Considerations For The 2018 Proxy Season: Part 2

By **Brian Breheny, Andrew Brady, Josh LaGrange, Justin Kisner, Hagen Ganem, Caroline Kim, Joseph Yaffe and Amanda Bradley**

Brian Breheny

Joseph Yaffe

Each company faces important decisions in preparing for its 2018 annual meeting and reporting season. This three-part series covers essential areas that companies should focus on as they plan for 2018, including corporate governance, executive compensation and disclosure matters. Part 2 of this article continues to focus on annual shareholder meeting matters with a discussion of trends in shareholder proposals and virtual shareholder meetings, efforts to increase board diversity, updates to director and officer reviews, changes to auditor reports and various proxy statement-related issues, such as reporting say-on-frequency results and finalizing pay ratio disclosures, in addition to other filing obligations. Read part 1 of the article **here**.

Consider Shareholder Proposal Trends and Developments

In addition to assessing proxy access proposals, as **discussed in part 1**, we recommend that companies consider recent trends and U.S. Securities and Exchange Commission staff guidance in preparing for non-proxy access-related shareholder proposals submitted for inclusion in company proxy materials.

Governance Proposals

After proxy access, requests for an independent board chair were the most common governance-related shareholder proposal in 2017, with approximately 50 proposals submitted to a shareholder vote in 2017. Average support continues to remain at around 30 percent of votes cast, however, with no proposals receiving majority support during the season.

Requests for the right of shareholders to call a special meeting and the right to act by written consent also were popular among shareholder proposal governance topics. Three of the four proposals seeking a new right to call a special meeting received majority support in 2017. Generally, companies require shareholders to hold 25 percent of the company's outstanding common stock to call a special meeting. Nineteen proposals sought to reduce the 25 percent ownership requirement to 10 percent or 15 percent, but with average support for these proposals just below 41 percent, only one of these proposals received majority support during 2017.

Proposals calling for the ability to act by written consent generally have not passed at companies already affording shareholders the right to call a special meeting. All three of the 15 written consent proposals that received majority support in 2017, however, were at such companies, showing that a special meeting right alone may not be sufficient to defeat such proposals. More broadly, average support for written consent proposals increased over four percentage points in 2017 to over 45 percent of votes cast.

Other successful governance-related shareholder proposals continue to include calls for the elimination of supermajority voting requirements, majority voting in uncontested director elections, and board declassification. Averaging majority support, all three categories of proposals generally pass when included on a company's ballot.

Board Diversity Proposals

Approximately 37 proposals calling for a report on steps to increase board diversity or for the adoption of a board diversity policy were submitted to companies in 2017, compared to 28 proposals in 2016. Consistent with the prior year, most of the board diversity proposals in 2017 were withdrawn by proponents following shareholder engagement and agreements to enhance disclosure and/or policies related to board recruitment. Two of the nine proposals that went to a vote received majority support (the boards of both companies did not have any female members) in 2017, and average levels of support increased almost six percentage points year-over-year to just over 28 percent in 2017. Given that board diversity is identified by a number of large institutional investors as a priority for portfolio companies, similar proposals and support levels are expected this upcoming season.

Climate Change Proposals

Despite a number of shareholder proposals on climate change having been submitted to companies over the past decade, proposals focusing on the subject have not fared well. In 2016 and 2017, for instance, a total of 103 proposals related to climate change went to a vote, yet those proposals averaged only 25 percent support. This past season, one variety of climate change proposal introduced in 2016 fared much better than the rest of its class. That proposal — which generally sought a report assessing the impact on the companies' portfolios of technological advances and governmental policies to limit global warming to well below 2 degrees Celsius — averaged almost 45 percent support among shareholders at 16 companies. Notably, the proposal received majority support at three companies (ExxonMobil, Occidental Petroleum and PPL Corp.). As with board diversity, climate change has been identified as a priority among certain large institutional investors, and Institutional Shareholder Services and Glass Lewis have updated their policies regarding climate change risk shareholder proposals to generally recommend in favor of proposals seeking disclosure on how the company identifies, measures and manages climate change risks. Accordingly, similar proposals and support levels are expected this upcoming season.

