enacted in July 2010 in response to the financial crisis in 2008 and 2009. The Dodd–Frank Act is intended to significantly restructure the regulatory framework for the US financial system and also extends federal regulation of corporate governance for all public companies. The SEC has promulgated several rules that implement provisions of the Dodd–Frank Act. Ongoing rule-making by the SEC and national securities exchanges are required for full implementation.

The Jumpstart Our Business Startups Act of 2012 (the JOBS Act) was enacted in April 2012 to, inter alia, facilitate private capital formation and ease reporting requirements that may apply to 'emerging growth companies' after the initial public offering. The JOBS Act requires the SEC to undertake various initiatives, including rule-making and studies touching on capital formation, disclosure and registration requirements.

Listing rules provide an additional source of corporate governance requirements. To list a security on any of the three major listing bodies – the New York Stock Exchange (NYSE), NYSE American (formerly known as the American Stock Exchange and NYSE MKT) or the Nasdaq Stock Market (Nasdaq) – a company must agree to abide by specific corporate governance listing rules. In 2003, the SEC approved significant amendments to both the NYSE and Nasdaq corporate governance listing rules as described below. The Dodd–Frank Act requires amendments to corporate governance listing rules to be made by the NYSE and Nasdaq.

In addition, a number of corporate governance guidelines and codes of best practice recommend how public company boards should organise their structures and processes. The American Law Institute's Principles of Corporate Governance: Analysis and Recommendations present a thorough discussion of governance practices from a legal perspective. Other influential recommendations from the business community include:

- the National Association of Corporate Directors (NACD):
  - Key Agreed Principles (developed in collaboration with Business Roundtable and the Council of Institutional Investors (CII));
  - Report of the NACD Blue Ribbon Commission on Director Professionalism;
  - Report of the NACD Blue Ribbon Commission on Building the Strategic-Asset Board;
- the Business Roundtable: Principles of Corporate Governance;
- the Conference Board, Commission on Public Trust and Private Enterprise: Findings and Recommendations; and
- the Commonsense Principles of Corporate Governance issued by a coalition of high-profile representatives of leading public companies and institutional investors in 2016 and updated in the form of Commonsense Principles 2.0 in October 2018.

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The investor community has also issued a number of corporate governance guidelines, codes of best practices and proxy voting policies that are increasingly influential. These include:

- the CII: Policies on Corporate Governance;
- the Teachers Insurance and Annuity Association of America-College Retirement Equities Fund (TIAA)/Nuveen: TIAA Policy Statement on Responsible Investing;
- the California Public Employees' Retirement System (CalPERS): Governance and Sustainability Principles;
- proxy voting policies of large institutional investors, such as BlackRock, Vanguard, State Street and Fidelity; and
- the Investor Stewardship Group, Corporate Governance Principles for US Listed Companies and Stewardship Principles issued in January 2017 by a group of US-based institutional investors and global asset managers representing more than US$20 trillion in assets under management.

In addition, proxy advisory firms, such as Institutional Shareholder Services (ISS) and Glass Lewis, have developed proxy voting guidelines that set forth the voting recommendations that these firms will make on particular issues to be voted on by shareholders. These guidelines are based on what these firms consider to be 'best practices' and have also become influential.

Unlike many corporate governance codes in the European Union and other parts of the world that call for voluntary adoption of their substantive provisions or 'comply or explain' disclosure requirements, the corporate governance rules in the United States are generally mandatory. However, most US federal securities regulation of listed issuers is disclosure-driven and, even where substantive matters are addressed, disclosure is most often used as the vehicle to achieve a desired objective or to add transparency to matters deemed worthy of public attention. For example, with respect to executive compensation, the rules provide for extensive disclosure requirements rather than substantive requirements.

Responsible entities

2 | What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The primary means of enforcing state corporate law is through derivative suits initiated by shareholders. At the federal level, the SEC has the power to regulate, implement and enforce the Securities Act and the Exchange Act (including the Sarbanes–Oxley Act, the JOBS Act and relevant provisions of the Dodd–Frank Act). In addition, the Sarbanes–Oxley Act created the Public Company Accounting Oversight Board (PCAOB) to regulate the services accounting firms provide to companies. The SEC oversees the PCAOB, appoints its members and must approve any rules adopted by the PCAOB.

The CII is an influential association of public and private pension funds that often pushes for governance reforms. Pension funds have traditionally been the most activist of the institutional investors, working both in concert and individually. Influential pension funds include TIAA/Nuveen and CalPERS – respectively, among the largest private and public pension funds in the world. The New York City Pension Funds have become increasingly active in recent years with highly effective campaigns urging companies to adopt proxy access and prioritise board composition, diversity and refreshment. In addition, Vanguard Group, BlackRock Inc and State Street Global Advisors, three of the United States' largest institutional investors, have recently become more assertive in pushing for corporate governance reforms and increased director-shareholder engagement at the companies in which they invest.

The views of proxy advisory firms ISS and Glass Lewis are also influential.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 | What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Under state corporate law, shareholders generally have the right to elect directors (see the Delaware General Corporation Law (DGCL), section 216).

For many years, it was common practice for directors to be elected by a plurality of shareholders that can either vote in favour of, or withhold their votes from, the director candidates nominated by the board; 'withheld' votes are not counted. Accordingly, absent a contested election, the candidates nominated by the board are automatically elected whether or not a majority of shareholders vote for them. Relatively recently, shareholders have pressed companies for the ability to veto the election of a particular director nominee or nominees in the context of an uncontested election. This can be achieved through the adoption of charter or by-law provisions requiring that director nominees receive the approval of a 'majority of the votes cast' to be elected, or, in lieu of a charter or by-law provision, the adoption of corporate policies that effectively require a director who has not received a majority of the votes cast to resign. In 2006, the Delaware legislature adopted amendments to the DGCL that facilitate both of these options. Specifically, the amended DGCL, section 141(b) expressly permits a director to irrevocably tender a resignation that becomes effective if he or she fails to receive a majority vote in an uncontested election. The amended DGCL, section 216 provides that a by-law amendment adopted by shareholders specifying the vote required to elect directors may not be repealed or amended by the board alone (generally, by-law provisions may be amended by the board).

The proportion of companies in the Standard & Poor's (S&P) 500 that have adopted some form of majority voting in uncontested director elections has increased dramatically from 16 per cent in 2006 to approximately 90 per cent in 2021.

Shareholders can also nominate their own director candidates either before or at the annual general meeting, although most public companies adopt 'advance notice' bylaws that require nominations to be received by the company several months before the annual general meeting. To solicit the proxies needed to elect their candidates, however, at a company that has not adopted 'proxy access' a shareholder must mail to all other shareholders, at the shareholder's own expense, an independent proxy solicitation statement that complies with the requirements of section 14 of the Securities Exchange Act of 1934 (the Exchange Act). Given these constraints, independent proxy solicitations are rare and usually undertaken only in connection with an attempt to seize corporate control.

In addition, shareholders generally have the right to remove directors with or without cause or, where the board is classified, only for cause (unless the certificate of incorporation provides otherwise); the vote required to remove directors is a majority of the shares then entitled to vote at an election of directors (subject to certain modifications, for example, where the company has adopted cumulative voting in director elections) (see DGCL, section 141(k)). However, as many publicly held companies do not permit shareholders to call special meetings or act by written consent, this power can be difficult to exercise in practice.

Shareholders' liability for corporate actions is generally limited to the amount of their equity investment. In keeping with their limited

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liability, shareholders play a limited role in the control and management of the corporation. A number of corporate decisions require shareholder approval. In addition, shareholders can typically enjoin ultra vires acts (see DGCL, section 124) and vote on certain issues of fundamental importance at the annual general meeting, including the election of directors (see DGCL, section 216).

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

Under state corporate law, shareholders typically have a right to participate in the following types of decisions:

- election of directors, held at least annually (see DGCL, sections 141(d), 211(b) and 216);
- filling of board vacancies and newly created directorships, if so provided in the certificate of incorporation or by-laws (see DGCL, section 223);
- removal of directors (see DGCL, section 141(k));
- approval or disapproval of amendments to the corporation's certificate of incorporation (which requires prior board approval) or by-laws, although the board is also typically authorised (in the certificate of incorporation) to amend the by-laws without shareholder approval (see DGCL, sections 109, 241 and 242); and
- approval or disapproval of fundamental changes to the corporation not made in the regular course of business, including mergers, consolidations, compulsory share exchanges, or the sale, lease or exchange of all or substantially all of the corporation's property and assets (see, for instance, DGCL, sections 251(c) and 271).

Other issues that may be brought to shareholder vote include:

- approval of certain business combinations with interested shareholders that would otherwise be prohibited (see DGCL, section 203(a)(3));
- approval of conversion to a different type of entity (see DGCL, section 266);
- approval of transfer, domestication or continuance in a foreign jurisdiction (see DGCL, section 390);
- approval of dissolution and revocation of dissolution (see DGCL, sections 275 and 311); and
- ratification of defective corporate acts that would have required shareholder approval (see DGCL, section 204(c)).

Shareholders may also be asked by the board to approve certain matters, including:

- approval of interested director or officer transactions (see DGCL, section 144);
- the making of determinations that indemnifying a director or officer is proper (see DGCL, section 145); or
- if so provided in the certificate of incorporation, the making of determinations that the consideration for which shares of stock with or without par value may be issued, and treasury stock disposed of (see DGCL, section 153).

Since 2011, the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 has required US public companies to conduct separate shareholder advisory votes on:

- executive compensation – to be held at least once every three calendar years (annual votes are typical);
- whether the advisory vote on executive compensation should be held every year, every two years or every three years – to be held at least once every six calendar years; and
- certain 'golden parachute' compensation arrangements in connection with a merger or acquisition transaction that is being presented to shareholders for approval.

The rules of the New York Stock Exchange (NYSE) and Nasdaq Stock Market (Nasdaq) also require that shareholder approval be obtained prior to:

- any adoption of an equity compensation plan pursuant to which officers or directors may acquire stock, subject to limited exceptions;
- issuance of common stock to directors, officers, substantial security holders or their affiliates if the number of shares of common stock to be issued exceeds either 1 per cent of the number of shares of common stock or 1 per cent of the voting power outstanding before the issuance, with some exceptions including in connection with certain transactions by early-stage companies (NYSE), or could result in an increase in outstanding common shares or voting power of 5 per cent or more (Nasdaq);
- issuance of common stock that will have voting power equal to or greater than 20 per cent of the voting power prior to such issuance or that will result in the issuance of a number of shares of common stock that is equal to or greater than 20 per cent of the number of shares of common stock outstanding prior to such issuance, subject to certain exceptions; and
- issuance of securities that will result in a change of control of the company.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Under state law, a corporation may issue classes of stock with different voting rights, limited voting rights and even no voting rights, if the rights are described in the corporation's certificate of incorporation (see DGCL, section 151). If, however, a corporation issues a class of non-voting common stock, it must have an outstanding class of common shares with full voting rights.

The NYSE and Nasdaq listing rules also permit classes of stock with different voting rights; however, the listing rules prohibit listed companies from disparately reducing or restricting the voting rights of existing shareholders unilaterally.

The Council of Institutional Investors (CII) and the California Public Employees' Retirement System have expressed their opposition to non-voting shares.

In 2017, two major stock index providers (S&P Dow Jones and FTSE Russell) announced changes to their index eligibility requirements that would exclude most companies going public with multiple classes of stock from the primary indices in the United States. Nevertheless, some companies in the technology industry and other industries have subsequently gone public with dual-class or multi-class stock.

Although it prefers equal voting rights, BlackRock acknowledges that newly public companies may benefit from a dual-class structure but endorses a limited duration through a sunset provision or periodic approval by shareholders.

ISS will generally recommend voting against or withholding votes from the entire board (except new nominees, who should be considered on a case-by-case basis) if, prior to or in connection with the company's public offering, the company or its board implemented a multi-class capital structure where the classes have unequal voting rights, unless the structure is subject to a reasonable time-based sunset provision. Glass Lewis may issue negative recommendations against directors at the first annual meeting after the company has become public if the company adopts a multi-class capital structure that does not include a reasonable sunset provision. Both ISS and Glass Lewis generally

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consider a reasonable sunset to be seven years or less. Furthermore, Glass Lewis will generally recommend that shareholders vote in favour of recapitalisation proposals that would eliminate a company's multi-class share structure to allow for all shareholders to have one vote per share.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Generally, all shareholders, at the record date set by the board, may participate in the corporation's annual general meeting, and are entitled to vote (unless they hold non-voting shares) in person or by proxy (see DGCL, sections 212(b) and (c) and 213). The proxy appointment may be in writing (although there is no particular form mandated by the DGCL) or provided by telephone or electronically.

In addition, section 14 of the Exchange Act and related SEC regulations set forth substantive and procedural rules with respect to the solicitation of shareholder proxies for the approval of corporate actions at annual general meetings and special shareholders' meetings. Foreign private issuers are exempt from the provisions of section 14 and related regulations insofar as they relate to shareholder proxy solicitations.

Shareholders may act by written consent without a meeting unless the certificate of incorporation provides otherwise (see DGCL, section 211(b)). The majority of companies in the S&P 500 do not permit shareholder action by written consent.

DGCL, section 211 permits a Delaware corporation to hold a meeting of shareholders virtually if it adopts measures to enable shareholders to participate in and vote at the meeting and verify voter identity, and if it maintains specified records. Prior to 2020, a small but growing number of US companies held virtual annual shareholder meetings, typically in one of two formats: exclusively online with no ability for a shareholder to attend an in-person meeting; or a hybrid approach whereby an in-person meeting is held that is open to online participation by shareholders who are not physically present at the meeting. The primary benefits of virtual shareholder meetings are increased shareholder participation and cost savings.