Other Noteworthy Proposal Topics

Political contributions and lobbying activities remain high on the list of proposal topics — with around 100 proposals submitted in each of the last six years. Despite their prevalence, proposals that make it to a vote receive on average only about 25 percent support.

Finally, proposals concentrating on diversity outside of the boardroom and on gender pay equity are on the rise. ISS has highlighted such concerns and announced that ISS would review shareholder requests for gender pay information on a case-by-case basis by considering factors that include the company's current diversity and inclusion policies, any recent instances of gender pay gap controversies or actions, and how the company compares to its peers.

Twenty-nine proposals related to discrimination and diversity issues were submitted in 2017, compared to 17 proposals in 2016, and 21 proposals concerning gender pay equity were submitted in 2017, compared to 13 proposals in 2016. Slightly more than half of those proposals did not make it to a vote in 2017, as many companies that received such proposals agreed to revise their policies and/or enhance their disclosures to address proponents' concerns. The nine (of 10) diversity proposals that made it on the ballot and with respect to which voting results have been published averaged slightly more than 30 percent support, and the 13 gender pay proposals that went to a vote in 2017 averaged approximately 13 percent support.

New Staff Guidance on Rule 14a-8

In early November 2017, the staff of the SEC's Division of Corporation Finance issued important new guidance concerning the review of no-action requests to exclude shareholder proposals.[1] In particular, Staff Legal Bulletin No. 14I expresses the SEC staff's views related to the application of the ordinary business and relevance exclusions, proposals submitted on behalf of shareholders, and the use of graphs and images in proposals. Below are some highlights from SLB 14I.[2]

- *Ordinary Business and Relevance Exclusions.* SLB 14I expresses the view that a board's consideration of the issues raised by a shareholder proposal may be helpful to the staff's analysis of whether a proposal focuses on a significant policy issue with a sufficient nexus to a company's business under Rule 14a-8(i)(7) and/or whether a proposal is "otherwise significantly related to the company's business" under Rule 14a-8(i)(5). As a result, companies will need to consider whether having the board or a board committee consider, and make a determination regarding, the significance of an issue to the company's business would benefit the company's chances of excluding a shareholder proposal.

- *Proposals by Proxy.* SLB 14I states that it may be possible to exclude a proposal purportedly submitted on behalf of a shareholder (known as a "proposal by proxy" submission) when the proponent does not provide sufficient proof of an agency relationship between itself and the shareholder. In order to exclude a proposal on this basis, a company must notify the proponent of the specific deficiency within 14 calendar days of receiving the proposal so that the proponent has an opportunity to cure the defects. SLB 14I provides a brief list of documentation that the staff generally would expect to sufficiently demonstrate that a proponent has the authority to submit a proposal on a shareholder's behalf.

- *Graphs and Images in Proposals.* Consistent with no-action letter precedent, SLB 14I expresses the view that graphs and images do not violate the 500-word limit in Rule 14a-8(d). The staff noted, however, that words contained in graphs and images would be counted toward the 500-word limit and that graphs and images still may be excludable under Rule 14a-8(i)(3) if they are materially false and misleading.

Consider Recommendations to Increase Board Diversity

We recommend that companies consider recommendations by certain market participants to increase the diversity of their board members, as well as enhance related disclosures in the annual proxy statement. While the gender of board members has been the primary focus of these diversity efforts, proponents also continue to highlight the importance of the age, race, ethnicity, culture, experience and education of board members. Board diversity is expected to be a key corporate governance focus of the 2018 proxy season.

Investor Interest

The push to improve board diversity remains the focus of a number of institutional investors. BlackRock has emphasized gender balance in the boardroom as one of its engagement priorities for 2017-18, indicating that it may vote against members of the nominating committee "if there is no progress within a reasonable time frame." State Street announced a similar position and, in 2017, voted against re-election of board members at nearly 400 companies that did not have at least one female director. Vanguard has announced that it expects companies to discuss — in both their public disclosures and their engagement with investors — their plans to incorporate appropriate diversity over time in their board composition.

Several institutional investors also have contacted companies directly to engage on the topic of board diversity. The California Public Employees' Retirement System, or CalPERS, sent letters to over 500 Russell 3000 companies requesting each company to develop and disclose corporate board diversity policies and implementation plans. In addition, the Office of the New York City Comptroller continued its campaign to make boards "more diverse, independent, and climate-competent" through its "Board Accountability Project 2.0." The comptroller sent letters to 151 companies that either adopted proxy access or had a majority-supported proxy access proposal in 2017, requesting disclosure of specific qualities of their directors in a standard matrix, including, among other things, gender and race.

Legislative and Regulatory Actions

The topic of board diversity also has been the subject of increased legislative focus at the federal and local levels. A growing number of members of Congress, including several from the House of Representatives, have called on new SEC Chairman Jay Clayton to continue efforts by his predecessor, Mary Jo White, to develop and propose new corporate board diversity rules to expand company disclosure requirements. Although the SEC has not yet proposed any changes, Clayton's statements during his nomination process indicate his support for gender diversity specifically and board diversity more generally. State and municipal legislatures also continue to propose measures in support of increased board diversity. Following in the steps of California, Illinois and Philadelphia, the commonwealth of Massachusetts has called on companies to put at least three women on their boards sized nine or greater by the year 2018 through a nonbinding resolution that was passed by unanimous vote in 2015.

Response to Shareholder Proposals

In addition, an increasing number of shareholder proposals relate to companies' diversity policies, which have generated greater shareholder engagement and support. Of the proposals that reached a vote last year, two received majority support from shareholders. Although overall support is limited, ISS' 2017-18 Governance Principles Survey suggests that 69 percent of investor respondents may consider it problematic if there are no female directors on a public company board, in which case many of those respondents indicated that they may consider it appropriate to engage with the company. Although ISS announced that it will not make an adverse vote recommendation if a board lacks such diversity, ISS will identify in its reports where a board has zero female directors, and a focus on general board diversity is now included in ISS' fundamental voting principles for director nominees.

Similarly, Glass Lewis has announced that it will continue to consider board gender diversity as a factor when evaluating the oversight structures of companies. In 2018, Glass Lewis will not make voting recommendations solely on the basis of board diversity, but, starting in 2019, it will generally recommend voting against the nominating committee chair of a board with no female members.

Companies considering whether to adopt or change board diversity policies should be mindful of the related SEC disclosure requirements, which require companies to state in their annual proxy statements whether, and if so how, diversity is considered in identifying director nominees, as well as describe any policies that require the consideration of diversity in identifying director nominees and how the nominating committee (or the board) assesses the effectiveness of these policies.

Review and Consider Updates to D&O Questionnaires

Companies should annually review their director and officer questionnaires to consider any regulatory or other updates. Although there have been no significant regulatory developments in 2017 that require revision for compliance purposes, companies may want to consider revisions relating to key corporate governance trends, including those described below.

Proxy Access

Companies that have adopted proxy access bylaws, which now include over 60 percent of S&P 500 companies, should consider whether such bylaws (or related changes) require director nominees to make certain representations that should be made as part of the D&O questionnaire. Such bylaws may require director nominees, including those nominated by a shareholder or the company's board of directors, to make certain undertakings or representations in order to be eligible for election or re-election as director of the company. For example, a nominee may be required to agree not to enter into any arrangement with a third party to receive any compensation, reimbursement or indemnification or to vote on a specific matter than as otherwise previously disclosed to the company. Revisions to D&O questionnaires for this reason are not always necessary, as it depends on a company's own facts and circumstances, including its existing procedures for onboarding director nominees.

Diversity and Skills

In light of recent pressures from institutional investors and other stakeholders to advance board diversity, companies that plan to provide more robust disclosures in their annual proxy statements should revise their D&O questionnaires accordingly. For example, if companies intend to disclose a form of the diversity and skills matrix requested by the Office of the New York City Comptroller, the company will need certain additional information from each director, including specific skills and experiences, board tenure, sexual orientation, gender, age, race or ethnicity. Companies may want to solicit such information through the D&O questionnaire process.