The number of US companies that held virtual-only annual shareholder meetings skyrocketed in 2020 when the covid-19 pandemic made in-person shareholder meetings impossible or inadvisable. Many US companies are considering holdings annual shareholder meetings in virtual or hybrid formats in the future.

Currently, ISS prefers a hybrid approach, but it does not have a policy to recommend voting against directors at companies that hold virtual-only meetings. In April 2020, ISS issued policy guidance that encouraged companies holding virtual-only meetings to explain why and provide shareholders with a meaningful opportunity to participate fully in the meeting (eg, engage in dialogue, ask questions of directors and senior management).

In egregious cases, Glass Lewis may recommend voting against governance committee members or the board chair where a company chooses to hold a virtual-only shareholder meeting but does not provide sufficient disclosure explaining how shareholders can participate in the meeting and engage with the board and management.

Several large institutional investors (eg, CII, CalPERS, CalSTRS and the New York City Pension Funds) oppose virtual-only shareholder meetings and may vote against directors at companies that hold them.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Generally, state law provides that every shareholder has the right to petition the court to compel an AGM if the board has failed to hold the AGM within a specified period of time (see DGCL, section 211). Special shareholders' meetings may be called by anyone authorised to do so in the company's certificate of incorporation or by-laws. The majority of S&P 500 companies permit shareholders meeting a minimum beneficial ownership requirement (such as 20 per cent or 10 per cent) to call special meetings.

Any shareholder of a reporting company who is eligible to bring matters before a shareholders' meeting under state law and the company's certificate of incorporation and by-laws may, at the shareholder's own expense, solicit shareholder proxies in favour of any proposal including director nominations. Such shareholder proxy solicitations must comply with section 14 of the Exchange Act and related SEC regulations, but need not be approved by the board.

Under circumstances detailed in Rule 14a-8 under the Exchange Act, a reporting company must include a shareholder's proposal in the company's proxy materials and identify the proposal in its form of proxy. The shareholder may also submit a 500-word supporting statement for inclusion in the company's proxy solicitation materials. This allows the proponent to avoid the costs associated with an independent solicitation. To qualify, a shareholder must have continuously held at least US$2,000 in market value or 1 per cent of the company's securities entitled to vote for at least one year by the date the shareholder submits the proposal. The shareholder must continue to hold those securities until the date of the meeting. The SEC adopted rule amendments in September 2020 that will significantly increase the eligibility requirements for submitting a shareholder proposal to a tiered approach depending on the level of ownership and the relevant holding period: at least US$2,000 if held for at least three years, at least US$15,000 if held for at least two years, and at least US$25,000 if held for at least one year. The heightened standards will apply to any shareholder proposal submitted for an annual shareholder meeting held on or after 1 January 2022.

Under specific circumstances, a company is permitted to exclude a shareholder proposal from its proxy solicitation, typically after obtaining 'no-action' relief from the SEC staff that confirms the company is entitled to exclude the proposal (eg, if the proposal deals with a matter relating to the company's ordinary business operations).

Since 2011, companies may not exclude from their proxy materials shareholder proposals (precatory or binding) relating to by-law amendments establishing procedures for shareholder nomination of director candidates and inclusion in the company's proxy materials, as long as the proposal is otherwise not excludable under Rule 14a-8. This amendment to Rule 14a-8 has facilitated the development of 'proxy access' via private ordering at companies chartered in states where permissible, as shareholders are able to institute a shareholder nomination regime via binding by-law amendment or request, via precatory shareholder proposal, that such a by-law be adopted by the board. The private ordering process to adopt proxy access has gained considerable momentum since the beginning of 2015.

Shareholders may act by written consent without a meeting unless the certificate of incorporation provides otherwise. The majority of companies in the S&P 500 do not permit shareholder action by written consent.

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Controlling shareholders' duties

8 | Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Controlling shareholders owe a fiduciary duty of fair dealing to the corporation and minority shareholders when the controlling shareholder enters into a transaction with the corporation. When a controlling shareholder transfers control of the corporation to a third party, this obligation may be extended to creditors and holders of senior securities as well. A controlling shareholder who is found to have violated a duty to minority shareholders upon the sale of control may be liable for the entire amount of damages suffered, instead of only the purchase price paid or for the amount of the control premium. Minority shareholders can bring claims against a controlling shareholder for breach of fiduciary duty on either a derivative or direct basis, depending on the nature of the harm suffered.

Shareholder responsibility

9 | Can shareholders ever be held responsible for the acts or omissions of the company?

Shareholders' liability for corporate actions is generally limited to the amount of their equity investment. In unusual circumstances, exceptions may apply.

Employees

10 | What role do employees have in corporate governance?

Employees have no formal role in corporate governance at public companies in the United States. However, it is not uncommon for employees to own shares of the corporation's stock directly or through employee stock option or retirement plans. Stock ownership enables employees to participate in corporate governance as shareholders.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

In general, anti-takeover devices are permitted. However, there are limits on what types of devices are allowed.

The shareholder rights plan or 'poison pill' is a device adopted by boards to grant existing shareholders the right to purchase large amounts of additional stock for a nominal price if and when an outsider acquires a certain amount of shares (eg, 15 per cent of the outstanding capital). This greatly dilutes the potential acquirer's holdings. Poison pills can usually be 'redeemed' or 'disarmed' by the board of directors before they are 'triggered'. Thus, a poison pill forces a potential acquirer to either negotiate with the existing board or incur the time and expense of initiating a proxy fight to replace the existing directors with directors friendly to the acquirer (who can then redeem the poison pill).

Variations on the traditional poison pill have been designed to make it even more difficult for potential hostile acquirers by restricting the ability of newly placed directors to redeem the poison pill. For example, a 'dead-hand' provision in a poison pill provides that only the specific directors who originally approved the adoption of the poison pill may redeem it. A 'no-hand' poison pill cannot be redeemed at all, and a 'chewable' poison pill gives the incumbent directors a specific period to negotiate before the pill becomes effective. Some states allow the use of dead-hand, no-hand and chewable poison pills (although Delaware does not permit the use of dead-hand or no-hand poison pills). Shareholder activists and proxy advisory firms tend to disfavour poison pills that have not been approved by shareholders. For 2021, the proxy advisory firm ISS revised its policies to clarify that it will generally recommend voting against all directors if a board unilaterally adopts a poison pill, whether in the short-term or long-term, that includes a dead-hand provision.

State corporate law does not prescribe the disclosure of poison pills. However, the Securities and Exchange Commission (SEC) requires reporting companies to disclose any by-law and charter provisions (eg, a poison pill) that would delay, defer or prevent a change in control in the course of an extraordinary corporate transaction, such as a merger, sale transfer or reorganisation. The rights underlying poison pills may also require SEC registration.

A variety of other anti-takeover devices and practices are also available. Courts have upheld the use of the following anti-takeover devices:

- acquisition of another business to increase the chances that the threatened takeover will raise antitrust considerations;
- adoption of voting and other procedures that make it difficult for an acquirer of a majority of voting shares to replace the board of directors (such as board classification, for example, into three classes of directors, pursuant to which one-third of the board is elected every year);
- imposition of restrictions on business combinations with significant shareholders without board approval ('freeze-out' – the default position in Delaware, Delaware General Corporate Law (GGCL), section 203);
- institution of a suit to enjoin the offer for violations of antitrust laws, rules regulating tender offers or other legal grounds;
- issuance, or proposed issuance, of additional shares to persons who oppose the takeover (a lock-up);
- amendment of basic corporate documents to make a takeover more difficult;
- buyout of the aggressor;
- inclusion of supermajority voting requirements in the corporate charter;
- issuance of dual classes of common stock;
- greenmail (but subject to 50 per cent federal excise tax);
- provision of extremely large severance payments to key executives whose employment is terminated following a change in control (golden parachutes);
- undertaking of defensive acquisitions;
- purchase of the corporation's own shares to increase the market price of the stock; and
- imposition of restrictions in connection with the creation of debt that frustrate an attempted takeover.

Under the New York Stock Exchange (NYSE) and Nasdaq Stock Market (Nasdaq) listing rules, listed companies are prohibited from using defensive tactics that would disparately reduce or restrict the voting rights of existing shareholders (eg, the adoption of time-phased voting plans or the issuance of super voting stock).

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Under Delaware law, the board is permitted to issue new shares without shareholder approval up to the amount of authorised capital set forth in the company's certificate of incorporation. Authorisation of additional shares for issuance will require shareholder approval. The SEC rules require registration of shares prior to their being issued unless an exception applies. In addition, the rules of the NYSE and Nasdaq require shareholder approval be obtained prior to:

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- any adoption of an equity compensation plan pursuant to which officers or directors may acquire stock, subject to limited exceptions;
- issuance of common stock to directors, officers, substantial security holders or their affiliates if the number of shares of common stock to be issued exceeds either 1 per cent of the number of shares of common stock or 1 per cent of the voting power outstanding before the issuance, with some exceptions including in connection with certain transactions by early-stage companies (NYSE), or could result in an increase in outstanding common shares or voting power of 5 per cent or more (Nasdaq);
- issuance of common stock that will have voting power equal to or greater than 20 per cent of the voting power prior to such issuance or that will result in the issuance of a number of shares of common stock that is equal to or greater than 20 per cent of the number of shares of common stock outstanding prior to such issuance, subject to certain exceptions; and
- issuance of securities that will result in a change of control of the company.

Under Delaware law, shareholders do not have any pre-emptive rights to acquire newly issued shares unless pre-emptive rights are expressly granted to shareholders in the certificate of incorporation (DGCL, section 102(b)(3)) or are granted to shareholders on a contractual basis.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Under the DGCL, section 202, restrictions on the transfer and ownership of fully paid securities are permitted. A corporation may impose these restrictions in its certificate of incorporation or by-laws, or through an agreement among shareholders. However, any restrictions imposed after the issuance of securities are not binding on those securities, unless the shareholders of the securities are parties to an agreement or voted in favour of the restriction. All permitted restrictions must be noted conspicuously on the certificate representing the restricted security, or, in the case of uncertificated shares, contained in the notice sent to the registered owner. Regardless of any such restrictions, all sales or transfers of securities by public (or private) corporations must be made pursuant to (or subject to an exemption under) the Securities Act of 1933.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Under the DGCL, section 253, a corporation owning at least 90 per cent of the outstanding shares of each class of the stock of a corporation may merge that other corporation into itself without requiring shareholder approval (known as a 'freeze-out' or 'short-form' merger). Minority shareholders who object to the merger are entitled to appraisal rights.

In addition, corporations may issue shares of stock subject to redemption by the corporation at its option or at the option of the holders of the stock upon the occurrence of certain events.

If a corporation chooses to issue shares subject to redemption, then it must state the time, place and rate at which the stock will be redeemed in the certificate of incorporation or in a board resolution on the issue.

There are two restrictions on a corporation's ability to redeem its own shares. First, state laws, such as the DGCL, section 151, require that immediately following the redemption the corporation must have at least one class or series of stock with full voting powers that is not subject to redemption. The second restriction only applies to listed corporations. Under listing rules, these companies must promptly notify, and provide specified information to, the NYSE or Nasdaq, as applicable, before they take any action that would result in the full or partial redemption of a listed security.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Under the DGCL, section 262, shareholders who do not vote in favour of a merger or consolidation are entitled to an appraisal by the Delaware Court of Chancery of the fair value of their shares unless:

- the shares were listed on a national securities exchange (for example, the NYSE or Nasdaq);
- the shares were held of record by more than 2,000 holders; or
- the merger or consolidation did not require a shareholder vote.

Notwithstanding the applicability of the above points, appraisal rights will be available if shareholders are required to accept anything other than:

1. shares of the surviving or resulting company;
2. shares listed on a national securities exchange;
3. cash in lieu of fractional shares; or
4. any combination of (1) to (3).

For example, a shareholder will retain his or her appraisal rights if he or she is required to accept cash, debt or shares of a private company in exchange for his or her shares in the company to be merged or consolidated.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The predominant board structure for listed companies in the United States is one-tier. The Delaware General Corporation Law (DGCL), section 141 states:

> *[The] business and affairs of every corporation organised under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.*

The board of directors delegates managerial responsibility for day-to-day operations to the chief executive and other senior executives. Members of senior management may serve on the board, but they are not organised as a separate management board.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The primary legal responsibility of the board is to direct the business and affairs of the corporation (see DGCL, section 141). While the functions of a board are not specified by statute, it is generally understood, as noted in the American Law Institute's Principles of Corporate Governance and other codes of best practice, that board functions typically include:

- selecting, evaluating, fixing the compensation of and, where appropriate, replacing the CEO and other members of senior management;
- developing, approving and implementing succession plans for the CEO and senior executives;
- overseeing management to ensure that the corporation's business is being run properly;
- reviewing and, where appropriate, approving the corporation's financial objectives and major corporate plans, strategies and actions;

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- understanding the corporation's risk profile and reviewing and overseeing the corporation's management of risks;
- reviewing and approving major changes in the auditing and accounting principles and practices to be used in preparing the corporation's financial statements;
- establishing and monitoring effective systems for receiving and reporting information about the corporation's compliance with its legal and ethical obligations, and articulating expectations and standards related to corporate culture and the 'tone at the top';
- understanding the corporation's financial statements and monitoring the adequacy of its financial and other internal controls, as well as its disclosure controls and procedures;
- evaluating and approving major transactions, such as mergers, acquisitions, significant expenditures and the disposition of major assets;
- providing advice and counsel to senior management;
- reviewing the process for providing adequate and timely financial and operational information to management, directors and shareholders;
- establishing the composition of the board and its committees, board succession planning and determining governance practices;
- retaining independent advisers to assist the board and committees;
- assessing the effectiveness of the board, its committees or individual directors; and
- performing such other functions as are necessary.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

Directors are elected by shareholders. They are fiduciaries of the corporation and its shareholders. Directors represent the shareholding body as a whole, and not any particular set of shareholding constituents. If a corporation becomes insolvent, directors continue to owe their fiduciary duties to the corporation, not directly to creditors; however, creditors will have standing to assert derivative claims. See *North American Catholic Educational Programming Foundation Inc v Gheewalla* (Del 2007).