Prepare for Changes to Auditor Reports

In October 2017, the SEC approved the Public Company Accounting Oversight Board's new model for auditor reports required to accompany audited financial statements in SEC filings. As a result, auditor reports related to audited financial statements for fiscal years ending on or after Dec. 15, 2017, including in annual reports on Form 10-K, will need to reflect a number of changes. Those changes, which are intended to make auditor reports more useful to investors, include:

- a statement disclosing the year in which the auditor began serving consecutively as the company's auditor;

- a statement that the auditor is required to be independent;

- the phrase "whether due to error or fraud," when describing the auditor's responsibility under PCAOB standards to obtain reasonable assurance about whether the financials are free of material misstatements;

- titles for each section of the report;

- the pass/fail opinion as the first section of the report under the heading "Opinion on the Financial Statements," immediately followed by a section titled "Basis for Opinion"; and

- the company's shareholders and board of directors or equivalents as the report's addressees (additional addressees are permitted).

A more significant addition to auditor reports — mandatory disclosure of "critical audit matters," or CAMs, from the current-period audit or a statement that there were no CAMs — also was proposed by the PCAOB and subsequently approved by the SEC. That addition, however, will not be required until the filing of audited financial statements for fiscal years ending on or after June 30, 2019 (for large accelerated filers) or fiscal years ending on or after Dec. 15, 2020 (for all other filers subject to the CAMs requirement).

In anticipation of the more immediate requirements, companies should consult with their auditors to understand how precisely their auditor reports will change and request the opportunity to review a draft of the report sufficiently in advance of its filing with the SEC. In addition, audit committees of companies with long-tenured auditors should consider enhancing their audit committee reports to explain the benefits of maintaining a long-term relationship with their auditors, such as greater institutional knowledge, higher-quality audits and fee efficiency, and describing the controls in place to ensure auditor independence. Finally, we recommend that companies consider requesting auditors provide insights into what CAMs could have been included in the auditor reports issued in connection of the audit of the 2017 and 2018 financial statements. This process will give audit committees an opportunity to plan for when the CAM disclosures will be required.

Note Results of Say-on-Frequency Votes and Reporting Requirements

The Dodd-Frank Act included a provision that requires companies that are subject to the SEC's proxy rules to conduct a shareholder vote on the frequency of the say-on-pay vote every six years. For companies that held an initial say-on-frequency vote in 2011 (the first year in which say-on-pay was applied), the 2017 proxy season marked the second occurrence of such a required vote.

In 2017, shareholders supported annual say-on-pay frequency voting in 91 percent of companies. This marks a 10 percentage-point increase from the initial say-on-pay frequency vote of 81 percent in 2011. Triennial say-on-pay frequency voting received 8 percent approval in 2017, down from 19 percent approval in 2011. Biennial say-on-pay voting received less than 1 percent approval in 2017, which is consistent with the 2011 results.

For companies that held an initial say-on-frequency vote in 2012, the 2018 proxy season will mark the second occurrence of such a required vote. Shareholders may vote for one-, two- or three-year periods between say-on-pay votes or to abstain from voting. While it is expected that most companies will propose annual frequency, a company with a history of high shareholder support for say-on-pay proposals may seek to propose biennial or triennial frequency.

Within four days following the annual meeting of the shareholders, a company must file a

Form 8-K disclosing the results of the say-on-frequency vote. The disclosure must state the number of votes cast for each of "one year," "two years" and "three years," as well as the number of abstentions. Although the say-on-frequency vote is advisory in nature, companies also must disclose the decision of the board of directors regarding the frequency of future say-on-pay votes in an 8-K filing. The SEC permits a company up to 150 calendar days after the annual shareholder meeting (but no later than 60 days prior to the deadline for shareholder proposals for the next year) to decide and disclose their decision on future say-on-pay frequency votes

Finalize Pay Ratio Disclosures

The rules adopted by the SEC that mandate pay ratio-related disclosures have gone into effect and apply to fiscal years commencing on or after Jan. 1, 2017. As a result, companies with compensation payable with respect to fiscal years ending on Dec. 31, 2017, will need to begin providing pay ratio information in their registration statements, annual reports on Forms 10-K or proxy statements filed in 2018, based on 2017 compensation.

As a reminder, the pay ratio rules require companies to disclose the ratio of the annual total compensation of the median company employee to the annual total compensation of the CEO. In addition, companies are required to provide a brief description of the methodology used to identify the median employee, as well as any material assumptions, adjustments or estimates used to determine the median employee or annual total compensation. There are certain aspects of the pay ratio disclosure requirements on which companies have been primarily focused. We provide an overview of those areas below.

Use of Reasonable Estimates, Assumptions and Methodologies

According to guidance released by the SEC and its staff on Sept. 21, 2017, companies have significant flexibility in identifying their median employee and calculating total annual compensation. The guidance acknowledged exercising this flexibility should not provide a basis for an SEC enforcement action, as long as the company uses reasonable estimates, assumptions and methodologies (unless the company lacked a reasonable basis for the disclosure or it was not made in good faith). Several important features of the guidance are addressed below:

- Certain types of workers are excluded from the pay ratio rules (e.g., independent contractors and leased workers who are employed by, and whose compensation is determined by, an unaffiliated third party). A company should not infer that the explicit exclusion of these workers represents the sole basis for excluding them from coverage under the pay ratio rules. When determining whether its workers are employees for purposes of the pay ratio rules, a company may apply a widely recognized test from another area of law, such as employment or tax law.

- In identifying its median employee, a company may use existing internal records that reasonably reflect employees' annual compensation. The records do not need to include every element of compensation, such as equity awards widely distributed to employees.

Calculating the Median Employee

The pay ratio rules permit registrants to calculate the median employee using "reasonable methods," yet the final rules do not specify what methods are considered reasonable. The SEC's Sept. 21, 2017, guidance addresses this uncertainty by:

- Outlining several acceptable sampling methodologies and other reasonable methods, including simple random sampling, stratified sampling, cluster sampling and systematic sampling.

- Providing examples of situations where a company's use of reasonable estimates would be appropriate, such as: (1) analysis of the composition of the company's workforce (e.g., by geographic unit, business unit or employee type); (2) evaluation of the likelihood of significant changes in employee compensation from year to year; and (3) calculating a consistent measure of compensation and annual total compensation or elements of the annual total compensation of the median employee.

- Confirming that companies may combine the use of sampling methods with estimates and other methods.

While the SEC appears to remain committed to the idea of promoting substantial flexibility in the pay ratio calculation, it is important to remember that companies must clearly explain their chosen methodology.

Treatment of Non-U.S. Employees

Unless one of the two limited exemptions discussed below applies, a company must include non-U.S. employees in its calculation of total annual compensation and the median employee.

The first exemption applies if a country's data privacy laws or regulations prohibit the transfer of compensation data outside a country's borders, making it impossible for the company to compile the information necessary to calculate the pay ratio. If this occurs, a company may exclude employees located in the specified jurisdiction so long as the company: (1) discloses the excluded jurisdiction and the pertinent data privacy law or regulations; (2) makes reasonable efforts to obtain the information (including seeking an exemption from the applicable data privacy laws or regulations); (3) obtains a legal opinion certifying its failure to obtain the requested information; and (4) attaches the legal opinion as an exhibit to the filing containing the pay ratio disclosure.

Under the second exemption, which is commonly referred to as the "de minimis rule," a company may exclude all non-U.S. employees when identifying its median employee, if non-U.S. employees constitute 5 percent or less of its total workforce. Utilization of the exemption bars the inclusion of any non-U.S. employees in the median employee calculation; therefore, if a company chooses to exclude any non-U.S. employees under this exemption, it must exclude all non-U.S. employees.