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgement rule?

Shareholders can bring suits against the directors on their own behalf or on behalf of the corporation (a derivative suit), depending on the nature of the allegation. To institute a derivative suit, a shareholder must first make a demand to the board of directors that the corporation initiate the proposed legal action on the corporation's own behalf. However, if the shareholder can show that bringing such a demand would be futile, it is not required.

Directors will not be held liable for their decisions, even if such decisions harm the corporation or its shareholders, if the decisions fall within the judicially created safe harbour known as the 'business judgement rule'. The rule states a judicial presumption that disinterested and independent directors make business decisions on an informed basis and with the good faith belief that the decisions will serve the best interests of the corporation. If a board's decision is challenged in a lawsuit, the court will examine whether the plaintiff has presented evidence to overcome this presumption. If the presumption is not overcome, the court will not investigate the merits of the underlying business decision.

This helps courts avoid second-guessing board decisions, and protects directors from liability when they act on an informed and diligent basis and are not otherwise tainted by a personal interest in the outcome. This is true even if the decision turns out badly from the standpoint of the corporation and its shareholders.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Directors owe duties encompassing both a duty of care and a duty of loyalty to the corporation and to the corporation's shareholders.

Although grounded in common law, the duty of care has been codified in more than 40 states. Most state statutes require that directors discharge their responsibilities in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner the director reasonably believes to be in the corporation's best interests. Conduct that violates the duty of care may also – in certain circumstances – violate the good faith obligation that is a component of the duty of loyalty. For example, a failure to ensure that reliable information and reporting systems are in place to detect misconduct could give rise to a claim for breach of the duty of care and the obligation of good faith. See *In Re Caremark International Inc Derivative Litigation* (Del Ch 1996) and *Stone v Ritter* (Del 2006).

The duty of loyalty prohibits self-dealing and misappropriation of assets or opportunities by board members. Directors are not allowed to use their position to make a personal profit or achieve personal gain or other advantage. The duty of loyalty includes a duty of candour that requires a director to disclose to the corporation any conflicts of interest. Transactions that violate the duty of loyalty can be set aside, and directors can be found liable for breach. Thus, whenever a board is considering a transaction in which a director has a personal interest, the material facts about the director's relationship or interest in the transaction should be disclosed to the board and a majority of the disinterested directors should authorise the transaction. Alternatively, the material facts should be disclosed to shareholders, for a vote to approve the transaction.

In 2003, the Delaware Court of Chancery rendered an important opinion concerning the 'duty of good faith' of corporate directors (*In Re The Walt Disney Co* (Del Ch 2003)). In this opinion, the court held that directors who take an 'ostrich-like approach' to corporate governance and 'consciously and intentionally disregard their responsibilities', adopting a 'we don't care about the risks' attitude may be held liable for breaching their duty to act in good faith. The opinion was rendered on a motion to dismiss for failure to state a claim. The opinion is notable for its sharp focus on the importance of good faith, in addition to due care and loyalty, when considering director conduct. By characterising the alleged lack of attention by directors as a breach of the duty of good faith rather than a breach of the duty of care, the Court effectively stripped the directors of the protection afforded by the Delaware Director Protection Statute (which allows adoption of a provision in the certificate of incorporation 'eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of a fiduciary duty as a director' with some exceptions (DGCL, section 102(b)(7)).

In 2005, the Delaware Court of Chancery rendered another opinion in connection with the same Disney litigation that further defines the contours of the duty of good faith (*In Re The Walt Disney Co* (Del Ch 2005)). In this opinion, the court focused on the element of intent in identifying whether a breach of the duty of good faith has occurred. Generally, the court determined, the duty of good faith is not satisfied where a director 'intentionally acts with a purpose other than . . . the best interests of the corporation'; where a director 'intend[s] to violate applicable . . . law'; or where a director 'intentionally fails to act in the face of a known duty to act'. With respect to the specific case at hand, however, the Court ruled that the Disney directors did not, in fact, breach their duty of good faith because they did make some business judgements and, therefore, their conduct did not meet the intent elements enumerated by the court as necessary to constitute a breach of the duty of good faith.

In 2006, the Delaware Supreme Court upheld the Delaware Court of Chancery's ruling that the Disney directors were not liable.

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The Supreme Court also provided guidance with respect to the contours of the duty of good faith, describing the following two categories of fiduciary behaviour as conduct in breach of the duty of good faith: conduct motivated by subjective bad faith (that is, actual intent to do harm); and conduct involving 'intentional dereliction of duty, a conscious disregard for one's responsibilities'. The Supreme Court further held that gross negligence on the part of directors 'clearly' does not constitute a breach of the duty of good faith.

In 2006, the Delaware Supreme Court held in *Stone v Ritter* (Del 2006) that 'good faith' is not a separate fiduciary duty. The Supreme Court stated that 'the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty' and the fiduciary duty of loyalty 'encompasses cases where the fiduciary fails to act in good faith'.

The duty of directors to provide oversight is based on the concept of good faith. In the oversight context, courts focus on whether the board has taken adequate steps to determine that the corporation's business and affairs are being properly administered by the company's officers and management. Boards are expected to ensure that reasonable information and reporting systems are implemented and maintained to provide the board and senior management with timely, accurate information to support informed decisions and so that directors can reach informed judgments concerning the corporation's performance.

In four recent instances, a Delaware court declined to dismiss a claim alleging that directors had not satisfied their duty to exercise oversight. In one case, the Delaware Supreme Court found that the plaintiff adequately pled that the directors failed to implement any monitoring or reporting system related to the most central safety and legal compliance risk facing the company (*Marchand v Barnhill* (Del 2019)). In another case, the Delaware Chancery Court found that the plaintiff adequately pled that the directors failed to appropriately monitor compliance systems and controls (*In Re Clovis Oncology, Inc Derivative Litigation* (Del Ch 2019)). That decision suggests that Delaware courts will impose a higher standard on directors of companies operating in the midst of mission-critical regulatory compliance risk. In addition, the Delaware Chancery Court found that the plaintiff adequately pled that the directors failed to make a good faith effort to put in place a board-level system for monitoring the company's financial reporting (*Hughes v Hu* (Del Ch 2020)). Finally, the Delaware Chancery Court found that the plaintiffs adequately stated a 'Caremark' claim for oversight liability in a case involving board failure to remediate legal issues disclosed in public filings (*Teamsters Local 443 Health Services & Insurance Plan v Chou* (Del Ch 2020)).

Board member duties

21 | To what extent do the duties of individual members of the board differ?

Generally, all board members owe the same fiduciary duties regardless of their individual skills. However, case law suggests that when applying the standard of due care (namely, that a director acted with such care as an ordinarily prudent person in a like position would exercise under similar circumstances) subjective considerations, including a director's background, skills and duties, may be taken into account. For example, 'inside' directors – usually officers or senior executives – are often held to a higher standard because they more actively participate in and have greater knowledge of the corporation's activities.

Additionally, in 2004, the Delaware Court of Chancery rendered an important opinion concerning the fiduciary duties of directors with special expertise (*Emerging Communications Shareholders' Litigation* (Del Ch 2004)). In *Emerging Communications*, the Court held a director in breach of his duty of good faith for approving a transaction 'even though he knew, or at the very least had strong reason to believe' that the per share consideration was unfair. The Court, in part, premised the culpability of the director (described in the opinion as a 'principal and general partner of an investment advisory firm') on his 'specialised financial expertise, and . . . ability to understand [the company's] intrinsic value, that was unique to [the company's] board members'. As the Court also found that the director in question was not 'independent' of management, the *Emerging Communications* decision should not necessarily be interpreted as a pronouncement holding directors with 'specialised expertise' to a higher standard of care in general.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

State corporate law generally provides that the business and affairs of the corporation shall be managed by or under the direction of the board of directors. The board has wide-ranging authority to delegate day-to-day management and other aspects of its responsibilities both to non-board members and to board committees and even individual directors. Typically, the board delegates wide powers to the corporation's senior managers. State laws generally make a distinction between the matters a board must address directly and those it may delegate to officers or other agents of the corporation, or to board committees. For example, under DGCL, section 141(c), the board of a company incorporated prior to 1 July 1996 cannot delegate the power to:

- adopt, amend or repeal any by-law of the corporation;
- amend the corporation's certificate of incorporation (except that a board committee may make certain specified decisions relating to the rights, preferences or issuance of authorised stock, to the extent specifically delegated by the board);
- adopt an agreement of merger or consolidation;
- recommend to shareholders the sale, lease or exchange of all or substantially all of the corporation's property and assets;
- recommend to shareholders a dissolution of the corporation or a revocation of a dissolution;
- approve, adopt or recommend to shareholders any action or matter that is required by the DGCL to be submitted to shareholders for approval;
- declare a dividend, unless that power is expressly provided for in the certificate of incorporation, resolution or by-laws; and
- authorise the issuance of stock or adopt a certificate of ownership and merger, unless that power is expressly provided for in the certificate of incorporation, resolution or by-laws.

The Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act) and the New York Stock Exchange (NYSE) and Nasdaq Stock Market (Nasdaq) listing rules also require that each listed company has an audit committee comprising independent directors who have responsibility for certain audit and financial reporting matters. As required by the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd–Frank Act), the NYSE and Nasdaq listing rules also require that each listed company has a compensation committee comprising independent directors who are responsible for certain matters relating to executive compensation. The NYSE listing standards require that each listed company have a nominating or corporate governance committee comprising independent directors who are responsible for director nominations and corporate governance. The Nasdaq listing rules require independent directors (or a committee of independent directors) to have responsibility for certain decisions relating to director nominations. These committees are permitted to delegate their responsibilities to subcommittees solely comprising one or more members of the relevant committee.

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Directors may also reasonably rely on information, reports and recommendations provided by officers, other agents and committees on matters delegated to them (see DGCL, section 141(e)). Nevertheless, the board retains the obligation to provide oversight of its delegates, to act in good faith and to become reasonably familiar with their services or advice before relying on this advice.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

The NYSE and Nasdaq listing rules require that independent directors comprise a majority of the board. Controlled companies (ie, companies in which more than 50 per cent of the voting power is held by an individual, group or another company) and foreign private issuers are exempt from this requirement.

Under the NYSE rules, for a director to be deemed 'independent', the board must affirmatively determine that he or she has no material relationship with the company. A material relationship can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. Under the NYSE rules, directors having any of the following relationships may not be considered independent:

- a person who is an employee of the listed company or is an immediate family member of an executive officer of the listed company;
- a person who receives, or is an immediate family member of a person who receives, compensation directly from the listed company, other than director compensation or pension or deferred compensation for prior service (provided this compensation is not contingent in any way on continued service), of more than US$120,000 per year;
- a person who is a partner of, or employed by, or is an immediate family member of a person who is a partner of, or employed (and works on the listed company's audit) by a present or former internal or external auditor of the company;
- a person, or an immediate family member of a person, who has been part of an interlocking compensation committee arrangement; or
- a person who is an employee or is an immediate family member of a person who is an executive officer, of a company that makes payments to or receives payments from the listed company for property or services in an amount that in a single fiscal year exceeds the greater of 2 per cent of this other company's consolidated gross revenues or US$1 million.

In applying the independence criteria, no individual who has had a relationship as described above within the past three years can be considered independent (except in relation to the test set forth in the final bullet point above, which is concerned with current employment relationships only). The Nasdaq listing rules take a different but similar approach to defining independence.

For NYSE and Nasdaq companies, only independent directors are allowed to serve on audit, compensation and nominating or governance committees. The Sarbanes–Oxley Act, section 301, defines an independent director for audit committee purposes as one who has not accepted any compensation from the company other than directors' fees and is not an 'affiliated person' of the company or any subsidiary. NYSE and Nasdaq listing standards require NYSE and Nasdaq companies to have an audit committee that satisfies the requirements of Rule 10A-3 under the Securities Exchange Act of 1934. That rule, which embodies the independence requirements of the Sarbanes–Oxley Act, section 301, provides that an executive officer of an 'affiliate' would not be considered independent for audit committee purposes. As required by the Dodd–Frank Act, the NYSE and Nasdaq developed heightened independence standards for compensation committee members that became effective during 2014. Under these standards, in affirmatively determining the independence of a director for compensation committee purposes, the board of directors must 'consider' all factors specifically relevant to determining whether a director has a relationship to the listed company that is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including the source of compensation received by the director and whether the director is affiliated with the company or any subsidiary.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The DGCL, section 141(b) requires that the board of directors comprises one or more members, each of whom must be a natural person. Beyond the requirement for at least one director, corporate law does not set a minimum or a maximum. As a practical matter, a board should be of a size sufficient to accommodate an appropriate amount of experience, independence and diversity for the full board and its committees. The number of directors is fixed by or in the manner provided in the by-laws or certificate of incorporation; typically the by-laws will specify a range and the board will fix the exact number of directors by resolution. Directors need not be shareholders of the corporation. The certificate of incorporation or the by-laws may provide for director qualifications and address who is authorised to fill vacancies on the board. Generally, the board is authorised to fill vacancies.

The NYSE and Nasdaq require that listed companies have an audit committee comprising at least three members. Nasdaq requires listed companies to have a compensation committee comprising at least two members; the NYSE does not require a minimum number of members of the compensation committee.

ISS has stated that a company should have no fewer than six nor more than 15 directors, with a board size of between nine and 12 directors 'considered ideal'.

The Securities and Exchange Commission (SEC) requires companies to provide the following proxy statement disclosures relating to board composition:

- which directors qualify as 'independent' under applicable independence standards; and
- for each director and nominee:
  - name, age and positions and offices held with the company;
  - term of office as a director;
  - any arrangements or understandings between the director or nominee and any other person pursuant to which the director or nominee was or is to be selected as a director or nominee;
  - family relationships with any director, nominee or executive officer;
  - business experience and other public company directorships over the past five years;
  - the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company; and
  - whether the director or nominee has been involved in certain kinds of legal proceedings during the past 10 years.

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There is no legal requirement or listing rule that mandates a certain number of female or minority directors, with a few exceptions. In September 2018, a California law was enacted that required California-headquartered publicly held domestic or foreign corporations to have at least one female director by the end of 2019 and, depending on board size, up to three female directors by the end of 2021. A similar California law was enacted in September 2020 that will require such corporations to have at least one director from an underrepresented community by the end of 2021 and, depending on the board's size, up to three directors from underrepresented communities by the end of 2022. Several other states have enacted or are considering legislation that would encourage greater board diversity or require disclosure about board diversity, including Colorado, Hawaii, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania and Washington.

There is increasing concern in the institutional investor community about the lack of gender and racial diversity on public company boards of directors, as well as long-tenured directors and lack of board refreshment. In 2017, the New York City Pension Funds announced a letter-writing campaign known as the Boardroom Accountability Project 2.0 targeting over 150 US public companies focused on board composition (eg, experience or skill-sets, tenure and diversity), board refreshment and director succession planning. The New York City Pension Funds will vote against all directors at companies with no female directors and against governance committee members at companies with just one female director. In October 2019, the New York City Pension Funds launched the Boardroom Accountability Project 3.0 urging public companies to adopt a diversity search policy requiring that qualified female and racially and ethnically diverse candidates be included in the pool of nominees from which directors and CEOs are selected, and that director searches include candidates from non-traditional backgrounds, such as government, academic or non-profit organisations.

State Street Global Advisors published guidance in 2017 indicating that it may vote against the chair of a nominating or governance committee of a company that has no female directors and fails to take action to increase the number of women on its board. Consistent with this guidance, in recent years State Street has voted against or withheld votes from nominating and governance committee chairs at hundreds of its portfolio companies with no female directors. Beginning in 2021, State Street will vote against nominating and governance committee chairs at S&P 500 companies that do not disclose the racial and ethnic composition of their boards, and beginning in 2022, State Street will vote against nominating and governance committee chairs at S&P 500 companies that do not have at least one director from an underrepresented community on their boards.

BlackRock issued updated proxy voting guidelines in 2018 stating its expectation for the US public companies in which it invests to have at least two female directors and noting that it may vote against nominating and governance committee members at a company BlackRock believes 'has not adequately accounted for diversity in its board composition'.

Effective as of 2020, ISS generally recommends voting against nominating committee chairs (and potentially other directors) at companies with no female directors unless certain mitigating factors apply. Glass Lewis adopted a similar policy that took effect for the 2019 proxy season. Beginning in 2022, Glass Lewis will recommend voting against nominating committee chairs at companies where a board with more than six members has fewer than two female directors. Beginning in 2022, ISS will recommend voting against nominating committee chairs at companies that have no racially or ethnically diverse directors, with certain exceptions.

For 2021, Glass Lewis revised its policy to indicate that when evaluating board diversity it will make recommendations in accordance with board composition requirements set forth in any applicable state laws on diversity that take effect. Specifically, beginning in 2022, Glass Lewis will base its vote recommendations at California-headquartered companies on compliance with the applicable board diversity thresholds then in effect.

Since July 2020, Goldman Sachs will not take a company public unless it has at least one diverse board candidate, 'with a focus on women'. Beginning in 2021, Goldman Sachs Asset Management will vote against the entire board at any company with no female directors, and against all nominating committee members at any company that does not have at least one female director and one additional diverse director based on gender identity, sexual orientation and racial or ethnic background.

SEC rules currently require companies to provide proxy statement disclosure regarding whether and, if so, how the nominating committee considers diversity in identifying nominees for director and, if the nominating committee has a policy with regard to the consideration of diversity in identifying director nominees, how this policy is implemented and how the nominating committee or the board assesses the effectiveness of its policy. Under guidance issued by the SEC in 2019, if the board or nominating committee considered 'certain self-identified diversity characteristics' (eg, race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background) when determining an individual's specific experience, qualifications, attributes or skills for board membership, then the SEC expects the company to disclose those characteristics and how they were considered in the nomination process. The guidance also requires a company to disclose how its diversity policy, if any, takes into account nominees' self-identified diversity attributes and any other qualifications (eg, diverse work experiences, military service or socio-economic or demographic characteristics).

Finally, in December 2020, the Nasdaq Stock Market (Nasdaq) filed a proposal with the SEC to adopt new listing standards that would require Nasdaq-listed companies to publicly disclose diversity statistics regarding their boards in a standardised disclosure matrix template and have, or explain why they do not have at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+. This proposal was amended in February 2021 and requires SEC approval. The SEC is expected to act on the proposal by August 2021.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

There is no legal requirement or listing rule that mandates that the positions of board chair and CEO be held separately or jointly. Corporate boards are generally free to decide for themselves the leadership structure of the board and company (although the corporate charter or by-laws could provide otherwise). Shareholder proposals calling for a separation of the board chair and CEO roles have become increasingly common in recent years; these proposals tend to receive relatively high shareholder support (typically less than majority although two proposals did pass in 2020).

The NYSE and Nasdaq listing rules require that the non-management directors meet without management present on a regular basis. Under the NYSE rules, companies are required to either choose and disclose the name of a director to preside during executive sessions or disclose the method it uses to choose someone to preside (for example, a rotation among committee chairs). Although the NYSE rules do not set forth other specific duties for the presiding director, some companies have a 'lead independent director' perform the presiding function while also having a role in agenda-setting and determining the information

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needs of the outside directors. The Nasdaq listing rules also require that boards convene executive sessions of independent directors, but do not include a presiding director disclosure requirement.

In 2009, the SEC adopted rules requiring each reporting company to disclose the board's leadership structure and why the company believes it is the best structure for the company. Each company must disclose whether and why it has chosen to combine or separate the CEO and board chair roles. Where these positions are combined, the company must disclose whether and why the company has a lead independent director and the specific role the lead independent director plays in the leadership of the company.

Independent board leadership is also supported by governance effectiveness guidance that expresses a 'best practice' consensus that boards should have some form of independent leadership. Several best practice codes recommend a clear division of responsibilities between a board chair and CEO to ensure that the board maintains its ability to provide objective judgement concerning management. Some recommend that the board should separate the roles of board chair and CEO, while others recommend designating a lead outside or independent director for certain functions. For example, the Report on Director Professionalism by the National Association of Corporate Directors (NACD) recommends appointing an independent board leader to:

- organise the board's evaluation of the CEO and provide feedback;
- chair sessions of the non-executive directors;
- set the agenda (with the CEO or chair and CEO); and
- lead the board in anticipating and responding to a crisis.

Many companies have recently expanded the responsibilities of the independent lead director in light of the increased appreciation of the importance of independent board leadership (see also Report of the NACD Blue Ribbon Commission on Fit for the Future: An Urgent Imperative for Board Leadership issued in 2019). These can include, in addition to the items set forth above from the NACD report:

- presiding over board meetings at which the chair is not present;
- approving board schedules;
- approving information provided to the board;
- serving as a liaison between the chair and the independent directors;
- having the authority to call meetings of the independent directors or the full board;
- being available for consultation and direct consultation with major shareholders;
- advising on, recommending or approving the retention of outside advisers and consultants who report to the board; or
- guiding, leading or assisting with the board and director self-assessment process, the CEO succession planning process or the board's consideration of CEO compensation.

Furthermore, under its proxy voting guidelines, ISS will generally vote for shareholder proposals requiring that the board chair position be filled by an independent director, taking into consideration the following:

- the scope of the proposal, such as whether it is precatory or binding;
- the company's current board leadership structure, including recent transitions in board leadership and the designation and responsibilities of an independent lead director;
- the company's governance structure and practices to assess whether more independent oversight at the company may be advisable; and
- the company's financial performance compared to its peers and the market as a whole.

Many companies combine the roles of CEO and chair; however, separation of the roles has become increasingly prevalent at Standard & Poor's (S&P) 500 companies over the past 10 years – the roles were separated at 55 per cent of S&P 500 companies in 2020, up from 40 per cent in 2010. Chairs who qualified as independent were in place at 34 per cent of S&P 500 companies in 2020 compared with 19 per cent in 2010. The vast majority of companies that do not have an independent chair have appointed an independent lead or presiding director.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Since 1999, the NYSE and Nasdaq listing rules have required that listed companies have audit committees consisting entirely of independent directors (prior to that time, a majority of independent directors had been a long-standing audit committee requirement for companies listed on the NYSE). In 2003, the NYSE and Nasdaq adopted listing rules that also require companies to have compensation and nominating or governance committees (or committees that perform those functions) consisting entirely of independent directors, although Nasdaq permits nomination decisions (and, until 2014, permitted certain executive compensation decisions) to be made by a majority of independent directors. The Sarbanes–Oxley Act requires that all boards of companies with listed securities have audit committees composed entirely of directors who receive no compensation from the company other than directors' fees and are not affiliated with the company. In addition, companies are required to disclose the name of at least one audit committee member who is an 'audit committee financial expert' as defined by the SEC, or explain why they do not have one. The NYSE and Nasdaq rules also require that the audit committee comprises at least three members and impose requirements with respect to the financial literacy of audit committee members. Since 2014, each Nasdaq listed company must have, and certify that it has and will continue to have, a compensation committee of at least two members, each of whom must be an independent director; the NYSE does not require a minimum number of members of the compensation committee. As required by the Dodd–Frank Act, the NYSE and Nasdaq each adopted heightened independence standards for compensation committee members that became effective in 2014 and require the board to 'consider' the source of compensation received by the director and whether the director is affiliated with the company or any subsidiary, when determining if a director is independent for purposes of serving on the compensation committee.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Under state law, the corporation's by-laws or certificate of incorporation prescribe the requirements for board meetings and may or may not prescribe a set number of meetings; it is typical for companies to not specify a minimum number of meetings in the certificate of incorporation or by-laws. Generally, it is believed that a board should meet at least once per financial-reporting quarter. However, most boards of large publicly traded corporations meet more frequently. For example, companies represented on the S&P 500 held 7.9 board meetings on average in 2020. SEC rules require companies to disclose the total number of board and committee meetings held during the past year and provide details regarding director attendance at these meetings.

ISS and Glass Lewis will issue negative vote recommendations with respect to directors who failed to attend a minimum of 75 per cent of the aggregate of his or her board and committee meetings (with some exceptions).

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Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

The SEC requires disclosure of certain board practices, including disclosures about the identity and compensation of directors and the composition and activities of the audit, compensation and nominating committees.

Under the NYSE listing rules, listed companies are required to adopt and disclose 'corporate governance guidelines' that address:

- qualification standards for directors;
- responsibilities of directors;
- director access to management and, as necessary, independent advisers;
- compensation of directors;
- continuing education and orientation of directors;
- management succession; and
- an annual performance evaluation of the board.

Nasdaq-listed companies are not required to adopt corporate governance guidelines, but many have done so as a best practice.

The NYSE rules also require listed companies to adopt and disclose charters for their compensation, nominating or governance and audit committees.

The compensation committee's charter must detail the committee's purpose and responsibilities, which include reviewing and approving corporate goals and objectives relevant to CEO compensation, evaluating the CEO's performance in light of those goals and objectives, setting his or her compensation level based on this evaluation, making recommendations to the board with respect to non-CEO executive officer compensation, incentive-based compensation plans and equity-based plans and producing a compensation committee report on executive compensation required by SEC rules to be included in the company's proxy statement. The charter must also provide that the committee will perform an annual self-evaluation. In addition, pursuant to the Dodd–Frank Act, the NYSE and Nasdaq adopted listing standards that became effective in 2014 requiring compensation committees to consider specified independence factors prior to engaging consultants and other advisers and giving compensation committees the authority and discretion to retain or obtain the advice of consultants and other advisers at the company's expense.

The nominating or governance committee's charter must detail the committee's purpose and responsibilities. These include:

- identifying the board's criteria for selecting new directors;
- identifying individuals who are qualified to become board members;
- selecting or recommending that the board select nominees for election at the next annual general meeting;
- developing and recommending to the board a set of corporate governance principles for the corporation; and
- overseeing the evaluation of the board and management.

In addition, the charter must include a provision for an annual performance evaluation of the committee. Unlike the NYSE, Nasdaq does not include a requirement with respect to the charter for the nominating or governance committee, although companies are required to certify that they have adopted a formal written charter or board resolution, as applicable, addressing the nominations process.

The audit committee charter must specify the committee's purpose, which must include: assisting board oversight of the integrity of the company's financial statements, the company's compliance with legal and regulatory requirements, the independent auditor's qualifications and independence and the performance of the company's internal audit function and independent auditors; and preparing the report that SEC rules require to be included in the company's annual proxy statement. The NYSE listing rules require that the charter must also detail the duties and responsibilities of the audit committee, including:

- the ability to hire and fire the company's independent auditor and other registered public accounting firms;
- establishing whistle-blowing policies and procedures for handling complaints or concerns regarding accounting, internal accounting controls or auditing matters;
- at least annually:
  - obtaining and reviewing a report by the independent auditor describing the independent auditor's internal quality control procedures;
  - reviewing any material issues raised by the auditor's most recent internal quality control review of themselves or peer review, or any inquiry or investigation by governmental or professional authorities within the preceding five years; and
  - assessing the auditor's independence;
- discussing the annual audited financial statements and quarterly financial statements with management and the independent auditor;
- discussing earnings press releases, as well as financial information and earnings guidance that is given to analysts and rating agencies;
- obtaining the advice and assistance of outside legal, accounting or other advisers, as necessary, with funding to be provided by the company;
- discussing policies with respect to risk assessment and risk management;
- meeting separately, from time to time, with management, with the internal auditors and with the independent auditor;
- reviewing with the independent auditor any audit problems or difficulties and management's response to such issues;
- setting clear hiring policies for employees or former employees of the independent auditor;
- reporting regularly to the board of directors; and
- evaluating the audit committee on an annual basis.