Investors Intend to Use Pay Ratio Disclosures

In its 2017 benchmark voting policy survey, ISS revealed that nearly 75 percent of the 131 investor respondents indicated that they intend to use pay ratio disclosures as one factor in their analysis of compensation issues. The investors intend to analyze a company's pay ratio by comparing it to that of other companies in its industry, by assessing year-over-year changes in the company's ratio, or both. These results suggest that, in addition to making the required disclosures, companies should be cognizant of potential investor, employee and media reaction to the disclosed pay ratio. In addition, companies should be prepared to engage with shareholders if their pay ratio substantially departs from that of their peers, or significantly changes from year to year.

Comply With Updated SEC Filing Requirements

The SEC adopted new rules and the SEC staff issued guidance that companies should consider as they prepare year-end reports and filings.

Cover Page

On March 31, 2017, the SEC adopted technical amendments to existing rules and forms so they conform with certain provisions of the Jobs Act and related SEC staff interpretations. [3] Importantly, the technical amendments result in changes to the cover pages of certain registration statements and Securities Exchange Act reports, including annual reports on Forms 10-K and 20-F, to require the addition of two check boxes to allow companies to indicate (1) whether, at the time of filing, the company is an "emerging growth company" and (ii) whether it has elected not to use the extended transition period for an EGC to comply with any new or revised financial accounting standards. All companies must comply with the modified cover pages when filing the affected forms regardless of their EGC status. As a result, companies should ensure they are using the new SEC form cover pages that include these two new EGC-related boxes when filing their upcoming annual reports.

In addition, the SEC adopted new rules to implement the statutory inflation adjustments, as required under the Jobs Act, to revise the definition of an EGC under Rule 12b-2 of the Exchange Act to raise the annual gross revenue threshold to qualify as an EGC from $1 billion to $1.07 billion. The adjustments fulfill a Jobs Act mandate to index to inflation every five years the annual gross revenue threshold to determine EGC status.

Exhibit Hyperlinks

The SEC rules requiring hyperlinked exhibits in SEC filings took effect for most public companies on Sept. 1, 2017.[4] The rules apply to a number of specified filings, including annual reports on Form 10-K and 20-F, as well as registration statements and Exchange Act reports that are required to include exhibits under Item 601 of Regulation S-K. If an exhibit is incorporated by reference, then an active hyperlink to the exhibit separately filed on the EDGAR system is required.

The filings must be supported in HTML format instead of ASCII format, as ASCII does not support hyperlinking. As a result, while the affected registration statements and Exchange Act reports will be required to be filed in HTML, companies may continue to file in ASCII any schedules or forms that are not subject to the exhibit filing requirements under Item 601 of Regulation S-K, such as proxy statements, Form 6-K or the multijurisdictional forms used by Canadian issuers. Smaller reporting companies and nonaccelerated filers that submit filings in ASCII format do not have to comply with the new rules until Sept. 1, 2018.

Importantly, the rules instruct companies on how to address inaccurate or nonfunctioning hyperlinks in their filings. In the case of a registration statement that is not yet effective, registrants must correct the error by filing a pre-effective amendment to such registration statement, and, in the case of an effective registration statement or an Exchange Act report, the registrant must correct the error in the next Exchange Act report that requires or includes an exhibit pursuant to Item 601 of Regulation S-K (or in the case of a foreign private issuer, pursuant to Forms 20-F and F-10). Note that the rules provide that an inaccurate hyperlink by itself will not render a filing materially deficient or affect a registrant's eligibility to use short-form registration statements, such as Forms S-3 and F-3.

Finally, with respect to the placement of the exhibit index, whereas Item 601(a)(2) of Regulation S-K and Rule 102(d) of Regulation S-T previously required the exhibit index to precede immediately the exhibits filed with such registration statement or document, the amended rules now require the exhibit index to appear before the required signatures in the registration statement, report or document. Accordingly, companies are not required to provide a separate exhibit index with hyperlinks following the signature page.