The Nasdaq listing rules also require an audit committee to have a charter addressing all of its duties and responsibilities under the Sarbanes–Oxley Act, including: having the sole power to hire, determine the funding for and oversee the outside auditors; having the authority to consult with and determine the funding for independent counsel and other advisers; and having the responsibility to establish procedures for receipt of complaints.

In addition, both the NYSE and Nasdaq rules require that companies adopt and disclose a code of conduct applicable to directors, officers and employees that addresses conflicts of interest and legal compliance. The NYSE rules also require that the code address corporate opportunities, confidentiality, fair dealing and protection of company assets.

Public companies post their corporate governance guidelines, board committee charters, codes of conduct and other governance documents on their corporate websites, typically under a heading such as 'corporate governance' or 'investor relations'.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

Under the NYSE listing rules, listed companies are required to adopt and disclose 'corporate governance guidelines' that address, among other things, an annual performance evaluation of the board. According to the rules, the 'board should conduct a self-evaluation at least annually to

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determine whether it and its committees are functioning effectively'. The NYSE listing rules also require that each of the audit, compensation and nominating and governance committee charters provide for an annual performance evaluation of the committee. Companies listed on Nasdaq do not have similar requirements, but many still engage in self-evaluation as a matter of good governance practice. In addition, independent auditors often inquire into the board's evaluation of the audit committee as part of the auditor's assessment of the internal control environment.

There has been a greater focus on director evaluations in recent years as investors are increasingly concerned about board quality and refreshment mechanisms in light of long director tenures, rising mandatory retirement age limits and perfunctory director renomination decisions. A robust performance evaluation of individual directors can help inform the renomination decision process.

In 2020, 98 per cent of boards at S&P 500 companies reported conducting an annual performance evaluation. Forty-nine per cent of S&P 500 boards evaluate the full board and committees and 42 per cent evaluate the full board, committees and individual directors annually. In 2020, 21 per cent of S&P 500 companies reported that they retained an independent expert to facilitate the evaluation process, compared to 13 per cent in 2019 and only 2 per cent in 2017.

The NYSE listing rules include 'overseeing the evaluation of the board and management' as a responsibility of the nominating or governance committee that must be included in its committee charter. Boards should determine the evaluation methodology, for example, the use of a written survey or interviews, or both, followed by a facilitated discussion, and will determine who will lead the evaluation process (eg, the chair, lead director or a third-party facilitator). A composite report of the feedback and any related recommendations are typically distributed to the board, committee or individual directors by the party leading the evaluation and discussed at a meeting.

In 2014, the Council of Institutional Investors (CII) issued a report calling for enhanced disclosure relating to board evaluation. Specifically, the CII provided 'best in class' examples of disclosure that explain the mechanisms of the evaluation process and discuss the key takeaways from the most recent evaluation. The CII acknowledged that the latter type of disclosure is uncommon among US public companies but is more prevalent in Europe and Australia. In 2019, the CII Research and Education Fund, an affiliate of the CII, issued an updated guide to encourage enhanced disclosure relating to board evaluation and endorse certain evaluation best practices. US public companies can expect more pressure to disclose their self-evaluation processes, especially in circumstances where shareholders have concerns about governance failures, the absence of regular director turnover or board composition generally.

In 2017, the New York City Pension Funds announced a letter-writing campaign targeting over 150 US public companies focused on board composition and refreshment. The group asked to engage with directors about the company's processes for refreshing the board, including an explanation of the evaluation process for individual directors and a description of processes for encouraging underperforming directors to come off the board.

The Report of the NACD Blue Ribbon Commission on Building the Strategic-Asset Board issued in 2016 also discusses board evaluation best practices in the context of other continuous improvement board processes.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

The remuneration of directors is generally a matter for the board of directors, or a committee of the board (usually, the compensation committee or the nominating or governance committee), to determine.

In determining the appropriate amount of compensation to be paid to directors, many boards and compensation or nominating or governance committees rely on the advice of independent compensation consultants, whose expertise lies in analysing compensation trends in industry or other market segments. The Securities and Exchange Commission (SEC) amended its regulations in 2012 to require enhanced disclosure with respect to a company's use of compensation consultants.

Boards should exercise caution when approving equity compensation plans that permit equity awards to be made to non-employee directors. Even if such a plan includes meaningful limits on the amount of equity that directors can award themselves and the plan is approved by shareholders, the directors must abide by their fiduciary duties when making awards under the plan (*In Re Investors Bancorp, Inc* (Del 2017)).

Compensation given to all directors must be disclosed by reporting companies. Under the Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act), audit committee members can only receive director's fees (including fees for committee work) from the companies they serve. In addition, the board must consider the source of compensation of a director when considering his or her suitability for compensation committee service. The New York Stock Exchange (NYSE) requires listed companies to adopt and disclose corporate governance guidelines, which are required to address, among other things, the compensation of directors. Since 2016, the Nasdaq Stock Market (Nasdaq) listed companies have been required to disclose compensatory arrangements between directors or nominees and third parties in connection with that person's candidacy or service as a director ('golden leashes').

There is no law, regulation or listing requirement that affects the length of directors' service contracts. Rather, directors are elected for a term by the shareholders and it is up to each company to determine whether to place any limits on the number or length of such terms, although NYSE listing rules provide that directors' terms of office should not exceed three years.

Term limits are very rare among large public companies, but retirement age policies are common. The average tenure of directors at S&P 500 companies is 7.9 years. Twenty-three per cent of S&P 500 boards have an average director tenure of five years or less, 62 per cent have an average director tenure between six and 10 years, and 14 per cent have an average tenure of 11 or more years. The corporate governance assessment tool of the proxy advisory firm Institutional Shareholder Services (ISS) tracks the proportion of non-executive directors who have served for less than six years, which suggests that ISS considers a term of longer than six years to be lengthy. While most institutional investors do not support individual term and age limits applicable to directors, some are adopting policies focused on average director tenure or individual director tenure (eg, by generally considering long-tenured directors to not be independent).

Section 402 of the Sarbanes–Oxley Act prohibits companies from extending or maintaining personal loans to their directors, other than certain consumer credit arrangements (eg, home improvement or

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credit card loans) made in the ordinary course of business of a type generally made available by the company to the public and on market terms or terms no more favourable than offered by the company to the general public.

The duty of loyalty restricts directors from competing with the corporation. Thus, while directors are not precluded from engaging in other businesses, they may not:

- use their position as directors to prevent the corporation from competing with their other businesses;
- divert corporate assets to their own uses or the uses of their other businesses;
- disclose the corporation's trade secrets or confidential information to others;
- lure corporate opportunities, business or personnel away from the corporation; or
- receive, unbeknown to the corporation, a commission on a corporate transaction.

Under the corporate opportunity doctrine, directors cannot divert to themselves an opportunity that belongs to the corporation. An opportunity belongs to the corporation if the corporation has a right to it, a property interest in it, an expectancy interest in it, or if by 'justice' it should belong to the corporation. The corporation may renounce any interest or expectancy in an opportunity in its certificate of incorporation or by an action of its board of directors (see the Delaware General Corporation Law, section 122(17)). At times, a director's interest may still conflict with the interests of the corporation. Conflicts that cannot be avoided must be fully disclosed by the interested director and any action that needs to be taken should be taken by vote of the disinterested directors.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

The remuneration of a corporation's CEO and senior management is generally a matter for the board of directors, or a committee of the board (usually, the compensation committee), to determine.

The NYSE listing rules require that a compensation committee comprising independent directors determines the amount of compensation paid to the CEO and makes recommendations to the board with respect to non-CEO executive officer compensation. These provisions are interpreted broadly, such that a compensation committee or group of independent directors, as the case may be, must approve each specific element of CEO compensation at all listed companies. Since 2014, the Nasdaq listing rules have required that CEO and executive officer compensation be determined by a compensation committee comprising at least two independent directors.

In addition, applicable tax and securities rules require the approval of independent directors to grant equity-based awards (eg, stock option and restricted stock awards) to senior management, and best practice would have the board or compensation committee approve the compensation paid to key members of senior management. Historically, the Internal Revenue Code, section 162(m) provided tax incentives for certain performance-based compensation decisions when made by a committee of outside directors. With the enactment of tax reform in the United States in 2017, this performance-based compensation exemption has been eliminated except with respect to grandfathered arrangements. The responsibility between the board (or compensation committee) and the CEO in determining the elements and amount of compensation paid to senior managers (other than the CEO) differs from company to company and, even within a company, from element of compensation to element of compensation.

In determining the appropriate amount of compensation to be paid to the CEO and other senior managers, many boards and compensation committees rely on the advice of independent compensation consultants, whose expertise lies in analysing compensation trends in industry or other market segments. The SEC amended its regulations in 2012 to require enhanced disclosure with respect to a company's use of compensation consultants.

Section 402 of the Sarbanes–Oxley Act prohibits companies from extending or maintaining personal loans to their executive officers, other than certain consumer credit arrangements (eg, home improvement or credit card loans) made in the ordinary course of business of a type generally made available by the company to the public and on market terms or terms no more favourable than offered by the company to the general public.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Since 2011, the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 has required US public companies to conduct a separate shareholder advisory vote on:

- executive compensation – to be held at least once every three calendar years;
- whether the advisory vote on executive compensation should be held every year, every two years or every three years – to be held at least once every six calendar years; and
- certain 'golden parachute' compensation arrangements in connection with a merger or acquisition transaction that is being presented to shareholders for approval.

The predominant practice is to hold a shareholder advisory vote on executive compensation every year.

US public companies are not required to seek shareholder approval of cash compensation for directors. The NYSE and Nasdaq listing rules require companies to obtain shareholder approval of equity compensation plans applicable to directors and executive officers.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Companies may purchase and typically do maintain directors' and officers' liability insurance to protect directors and officers against the risk of personal liability (see the Delaware General Corporation Law (DGCL), section 145(g)). Although this coverage has become substantially more expensive, it is usually available and has not been limited by legislative and regulatory actions. Companies are allowed to pay the premiums for directors' and officers' liability insurance.

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Indemnification of directors and officers

34 | Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

A company may indemnify a director for liability incurred if that director: acted in good faith; acted in a manner that he or she reasonably believed was in the best interests of the company; and in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful (see DGCL, section 145). Many companies employ such indemnities.

Advancement of expenses to directors and officers

35 | To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Under Delaware law, expenses (including attorneys' fees) incurred by an officer or a director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of this action, suit or proceeding upon receipt of an undertaking by or on behalf of this director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation, for example, because of a lack of good faith (see DGCL, section 145(e)). Delaware courts have consistently interpreted DGCL, section 145(e) as granting corporations discretion to determine whether to advance litigation expenses to a covered director or officer.

Exculpation of directors and officers

36 | To what extent may companies or shareholders preclude or limit the liability of directors and officers?

The Delaware Director Protection Statute allows the shareholders of a corporation to provide additional protection to corporate directors through the adoption of a provision in the certificate of incorporation 'eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of a fiduciary duty as a director' (DGCL, section 102(b)(7)). Such a provision, however, may not shield directors from liability for: breaches of the duty of loyalty; 'acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law'; unlawful payments of dividends or unlawful stock purchases or redemptions; or 'any transaction from which the director derived an improper personal benefit'.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 | Are the corporate charter and by-laws of companies publicly available? If so, where?

Corporate certificates of incorporation are publicly available for a small fee from the office of the secretary of state in the state of incorporation. By-laws of private companies are generally not publicly available because they are not required to be filed with the secretary of state. If the corporation is a reporting company, its certificate of incorporation and by-laws are also available as exhibits to various forms filed with the Securities and Exchange Commission (SEC), which can be accessed over the internet free of charge from EDGAR, the SEC database, which is accessible via the SEC's website.

Company information

38 | What information must companies publicly disclose? How often must disclosure be made?

Federal securities laws and SEC rules require reporting companies (or companies making public offerings) to disclose a wide variety of information in annual and quarterly reports, as well as in proxy statements and public offering prospectuses. In general, a company must disclose all information that would be material to investors. This includes:

- a business description;
- a description of material legal proceedings;
- detailed disclosure of the risks associated with the business and market risk;
- related person transaction disclosure;
- the number of shareholders of each class of common equity;
- management's discussion and analysis of the company's financial condition and results of operations (MD&A);
- a statement as to whether the company has had any disagreements with its accountants;
- disclosure regarding the effectiveness of disclosure controls and procedures, and changes in and the effectiveness of internal control over financial reporting;
- financial information;
- executive and director compensation; and
- a signed opinion of the company's auditors with respect to the accuracy of the financial information.

This report will also need to discuss any critical audit matters or state that the auditor determined that there were no critical audit matters; this requirement took effect beginning with audits of fiscal years ending on or after 30 June 2019 for large filers and ending on or after 15 December 2019 for other companies to which the requirements apply.

Corporations are expected to keep all this public information current by filing 'current' reports whenever certain specified events occur, as well as issuing press releases and providing website disclosure.

Since the passage of the Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act) and its accompanying SEC implementing rules, reporting companies are also required to disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and certain other relationships of the company with unconsolidated entities or other persons. In addition, the Sarbanes–Oxley Act requires that a reporting company's financial reports reflect 'all material correcting adjustments' identified by outside auditors.

Section 404 of the Sarbanes–Oxley Act requires that a reporting company's annual report include an internal control report from management containing a statement of the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting and an assessment at the end of the company's most recent fiscal year of the effectiveness of the company's internal control structure and procedures for financial reporting. The company's registered public accounting firm must also attest to, and report on, the effectiveness of the company's internal control over financial reporting.

Reporting companies are also required to disclose the 'total compensation' received by the corporation's CEO, its CFO and its three most highly compensated executive officers other than the CEO and CFO (together, the named executive officers) and directors. The information is required to be presented in the form of a summary compensation table listing the name of the employee, the year, salary, bonus, other annual compensation, stock and option awards, changes in pension value and non-qualified deferred compensation earnings, all other forms of compensation and total compensation, as well as several

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other tables relating to grants of plan-based awards, outstanding equity awards, option exercises and vested stock, pension benefits, non-qualified deferred compensation and director compensation. In addition, reporting companies are required to include a 'compensation discussion and analysis' section in their disclosure documents that explains all material elements of the company's compensation of the named executive officers, and includes a description of the company's compensation philosophy and objectives.

The Jumpstart Our Business Startups Act of 2012 affords 'emerging growth companies' (companies that conducted an IPO after 8 December 2011 and have total annual revenues of less than US$1 billion) the flexibility to provide reduced disclosures relating to financials, MD&A and compensation for a maximum period of five years.

SEC regulations also require the disclosure of certain information concerning any beneficial owner known to the company to possess more than 5 per cent of any class of the corporation's voting securities, including the amount of ownership and percentage and title of the class of stock owned. Any person acquiring more than 5 per cent of the equity of a reporting company also must publicly disclose its intentions with respect to such acquisition. In addition, the Securities Exchange Act of 1934 requires that officers, directors and beneficial owners of 10 per cent or more of a company's equity securities file a statement of ownership each time there has been a change in that person's beneficial ownership of the company's securities.

In addition, special attention is given to corporate governance. Reporting companies must include a copy of the audit committee report in their annual proxy statements. This report must disclose, inter alia, whether the committee has reviewed the audited financial statements with management, recommended that the audited statements be included in the corporation's annual report to the board, and discussed certain matters with independent auditors to assess their views on the auditors' independence, the quality of the corporation's financial reporting and the name of the committee member with financial expertise (if any). Under section 406 of the Sarbanes–Oxley Act, companies are required to disclose whether they have adopted a code of ethics for their senior financial officers. If a company has not adopted such a code it must explain why it has not done so. Certain changes to or waivers of any provision of the code must also be disclosed.

Under the Sarbanes–Oxley Act, the reliability and accuracy of the financial and non-financial information disclosed in a company's periodic reports has to be certified by the company's CEO and CFO. In each quarterly report both officers must certify, among other things, that:

- they reviewed the report;
- to their knowledge the report does not contain a material misstatement or omission and that the financial statements and other financial information in the report fairly present, in all material respects, the financial condition of the company, results of its operations and cash flows for the periods covered in the report;
- they are primarily responsible for the company's controls and procedures governing the preparation of all SEC filings and submissions, not just the periodic reports subject to certification; and
- they evaluated the 'effectiveness' of these controls and procedures and reported to the audit committee any significant deficiencies or material weaknesses in the company's financial reporting controls, together with any corrective actions taken or to be taken. Their conclusions must be disclosed in the certified report.

Companies listed on the New York Stock Exchange are required to disclose their corporate governance guidelines. Committee charters (if any) must be disclosed also.

In 2003, the SEC adopted rules that require reporting companies to disclose in their proxy statements or annual reports certain information regarding the director nomination process, including:

- whether the company has a nominating committee and, if not, how director nominees are chosen;
- whether the members of the nominating committee are independent;
- the process by which director nominees are identified and evaluated;
- whether third parties are retained to assist in the identification and evaluation of director nominees;
- minimum qualifications and standards used in identifying potential nominees;
- whether nominees suggested by shareholders are considered; and
- whether nominees suggested by large, long-term shareholders have been rejected.

These rules also require reporting companies to disclose certain information regarding shareholder communications with directors, including:

- the process by which shareholders can communicate with directors (and, if the company does not have an established process, why it does not);
- whether communications are screened and, if so, how;
- any policies regarding the attendance of directors at annual general meetings (AGMs); and
- the number of directors that attended the preceding year's AGM.

In 2006, the SEC adopted rules that require reporting companies to disclose in their proxy statements or annual reports certain information regarding the corporate governance structure that is in place for considering and determining executive and director compensation, including:

- the scope of authority of the compensation committee;
- the extent to which the compensation committee may delegate any authority to other persons, specifying what authority may be so delegated and to whom;
- any role of executive officers in determining or recommending the amount or form of executive and director compensation; and
- any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying these consultants, stating whether they are engaged directly by the compensation committee or any other person, describing the nature and scope of their assignment and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

Moreover, in 2009, the SEC adopted rules requiring companies to provide the following enhanced proxy statement disclosures:

- for each director and nominee, the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company;
- other directorships held by each director or nominee at any public company during the previous five years (rather than only current directorships);
- expanded legal proceedings disclosure relating to the past 10 years (rather than five years);
- whether and, if so, how the nominating committee considers diversity in identifying nominees for director;
- if the nominating committee has a policy with regard to the consideration of diversity in identifying director nominees, how this policy is implemented and how the nominating committee or the board assesses the effectiveness of its policy;
- the board's leadership structure and why the company believes it is the best structure for the company;
- whether and why the board has chosen to combine or separate the CEO and board chair positions;

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- where these positions are combined, whether and why the company has a lead independent director and the specific role the lead independent director plays in the leadership of the company;
- the board's role in the oversight of risk management and the effect, if any, that this has on the company's leadership structure;
- the company's overall compensation policies or practices for all employees generally, not just executive officers, 'if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company'; and
- fees paid to and services provided by compensation consultants and their affiliates if the consultants provide consulting services related to director or executive compensation and also provide other services to the company in an amount valued in excess of US$120,000 during the company's last fiscal year.

In 2010, the SEC also issued an interpretive release on disclosure relating to climate change, which is intended to provide guidance to reporting companies on the application of existing disclosure requirements to climate change and other matters. Also in 2010, the SEC issued an interpretive release relating to disclosure of liquidity and funding risks posed by short-term borrowing practices.

The SEC issued disclosure guidance relating to cybersecurity (2011, which was updated in 2018) and European sovereign debt exposure (2012), among other matters.

In 2011, the SEC approved final rules relating to advisory votes on executive compensation (say-on-pay) pursuant to the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd–Frank Act), which also require companies to include a discussion in the proxy statement as to whether and, if so, how the company has considered the results of the most recent say-on-pay vote in determining compensation policies and decisions and, if so, how that consideration has affected the company's executive compensation decisions and policies.

In 2012, the SEC approved final rules mandated by the Dodd–Frank Act requiring proxy statement disclosure regarding compensation consultant conflicts of interest. Such disclosure became required to be included in proxy statements for annual meetings occurring on or after 1 January 2013.

In 2012, the Exchange Act was amended by the Iran Threat Reduction and Syria Human Rights Act of 2012 to require public companies to provide disclosure if the company or any of its affiliates (including its directors and officers) has knowingly engaged in certain enumerated activities subject to US trade sanctions involving Iran or specified Iranian entities or nationals as well as certain other non-Iranian persons or entities deemed to promote terrorist activities or the proliferation of weapons of mass destruction. Such disclosure became required to be included in quarterly and annual reports beginning in February 2013.

The Dodd–Frank Act amended the Exchange Act to require disclosure relating to conflict minerals (gold, tantalum, tin and tungsten) originating from the Democratic Republic of Congo or an adjoining country. Since May 2014, public companies have been required to make various disclosures where conflict minerals are necessary to the functionality or production of a product that is either manufactured by the company or by a third party with which the company contracts for such manufacture. A group of business groups filed litigation challenging the conflict minerals rule on several grounds, including that the required disclosure would violate the First Amendment to the US Constitution. In April 2014, the US Court of Appeals for the District of Columbia Circuit found that one disclosure provision of the conflict minerals rule violated the First Amendment but upheld the remainder of the rule. The Court reaffirmed its original ruling in August 2015 and the final judgment in the case was entered in April 2017. In January 2017, the acting chair of the SEC had requested comments on the rule and related guidance through March 2017. In April 2017, the staff of the SEC's Division of Corporation Finance announced that it will not recommend enforcement action if a company fails to comply with certain aspects of the rule relating to due diligence on the source and chain of custody of conflict minerals and an independent private sector audit. The acting chair of the SEC released a statement on the same day announcing that this relief is appropriate because the primary purpose of those requirements is to enable companies to make the disclosure that was found to violate the First Amendment. He directed the SEC Staff to develop a recommendation for future SEC action on the rule after taking into consideration the public comments received.

In addition, the Dodd–Frank Act amended the Exchange Act to require 'resource extraction issuers' to disclose specified information regarding payments made to a foreign government or the US federal government for the purpose of commercial development of oil, natural gas or minerals. The SEC adopted a resource extraction disclosure rule in 2012 that was vacated by the US District Court for the District of Columbia in 2013. Later in 2013, the SEC announced that it would redraft the resource extraction rule rather than appeal the ruling. The SEC re-proposed the resource extraction rule in 2015. The SEC rule was repealed in 2017, but the underlying Dodd–Frank Act mandate for SEC rule-making remains intact. The SEC proposed rules in 2019 and the SEC adopted final rules in December 2020 that will require resource extraction issuers to make annual filings disclosing payments made to foreign governments or the US federal government for the commercial development of oil, natural gas or minerals.

The Dodd–Frank Act requires several new disclosures requiring SEC rule-making, including in relation to 'pay versus performance', the CEO pay ratio (requiring disclosure of the median of the annual total compensation of all company employees except the CEO, the CEO's total annual compensation and the ratio of the former to the latter), clawback policies requiring the recovery of excess compensation paid to executives and corporate policies on hedging of company stock by directors and employees. The SEC has adopted rules relating to the CEO pay ratio disclosure requirements and corporate hedging policies (see below) and has proposed rules relating to the pay versus performance disclosure requirements and clawback policies. In 2017, the SEC published guidance to assist US public companies as they prepare for compliance with the CEO pay ratio disclosure rule. Taken as a whole, the guidance makes clear that companies have substantial flexibility in developing their response to the new disclosure requirement.

In 2018, the SEC issued new interpretive guidance on cybersecurity disclosure that reinforced and expanded upon the 2011 guidance issued by the SEC's Division of Corporation Finance. The guidance illustrates the SEC's increased expectations with respect to how US public companies monitor and disclose cybersecurity risks and incidents.

Since early 2014, the SEC has engaged in a 'disclosure effectiveness project'. The goal of the project is to review existing disclosure requirements to determine whether modifications should be made to reduce the costs and burdens on public companies while also promoting the disclosure of material information to investors and eliminating duplicative disclosures. In September 2015, the SEC requested comment on the form and content of financial statement disclosures required under Regulation S-X. In April 2016, the SEC issued a concept release seeking public comment on modernising certain business and financial disclosures required by Regulation S-K to be included in public companies' periodic reports. In August 2016, the SEC requested public comment on the compensation and corporate governance information to be included in US public companies' proxy statements. In March 2017, the SEC approved rules that will require US public companies to provide hyperlinks to the exhibits to their SEC filings, which became effective for the largest category of filers in September 2017. In August 2018, the SEC adopted rule amendments to eliminate or update certain

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disclosure requirements that have become redundant, duplicative, overlapping, outdated or superseded as a result of more recently updated SEC or generally accepted accounting principles requirements or changes in the information environment. The amendments became effective in November 2018. The SEC adopted rule amendments in March 2019 intended to streamline and improve disclosure requirements applicable to US public companies. The key rule amendments, which became effective in April and May 2019, streamline MD&A disclosure in annual reports, reduce the need to submit confidential treatment requests to the SEC and simplify exhibit filing requirements. In August 2020, the SEC adopted amendments to modernise its rules requiring disclosure about a company's business description, legal proceedings and risk factors. Most notably, the rule amendments require a public company to describe its human capital resources, including any human capital measures or objectives the company focuses on in managing its business, to the extent material to an understanding of the company's business taken as a whole. The amendments became effective in November 2020. In November 2020, the SEC adopted amendments to modernise, streamline and enhance certain financial disclosure requirements in Regulation S-K. The rule amendments, which became effective in February 2021, are intended to improve the quality of MD&A disclosures by emphasising a principles-based approach and reduce the compliance burden on companies by eliminating several more prescriptive requirements.

In December 2018, the SEC adopted a rule that requires a US public company to disclose whether it has adopted practices or policies regarding the ability of its directors and employees (including officers) to hedge the company's equity securities. Most US public companies first had to comply with the new disclosure requirement in their 2020 annual meeting proxy statements.

In January 2020, the SEC issued new interpretive guidance on disclosure of key performance indicators and other metrics in the MD&A section of public companies' periodic reports.

In December 2020, the Nasdaq Stock Market (Nasdaq) filed a proposal with the SEC to adopt new listing standards that would require Nasdaq-listed companies to publicly disclose diversity statistics regarding their boards in a standardised disclosure matrix template and have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+. This proposal was amended in February 2021 and requires SEC approval. The SEC is expected to act on the proposal by August 2021.