Given that the list of exhibits included in annual reports on Forms 10-K and 20-F are typically more extensive than those contained in registration statements and other Exchange Act reports, companies should begin to review the exhibits that will be filed with and incorporated by reference into their annual reports in advance of their respective 2018 filing deadlines to ensure that hyperlinks are appropriately included in the list of exhibits. In addition to reviewing last year's annual report exhibit index, updating for new exhibits and confirming that all exhibits incorporated by reference from registration statements and Exchange Act reports include accurate hyperlinks, companies should consider contacting their financial printer, EDGAR filing agent or EDGAR filing software provider, to the extent not already done so in connection with Forms 10-Q for their most recent periodic or current report, to confirm that their annual report exhibit indexes are appropriately included with the annual report filing.[5]

Consider Recent Trends in Virtual Shareholder Meetings

In recent years, an increasing number of companies have embraced the use of virtual annual shareholder meetings. Virtual meetings generally take on two forms: a virtual-only meeting or a hybrid approach, which involves both an in-person and a virtual participation component.

Broadridge Financial Solutions, an investor communications firm and a provider of a virtual meeting platform, reported that, during 2016, 187 companies held virtual meetings, of which 155, or 83 percent, were virtual-only meetings, as compared to 67 percent virtual-only meetings in 2015.[6] It has been reported that 234 companies included a virtual component to their 2017 annual meetings. According to ISS' 2017-18 Global Policy Survey, the increasing prevalence of virtual meetings has generally been viewed favorably by its investor respondents, with a slight preference for a hybrid approach rather than virtual-only meetings. A majority of ISS investor respondents, approximately 87 percent, generally approve of the hybrid approach as an acceptable practice, whereas 32 percent indicate they would be comfortable with a virtual-only meeting if such meetings provided the same shareholder rights as physical meetings.

Potential Advantages

Virtual meetings present certain potential advantages to both companies and shareholders, including the ability to enhance shareholder participation through improved access without the added costs of planning or attending an in-person meeting. In addition to promoting shareholder engagement by fostering participation in a greater number of meetings throughout the typical annual meeting season, virtual meetings offer companies greater flexibility and reduced time constraints, as compared to in-person meetings, thereby encouraging companies to prepare comprehensive answers to shareholder questions and accommodate a greater number of participating shareholders during the question-and-answer segment. Finally, a company may further promote engagement among its shareholders by making available on its website a webcast or audio recording of the meeting.

State and Federal Law Considerations

A company's ability to hold a virtual meeting is a matter of state law. In particular, Section 211 of the Delaware General Corporation Law enables a Delaware corporation to hold its annual meeting virtually solely by means of "remote communication," although the company must "implement reasonable measures" to confirm that each person permitted to vote at the meeting is a shareholder or proxy holder and to provide such persons "a reasonable opportunity to participate in the meeting and to vote," including the ability to read or hear the proceedings on a "substantially concurrent" basis with such proceedings.

[7] In addition to applicable state law, if a company's governing documents specify a physical location of the annual meeting, the company must amend its governing documents to provide for the ability to conduct the annual meeting virtually.

U.S. federal securities laws and SEC rules do not impose any requirements in connection with a virtual annual meeting, except for the solicitation of proxies. Interestingly, although not authority on the substance of virtual meetings, the SEC staff in 2016 granted HP Inc. no-action relief to exclude from its annual meeting proxy statement a shareholder proposal requesting that the board adopt a corporate governance policy to initiate or restore in-person annual meetings on the basis that the "determination of whether to hold annual meetings in person" is related to the company's ordinary business operations.[8] Both the New York Stock Exchange and Nasdaq require listed issuers to hold annual shareholder meetings, but neither impose restrictions on virtual meetings. Nasdaq has stated informally that webcasts are permitted instead of, or in addition to, an in-person meeting, provided that shareholders have an opportunity to ask questions of management.