SEC developments in early 2021 illustrate a heightened focus on matters related to climate and environmental, social and governance matters and momentum toward the SEC developing a comprehensive ESG disclosure framework. The incoming SEC chair has signalled support for corporate disclosures about political contributions, climate risks and workforce diversity in light of strong investor interest in those topics. In March 2021, the acting chair of the SEC invited public comment on public company climate disclosures. Her statement set forth 15 sets of questions that investors, public companies and other market participants can answer to inform the SEC staff as it considers rule amendments aimed at making climate disclosures more consistent, comparable and reliable.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Since September 2011, companies can no longer exclude from their proxy materials shareholder proposals (precatory or binding) relating to by-law amendments establishing procedures for shareholder nomination of director candidates and inclusion in the company's proxy materials, as long as the proposal is not otherwise excludable under Rule 14a-8. This amendment to Rule 14a-8 facilitates the development of 'proxy access' via private ordering at companies chartered in states where permissible, as shareholders are able to institute a shareholder nomination regime via binding by-law amendment or request, via precatory shareholder proposal, that such a by-law be adopted by the board.

The private ordering process gained considerable momentum during 2015, which saw a significant increase in the number of shareholder proxy access proposals submitted (more than 100) and shareholder support for such proposals (60 per cent of the total proposals voted on passed), as well as an increased frequency of negotiation and adoption of proxy access via board action. In response to shareholder proposals and increasing pressure from institutional investors and proxy advisory firms, over 720 companies have adopted proxy access, including more than 80 per cent of S&P 500 companies as of May 2021 (up from less than 1 per cent in 2014). Proxy access is extending significantly into the next tier of large public companies with just over half of Russell 1000 companies have adopted proxy access as of May 2021. The market standard that has emerged gives a group of up to 20 shareholders who hold 3 per cent of the company's common stock for at least three years the right to nominate up to 20 per cent of the company's directors (or at least two directors) using the company's proxy materials. Proxy access provisions typically include limitations on the use of proxy access (eg, in contested election situations) and require detailed information to be provided in relation to the nominee and the nominating group, among other requirements.

In the past five years, shareholders have been submitting proposals requesting that companies make amendments to their proxy access by-laws (eg, to increase or remove the limit on the size of the nominating shareholder group). These 'fix-it' proposals have largely been excludable if the Securities and Exchange Commission (SEC) staff has agreed that the company has substantially implemented the proposal, or failed to receive majority support. Two 'fix-it' proposals filed by shareholders passed in 2016, but all others filed in the past five years have failed.

Furthermore, the SEC proposed changes to the federal proxy rules in 2016 to require the use of universal proxy cards, which would allow shareholders to vote for a mix of management and dissident nominees in a contested director election.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

Shareholder influence is more potent than ever and continued attention to the quality of shareholder relations has become paramount. Companies are engaging with their key large institutional investors more directly and more frequently to hear their interests and concerns, including from a governance perspective. Whereas engagement with shareholders used to occur primarily during the annual meeting season, companies are now engaging with their shareholders throughout the year. There are several reasons for this including:

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- the advent of the shareholder advisory vote on executive compensation;
- a rise in hedge fund activism;
- proxy advisory firm policies that expect companies to respond to shareholder advisory votes that receive significant (but less than passing) support; and
- shareholder expectations.

Shareholders are also increasingly seeking to engage with companies outside of the shareholder proposal mechanism. For example, in addition to more frequent one-on-one meetings between the company and shareholders, it is becoming more common for large institutional investors to send letters on specific issues of concern to portfolio companies. In recent years, public campaigns of this sort have urged CEOs to disclose a long-term strategic plan to shareholders, the adoption of proxy access and more direct engagement between directors and shareholders. In particular, BlackRock, State Street and Vanguard, three of the largest institutional investors in the United States, have recently become more assertive in pushing for corporate governance reforms and increased director–shareholder engagement at the companies in which they invest.

Members of senior management, such as the CEO and CFO, are typically the company representatives who engage with shareholders. Investor relations personnel may also be involved in shareholder engagement efforts. Outside counsel rarely participates. Directors are becoming more involved in shareholder engagement. Which director is involved depends on the topics to be discussed. Often the lead director or the relevant committee chair will meet with the shareholder along with a member of senior management. For example, the compensation committee chair may be called upon to meet with an investor who has concerns with the company's executive compensation programme.

Directors of US public companies should understand the composition and particular interests of their shareholder base and be actively involved in overseeing the company's shareholder engagement and investor relations efforts. Many companies are also engaging with a broader group of shareholders rather than just the top few holders. Companies are also increasingly providing disclosure regarding their shareholder engagement efforts in their annual meeting proxy statements. In 2015, the Council of Institutional Investors (CII) issued a report calling for enhanced disclosure relating to company-shareholder engagement. Specifically, the CII provided 'best in class' examples of disclosure of engagement policies and practices.

Sustainability disclosure

41 | Are companies required to provide disclosure with respect to corporate social responsibility matters?

It is common for US public companies to report on corporate social responsibility (CSR) and ESG matters including environmental, social and ethical issues. Several SEC disclosure requirements tend to trigger disclosure of CSR matters, typically in quarterly and annual reports:

- business description disclosure;
- legal proceedings disclosure;
- material known events and uncertainties disclosure included in management's discussion and analysis of the company's financial condition and results of operations;
- risk factor disclosure;
- guidance regarding climate change disclosure; and
- conflict minerals disclosure.

In August 2020, the SEC adopted rules that require disclosure of any human capital measures or objectives that management focuses on in managing the business (such as those that address the attraction, development and retention of personnel) to the extent material to an understanding of the company's business.

SEC developments in early 2021 illustrate a heightened focus on climate and ESG-related matters and momentum toward the SEC developing a comprehensive ESG disclosure framework. The incoming SEC chair has signalled support for corporate disclosures about political contributions, climate risks and workforce diversity in light of strong investor interest in those topics. In March 2021, the acting chair of the SEC invited public comment on public company climate disclosures. Her statement set forth 15 sets of questions that investors, public companies and other market participants can answer to inform the SEC staff as it considers rule amendments aimed at making climate disclosures more consistent, comparable and reliable.

Many companies also report on ESG matters voluntarily (eg, 90 per cent of S&P 500 companies published annual sustainability or responsibility reports in 2019). In late 2019, the US Chamber of Commerce released a set of best practices to guide companies in making voluntary disclosure about ESG topics and steer the development of a widely adopted approach to voluntary ESG reporting without the need for additional regulatory mandates. Companies may be subject to additional disclosure requirements under state law (eg, certain companies doing business in California are required to disclose measures they take to eliminate slavery and human trafficking in their supply chains).

Many companies consider three influential guides when determining if and what to disclose regarding ESG issues: the Global Reporting Initiative Sustainability Reporting Standards, the Sustainability Accounting Standards Board Implementation Guide (the final standards of which were released in November 2018) and the Recommendations of the Task Force on Climate-related Financial Disclosures.

In 2018, ISS launched an Environmental & Social (E&S) QualityScore scoring tool that measures the depth and extent of corporate disclosure on environmental and social issues, including sustainability governance, and identifies key disclosure omissions. This metric for institutional investors to use to evaluate the E&S risk of their portfolio companies has prompted greater disclosure of E&S matters by some US public companies.

In recent years, large institutional investors have urged companies to disclose how long-term strategy incorporates corporate sustainability considerations. In February 2018, State Street sent letters to all companies in the S&P 500 encouraging them to proactively disclose their compliance with the Investor Stewardship Group's corporate governance and sustainability principles. State Street votes against the independent board leader at companies that do not comply with the principles and companies that cannot explain the nuances of their governance structure effectively, either publicly or through engagement.

In January 2021, Larry Fink, BlackRock's chair and CEO released his annual letter to the CEOs of its portfolio companies warning that BlackRock will vote against directors at companies that do not make sufficient progress on implementing sustainable business practices and improving their climate change and sustainability-related disclosures. He called for a single global standard for ESG disclosure but, in the meantime, BlackRock continues to endorse the ESG disclosure framework of the Sustainability Accounting Standards Board (SASB) and the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). He also noted that BlackRock expects public companies to incorporate climate risk as part of their oversight of long-term strategies and to disclose how they are addressing climate-related risks. Finally, BlackRock asked companies to disclose their long-term strategies for improving diversity, equity and inclusion in their sustainability reports.

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Also in January 2021, Cyrus Taraporevala, the president and CEO of State Street Global Advisers sent a letter to the boards of its portfolio companies announcing that State Street will prioritise systemic risks associated with climate change and a lack of racial and ethnic diversity – and will hold boards and management accountable for enhancing disclosures on these topics. State Street will continue to engage with companies in the S&P 500 and certain other indices that lag behind their peers in State Street's 'R-Factor' score, which is used to measure company performance in business operations and governance related to financially material and industry-specific ESG issues. Specifically, State Street will ask companies especially vulnerable to the transition risks of climate change about their plans to mitigate and manage the physical and transitional impacts of climate change. The letter also discussed State Street's recent efforts to proactively address racial and ethnic diversity, including through the issuance of new Guidance on Enhancing Racial and Ethnic Diversity Disclosures and related proxy voting guidelines. Beginning in 2021, State Street will vote against nominating and governance committee chairs at S&P 500 companies that do not disclose the racial and ethnic composition of their boards. Beginning in 2022, State Street will vote against compensation committee chairs at S&P 500 companies that do not disclose their EEO-1 Survey responses (referring to a disclosure framework set forth by the US Equal Employment Opportunity Commission that tracks employee diversity by race, ethnicity and gender, broken down by industry, employment categories or seniority levels, for all full-time US employees). Finally, beginning in 2022, State Street will vote against nominating and governance committee chairs at S&P 500 companies that do not have at least one director from an underrepresented community on their boards.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

The SEC adopted the CEO pay ratio rule in August 2015 requiring US public companies to disclose the median of the annual total compensation of all company employees except the CEO, the CEO's total annual compensation and the ratio of the former to the latter. For calendar-year companies, the first disclosure was required in 2018 annual meeting proxy statements based on 2017 compensation. In September 2017, the SEC published guidance to assist US public companies as they prepare for compliance with the CEO pay ratio disclosure rule. Taken as a whole, the guidance makes clear that companies have substantial flexibility in developing their response to the new disclosure requirement.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

US public companies are not required to disclose gender pay gap information. However, in recent years some investors have filed shareholder proposals primarily at companies in the technology and financial services industries requesting them to measure, disclose and take action to close gender pay gaps. In exchange for withdrawal of the proposals, some of the targeted companies committed to report certain pay data by gender and take steps to reduce any identified gender pay gaps. The first of these reports among US public companies was published by a large financial institution in early 2019. Since 2018, ISS evaluates shareholder proposals seeking reports on a company's pay data by gender, or policies or goals aimed at reducing any gender pay gap, on a case-by-case basis considering specified factors. Glass Lewis adopted a similar policy that took effect for the 2017 proxy season.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Public companies are facing increased pressures from investors, customers and employees on environmental, social and governance (ESG) issues, especially human capital management and climate issues. Human capital management covers a broad range of workforce matters, including diversity and inclusion, employee satisfaction and engagement, succession and talent management, and ethics, workforce culture and risk. In August 2020, the Securities and Exchange Commission (SEC) adopted rules that require disclosure of any human capital measures or objectives that management focuses on in managing the business (such as those that address the attraction, development and retention of personnel) to the extent material to an understanding of the company's business. This disclosure was first required in companies' 2020 Form 10-Ks filed in early 2021.

Calls among investors and other stakeholders for disclosure of EEO-1 workforce demographic data have been gaining traction. Disclosure of EEO-1 reports (which provide a racial, gender and job category breakdown of a company's US workforce) would enable measurement and comparison over time between companies and within individual companies. Sustainability Accounting Standards Board (SASB) Standards for certain industries recommend disclosure of EEO-1 data and recent shareholder proposals have asked for annual disclosures of EEO-1 data. In July 2020, the Office of the New York City Comptroller sent a letter to the CEOs of 67 S&P 100 companies urging each company to commit to publicly disclose its EEO-1 report when submitted to the EEOC in 2021. In December 2020, the NYC Comptroller reported that 40 of the targeted companies agreed to comply with the request to publicly disclose their EEO-1 report and that it submitted shareholder proposals at 24 targeted companies that were not responsive which will be voted on at their 2021 annual shareholder meetings.

US public companies are under increasing pressure to enhance the diversity of their boards and related disclosures, and the focus has expanded from gender diversity to ethnic and racial diversity. In September 2018, a California law was enacted that required California-based publicly held domestic or foreign corporations to have at least one female director by the end of 2019 and, depending on board size, up to three female directors by the end of 2021. A similar California law was enacted in September 2020 that will require such corporations to have at least one director from an underrepresented community by the end of 2021 and, depending on the board's size, up to three directors from underrepresented communities by the end of 2022. Several other states have enacted or are considering legislation that would encourage greater board diversity or require disclosure about board diversity, including Colorado, Hawaii, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania and Washington.

Effective as of 2020, ISS generally recommends voting against nominating committee chairs (and potentially other directors) at companies with no female directors unless certain mitigating factors apply. Glass Lewis adopted a similar policy that took effect for the 2019 proxy season. Beginning in 2022, Glass Lewis will recommend voting against nominating committee chairs at companies where a board with more than six members has fewer than two female directors. Beginning in 2022, ISS will recommend voting against nominating committee chairs at companies that have no racially/ethnically diverse directors, with certain exceptions.

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For 2021, Glass Lewis revised its policy to indicate that when evaluating board diversity it will make recommendations in accordance with board composition requirements set forth in any applicable state laws on diversity that take effect. Specifically, beginning in 2022, Glass Lewis will base its vote recommendations at California-headquartered companies on compliance with the applicable board diversity thresholds that are in effect.

Since July 2020, Goldman Sachs will not take a company public unless it has at least one diverse board candidate, 'with a focus on women'. Beginning in 2021, Goldman Sachs Asset Management will vote against the entire board at any company with no female directors, and against all nominating committee members at any company that does not have at least one female director and one additional diverse director based on gender identity, sexual orientation and racial or ethnic background.

In December 2020, the Nasdaq Stock Market (Nasdaq) filed a proposal with the SEC to adopt new listing standards that would require Nasdaq-listed companies to publicly disclose diversity statistics regarding their boards in a standardised disclosure matrix template and have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+. This proposal was amended in February 2021 and requires SEC approval. The SEC is expected to act on the proposal by August 2021.

The national focus on racial justice and equity in the United States in 2020 stemming from the killing of George Floyd created a new theory of liability in shareholder litigation, alleging that company directors can violate their duties to the company and shareholders by, among other things, failing to have a sufficiently racially diverse board. Since summer 2020, more than a dozen shareholder derivative actions alleging this theory have been filed. Three such lawsuits were dismissed in March and April 2021 which may foreshadow whether similar suits will be successful.

The SEC adopted controversial rule amendments in September 2020 that will significantly increase the eligibility requirements for submitting a shareholder proposal to a tiered approach depending on the level of ownership and the relevant holding period: at least US$2,000 if held for at least three years, at least US$15,000 if held for at least two years and at least US$25,000 if held for at least one year. The rule amendments also significantly increase the prior shareholder support thresholds for resubmitting substantially similar shareholder proposals at the same company in future years and clarify that one person may not submit more than one proposal, directly or indirectly, to a company for the same shareholder meeting. The heightened standards will apply to any shareholder proposal submitted or re-submitted for an annual shareholder meeting held on or after 1 January 2022 and are expected to reduce the number of proposals beginning with the 2022 proxy season.

In late 2020, ISS and Glass Lewis released updates to their proxy voting policies for the 2021 proxy season. The key policy updates relate to the following topics:

- board diversity and related disclosures;
- director tenure;
- board oversight of environmental and social risk;
- virtual shareholder meetings;
- ESG-related shareholder proposals; and
- compensation-related matters.

In January 2021, Larry Fink, BlackRock's chair and CEO released his annual letter to the CEOs of its portfolio companies warning that BlackRock will vote against directors at companies that do not make sufficient progress on implementing sustainable business practices and improving their climate change and sustainability-related disclosures. He called for a single global standard for ESG disclosure. In the meantime, BlackRock continues to endorse the ESG disclosure framework of the SASB and the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). He also noted that BlackRock expects public companies to incorporate climate risk as part of their oversight of long-term strategies and to disclose how they are addressing climate-related risks. Finally, BlackRock asked companies to disclose in their sustainability reports their long-term strategies for improving diversity, equity and inclusion.

Shortly thereafter, Cyrus Taraporevala, the president and CEO of State Street, sent a letter to the boards of its portfolio companies announcing that State Street will prioritise systemic risks associated with climate change and a lack of racial and ethnic diversity – and will hold boards and management accountable for enhancing disclosures on these topics. State Street will continue to engage with companies in the S&P 500 and certain other indices that lag behind their peers in State Street's 'R-Factor' score (used to measure company performance in business operations and governance related to financially material and industry-specific ESG issues). Specifically, State Street will ask companies especially vulnerable to the transition risks of climate change about their plans to mitigate and manage the physical and transitional impacts of climate change. The letter also discussed State Street's recent efforts to proactively address racial and ethnic diversity, including through the issuance of new Guidance on Enhancing Racial and Ethnic Diversity Disclosures and related proxy voting guidelines. Beginning in 2021, State Street will vote against nominating and governance committee chairs at S&P 500 companies that do not disclose the racial and ethnic composition of their boards. Beginning in 2022, State Street will vote against compensation committee chairs at S&P 500 companies that do not disclose their EEO-1 Survey responses (referring to a disclosure framework set forth by the US Equal Employment Opportunity Commission that tracks employee diversity by race, ethnicity and gender, broken down by industry, employment categories or seniority levels, for all full-time US employees). Finally, beginning in 2022, State Street will vote against nominating and governance committee chairs at S&P 500 companies that do not have at least one director from an underrepresented community on their boards.

In 2020, boards and management faced complex issues presented by the covid-19 pandemic relating to:

- health and safety;
- operating and risk oversight;
- business continuity, including disruption to employees, operations, supply chain, liquidity, internal controls and incentives, and cybersecurity;
- financial reporting and trends;
- board and management resiliency;
- shareholder relations and activism;
- annual meetings (including a shift to virtual-only annual meetings); and
- strategic opportunities.

In four recent instances, a Delaware court declined to dismiss a claim alleging that directors had not satisfied their duty to exercise oversight. This unprecedented number of 'Caremark' claims surviving a motion to dismiss re-emphasizes the importance of board focus on risk oversight, process and controls. This is especially important now because the covid-19 pandemic presents companies with unique challenges and risks. To avoid any potential 'Caremark' claim, directors must become informed of the critical risks facing the company (including from covid-19), ask questions and take timely and informed actions to ensure that management is addressing those critical risks.

The number of US companies that held virtual-only annual shareholder meetings skyrocketed in 2020 when the covid-19 pandemic made in-person shareholder meetings impossible or inadvisable. Many US companies are considering holding annual shareholder meetings in a virtual-only or hybrid format in the future.

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Currently, ISS prefers a hybrid approach but does not have a policy to recommend voting against directors at companies that hold virtual-only meetings. In April 2020, it issued policy guidance that encouraged companies holding virtual-only meetings to explain why and provide shareholders with a meaningful opportunity to participate fully in the meeting (eg, engage in dialogue, ask questions of directors and senior management).

In January 2021, acknowledging that virtual shareholder meetings may become the 'new normal', Glass Lewis announced its expectations for companies holding virtual shareholder meetings. If a company chooses to hold its annual meeting in a virtual-only format, Glass Lewis expects robust disclosure in the proxy statement that assures shareholders that they will be afforded the same rights and opportunities to participate as they would have at an in-person meeting. In egregious cases, Glass Lewis may recommend voting against governance committee members or the board chair where a company chooses to hold a virtual-only shareholder meeting and does not provide sufficient disclosure explaining how shareholders can participate in the meeting and engage with the board and management.

Several large institutional investors (eg, CII, the California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS) and the New York City Pension Funds) oppose virtual-only shareholder meetings and may vote against directors at companies that hold them.

Shareholder activism

Shareholders are continuing to engage companies and press for reforms in the areas of shareholder rights and board composition and quality, but they are also increasing their focus on ESG issues, such as climate change, diversity, and board effectiveness, and the impact of ESG issues on companies' financial performance. ESG is no longer a fringe issue of interest only to special issue investors – particularly after the widespread impacts of the covid-19 pandemic and the racial and social justice movements in 2020. Mainstream institutional investors are recognising that attention to ESG and corporate social responsibility affects portfolio company financial performance. The rising interest in ESG among investors is apparent in the sharp rise in US-domiciled assets under management using ESG strategies, increasing support for shareholder proposals relating to ESG issues, as well as in the focus of engagement efforts.

The year 2020 marked the fourth consecutive year in which environmental and social (E&S) issues (eg, board and workforce diversity, improved sustainability reporting and climate risk disclosures, corporate political spending) accounted for a majority of all shareholder proposals filed. Although the total number of E&S proposals declined in 2020, the percentage of proposals voted on and receiving majority support increased substantially. A record number of E&S proposals – 21 – received majority support from shareholders in 2020. Successful E&S proposals spanned a variety of topics, including political contributions and lobbying disclosures, human capital management issues such as board and workforce diversity reporting and climate change and environmental matters. We expect to see continued growth in support for E&S proposals among public pension funds, large institutional investors, proxy advisers and individual shareholder proponents in 2021.

Governance-related shareholder proposals were the most prevalent category of proposals submitted in 2020. They primarily addressed the following topics: the right to act by written consent, independent chairs and the right to call special meetings. The number of governance proposals that received majority support declined, largely because there were fewer proposals submitted to topics that had a historically high success rate. Independent chair proposals saw average support increase substantially to 35 per cent and two proposals received majority support in 2020. There was a sharp increase in the number of proposals that went to vote that sought the right to act by written consent – 63 in 2020 versus 35 in 2019 – but average support for such proposals continued to decline.

Most E&S proposals submitted for the 2021 proxy season address workforce diversity reporting, political contributions and lobbying disclosures and environmental issues. The most common governance proposals submitted for 2021 address the right to act by written consent, an independent chair and the right to call special meetings. A new proposal type has emerged for 2021 whereby a non-profit shareholder proponent has asked approximately 20 companies to convert to public benefit corporations.

The covid-19 pandemic, stock market volatility and depressed market valuations presented opportunities in 2020 for activists to invest at lower prices. In the spring of 2020, there was a significant uptick in the number of US public companies adopting shareholder rights plans (poison pills), either in response to a specific threat or as a preventative measure. ISS, Glass Lewis and many institutional investors generally disfavour the adoption of poison pills in the absence of a specific activist or takeover threat or significant net operating losses to protect. In April 2020, ISS and Glass Lewis each issued guidance indicating that a severe stock price decline would likely be deemed an acceptable justification to adopt a pill with a term of less than one year under certain circumstances.

Boards are facing mounting pressure from investors to integrate ESG considerations into corporate strategies and operations and to disclose information relating to ESG matters. Activists are increasingly bringing ESG-related campaigns seeking changes to board composition or strategic direction at target companies that they argue will increase the stock price.

Coronavirus

45 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

In July 2020, the Delaware legislature amended the Delaware General Corporation Law (DGCL), section 110, which governs a board's authority to adopt emergency bylaws and exercise certain powers during an emergency. These amendments took effect retroactively from 1 January 2020. First, 'an epidemic or pandemic, and a declaration of a national emergency by the US government' was explicitly added to the non-exclusive list of events that constitute an emergency. Second, the amended provision permits emergency bylaws to be adopted, and emergency powers to be exercised, by a majority of the directors present if a quorum of directors cannot be readily convened. The new DGCL, section 110(i) gives the board of a Delaware corporation the discretion to take any action that it determines to be practical and necessary to address the circumstances of an emergency with respect to a shareholder meeting, including postponing the meeting to a later time or date, changing the location of the meeting or holding the meeting virtually and providing shareholders with notice of any such postponement or change solely through an SEC filing. The amendment also provides that, during an emergency, a board may change the record date and payment date of an already declared dividend as long as the record date has not yet passed. If the record date is delayed, the new payment date must be no more than 60 days after the new record date. The corporation must provide notice to shareholders of any change to the record or payment dates as promptly as practicable and in any event before the applicable record date, which notice may be provided solely through an SEC filing. Finally, the amendments provide that no person shall be liable for, and

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no shareholder meeting shall be voided, for failure to make a shareholder list available at a meeting pursuant to DGCL, section 219 if an emergency made it impracticable to allow inspection of the list.

In March and April 2020, the SEC staff issued guidance for public companies on conducting annual shareholder meetings in light of covid-19 concerns. The guidance encouraged prompt disclosure to shareholders about changes made to the date, time, location or format of shareholder meetings (including a switch from an in-person meeting to a virtual-only or hybrid meeting). In the spring of 2020, several states passed emergency legislation or executive orders in light of the covid-19 pandemic to permit or facilitate virtual-only and hybrid annual meetings.

In March 2020, the SEC's Division of Corporation Finance published guidance providing its views on disclosure and other securities law matters that public companies should consider regarding the covid-19 pandemic and related business and market disruptions. Noting that covid-19 is a material risk for all public companies, the guidance encouraged public companies to consider whether and the extent to which disclosure of covid-19-related risks and effects may be necessary in management's discussion and analysis (MD&A), the business section, risk factors, legal proceedings, disclosure controls and procedures, internal control over financial reporting and the financial statements. The SEC also provided public companies additional time in which to comply with their filing obligations. Finally, the guidance advised that, where a company is affected by covid-19 in a way that would be material to investors, the company, its directors and officers and other insiders aware of these matters should refrain from trading in the company's stock until such information has been publicly disclosed.

In April 2020, the chair of the SEC and the Director of the SEC's Division of Corporation Finance issued a significant joint statement urging public companies to provide as much information as is practicable regarding their current financial and operating status and future planning with respect to the covid-19 pandemic in their earnings releases. Specifically, they encouraged companies to respond to investor interest by disclosing:

- where the company currently stands, operationally and financially;
- how the company's covid-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing; and
- how its operations and financial condition may change as the nation's efforts to fight covid-19 progress.

In June 2020, the Division of Corporation Finance supplemented its March 2020 guidance to provide additional views on disclosures regarding operations, liquidity and capital resources in light of business and market disruptions from covid-19. It also added specific guidance on disclosures required if a company received federal government assistance in connection with the covid-19 pandemic or has doubts about its ability to continue as a going concern.

In April 2020, ISS issued guidance explaining how it planned to apply certain voting policies during the 2020 proxy season in light of the challenges and uncertainty caused by the covid-19 pandemic. In general, ISS agreed to take a more flexible approach when applying its policies on virtual annual shareholder meetings, poison pills, director attendance and leadership changes, executive compensation and capital structure. In October 2020, ISS issued a frequently asked questions document on US compensation policies and the covid-19 pandemic. In January 2021, Glass Lewis released illustrative guidance to explain how it intends to apply its executive compensation-related policies in the context of the covid-19 pandemic during the 2021 proxy season. ISS and Glass Lewis will scrutinise covid-19-related compensation adjustments but may find them acceptable if a company clearly discloses a compelling justification for the changes and the resulting outcomes appear reasonable relative to the company's performance.

In January 2021, acknowledging that virtual shareholder meetings may become the 'new normal', Glass Lewis announced its expectations for companies holding virtual shareholder meetings. If a company chooses to hold its annual meeting in a virtual-only format, Glass Lewis expects robust disclosure in the proxy statement that assures shareholders that they will be afforded the same rights and opportunities to participate as they would have at an in-person meeting.

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