Potential Challenges

Notwithstanding some potential advantages, virtual meetings also present potential challenges in facilitating shareholder engagement. Shareholder activists and certain institutional investors, including the Council of Institutional Investors, have expressed concerns that virtual meetings reduce the ability of shareholders to participate meaningfully by eliminating shareholders' ability to express concerns face-to-face with senior management and directors and engage in constructive "back and forth" dialogues on controversial issues. For these reasons, CII and CalPERS do not support virtual-only meetings, and provide in their corporate governance policies that a virtual meeting component should only supplement a traditional in-person shareholder meeting, not serve as a substitute, to "facilitate the opportunity for remote attendees to participate in the meeting to the same degree as in-person attendees."[9]

The Office of the New York City Comptroller, however, has taken a more aggressive position against virtual-only meetings by adopting a change to its proxy voting guidelines to vote against all incumbent directors of a governance committee subject to election at a virtual-only meeting because in-person meetings, according to the comptroller, provide shareholders the opportunity to engage with senior management and directors face-to-face at least once per year.[10] Similarly, Glass Lewis recently announced that beginning in 2019, it will generally recommend voting against all incumbent directors of the governance committee at companies planning to hold virtual-only meetings unless companies provide assurances through proxy statement disclosure that shareholders will be afforded the same rights and opportunities to participate as they would be at an in-person meeting.[11]

Furthermore, although proxy advisory firms such as ISS and Glass Lewis have not published policies against virtual meetings in their guidelines, ISS has indicated it may make adverse recommendations if companies use virtual meetings to frustrate meaningful shareholder participation and engagement directly with senior management and directors. Finally, in addition to shareholder engagement challenges relating to communication concerns, a virtual-only meeting may create greater uncertainty in shareholder voting because shareholders are provided greater flexibility to delay or change votes electronically. This type of shareholder engagement issue is an important consideration for companies engaged in a contested solicitation because it may impact a company's solicitation strategy depending upon preliminary voting results.

Matters to Consider

Companies considering whether to add virtual components to their annual shareholder meetings should consider the points noted above. They also may want to review the

“Guidelines for Protecting and Enhancing Online Shareholder Participation in Annual Meetings” published by a group of institutional investors and public company representatives, as well as proxy and legal service providers.[12] The guidelines suggest, among other things, that companies:

- adopt safeguards and mechanisms to protect shareholder interests and ensure online participation and interaction that would otherwise be available at in-person meetings;
- establish procedures to verify meeting participants as shareholders and proxy holders and enable online voting; and
- confirm, from a logistical perspective, that the technology platform is functioning properly and technical support operations are prepared in advance.

Brian V. Breheny is a Washington, D.C.-based partner and heads the SEC reporting and compliance practice at Skadden Arps Slate Meagher & Flom LLP. Andrew J. Brady is of counsel in the firm's Washington office. Josh LaGrange is a counsel in Skadden's Palo Alto, California, office. Justin A. Kisner, Hagen J. Ganem and Caroline S. Kim are associates in Washington. Joseph M. Yaffe is a partner and heads the firm's West Coast executive compensation and benefits group. Amanda M. Bradley is a law clerk in Palo Alto.

[1] Staff Legal Bulletin No. 14I (November 1, 2017) is available at https://www.sec.gov/interps/legal/cfslb14i.htm.

[2] For more detail, please see SLB 14I (link available above).

[3] https://www.sec.gov/rules/final/2017/33-10332.pdf.

[4] https://www.sec.gov/rules/final/2017/33-10322.pdf.

[5] For additional guidance, the EDGAR Filer Manual, Volume II, Version 43, Section 5.4.2 Exhibits (September 2017) is available at https://www.sec.gov/ info/edgar/edgarfm-vol2-v43.pdf

[6] http://media.broadridge.com/documents/mkt-1956-17-vsm-article4.pdf.

[7] http://delcode.delaware.gov/title8/c001/sc07.

[8] https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2016/cheveddennaylor122816-14a8.pdf.

[9] https://www.calpers.ca.gov/docs/forms-publications/global-principles-corporate-governance.pdf; http://www.cii.org/corp_gov_policies.

[10] https://comptroller.nyc.gov/newsroom/comptroller-stringer-virtual-only-meetings-deprive-shareowners-of-important-rights-stifle-criticism.

[11] http://www.glasslewis.com/wp-content/uploads/2017/11/US_Guidelines_2018.pdf.

[12] http://www.calstrs.com/sites/main/files/file-attachments/shareholder_
participation_annual_meetings.pdf.