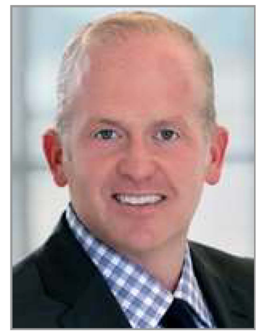
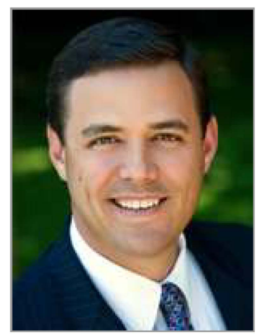
2019 Annual Meeting And Reporting Considerations: Part 4

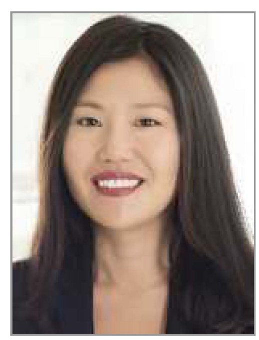
By **Brian Breheny, Joseph Yaffe, Caroline Kim, Hagen Ganem and Andrew Brady** (January 17, 2019, 12:40 PM EST)



Brian Breheny



Joseph Yaffe



Caroline Kim

Each company faces important decisions in preparing for its 2019 annual meeting and reporting season. This four-part series covers essential areas on which companies should focus as they plan for 2019, including corporate governance, executive compensation and disclosure matters. Part 4, below, focuses on corporate governance best practices such as disclosures related to board evaluations and virtual shareholder meetings; the status of Dodd-Frank and other U.S. Securities and Exchange Commission rule-making matters; considerations in assessing social media policies; and disclosure controls and procedures. See part 1 of the series **here**, part 2 **here** and part 3 **here**.

Consider Providing or Enhancing Disclosures of the Board Evaluation Process

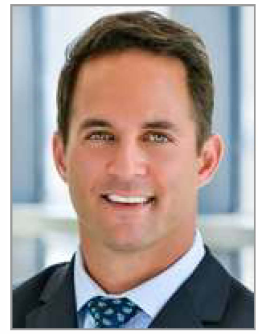
With investors increasingly focused on the performance of boards of directors, boards have come to rely upon an annual evaluation process as an important tool to assess their performance and to identify areas for improvement. In recent years, an increasing number of companies have voluntarily provided disclosures about their board evaluation processes in their annual proxy statements. According to a recent Ernst & Young survey of proxy disclosures by Fortune 100 companies:

- 93 percent included board evaluation disclosures in the most recent proxy statement;
- 40 percent disclosed subjects addressed in their evaluations; and
- 21 percent disclosed measures taken in response to the results of evaluations.[1]

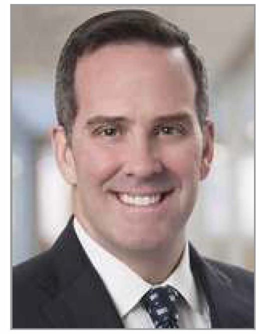
In light of the increased focus on this area, we recommend that companies consider whether additional disclosures related to their board evaluation processes should be made. Although it is important for the results of annual board evaluation surveys to remain confidential in order to, among other things, solicit and obtain candid director feedback, companies may want to consider providing some additional disclosure in the proxy statement to better inform investors about the company's board evaluation process and the steps the board has taken in response to the feedback received.

Here are two samples of recent board evaluation disclosures in company proxy statements that provide additional information:

Consider Best Practices for Virtual Shareholder Meetings



Hagen Ganem



Andrew Brady

In recent years, an increasing number of companies have embraced the use of virtual annual shareholder meetings. Virtual meetings generally take on two forms: (1) a virtual-only meeting, which refers to a meeting of shareholders that is held exclusively through the use of technology (either online audio or video) without a corresponding in-person meeting component or (2) a hybrid meeting, which refers to an in-person, or physical, meeting that shareholders are able to attend virtually through an online audio or video format and in which they cast votes online via the internet, if desired.

During the 2018 proxy season, companies held 236 virtual meetings, an increase of 26 percent (187) over the prior year, of which 212, or 90 percent, were virtual-only meetings, as compared to 67 percent and 83 percent virtual-only meetings in 2015 and 2016, respectively, according to data from Broadridge Financial Solutions.

Board and Committee Evaluations

Each year, your Board and its Committees perform a rigorous self-evaluation. As required by [the company's] Corporate Governance Guidelines, the Board Nominating and Governance Committee oversees this process. The performance evaluations solicit anonymous input from Directors regarding the performance and effectiveness of the Board, the Board Committees and individual Directors, and provide an opportunity for Directors to identify areas for improvement. In addition, the independent Lead Director has individual conversations with each member of the Board, providing further opportunity for dialogue and improvement. The Board Nominating and Governance Committee reviews the results and feedback from the evaluation process and makes recommendations for improvements as appropriate. The independent Lead Director leads a discussion of the evaluation results during an executive session of the Board and communicates relevant feedback to the CEO. Your Board has successfully used this process to evaluate Board and Committee effectiveness and identify opportunities to strengthen the Board.

Our Board Evaluation Process

Each year, our Board conduct a rigorous self-evaluation process, which includes individual director evaluations. This process is overseen by the Nominating and Governance Committee, led by our independent Lead Director and conducted by an outside facilitator with corporate governance experience. The outside facilitator interviews each director to obtain feedback regarding the Board's performance and effectiveness, as well as feedback on each director. This feedback, which is compiled anonymously, helps the Board identify follow-up

items and provide feedback to management.

The Board evaluation process includes an assessment of both Board process and substance, including:

- **The Board's effectiveness, structure, composition, succession and culture;**

- **The quality of Board discussions;**

- **The Board's performance in oversight of business performance, strategy, succession planning, risk management, ethics and compliance and other key areas; and**

- **Agenda topics for future meetings**

The outside facilitator also compiles feedback regarding each individual director, which is provided to each director in individual discussion. The Board believes that this annual evaluation process supports its effectiveness and continuous improvement.

Investor Perspectives

According to the results of the Institutional Shareholder Services, or ISS, 2017-18 Global Policy Survey, investor respondents generally view the increasing frequency of virtual meetings favorably.[2] Approximately 20 percent of investor respondents indicated that either virtual-only or hybrid meetings were acceptable, whereas only 8 percent indicated neither were acceptable. In addition, 32 percent of investor respondents expressed they would be comfortable with a virtual-only meeting if such meetings provided the same shareholder rights as physical meetings, and among noninvestors, 42 percent viewed either virtual-only or hybrid meetings to be acceptable without reservation.

Despite these trends, there has been some notable public opposition to the small but growing contingent of companies electing to conduct virtual-only meetings. For example, beginning in 2017, the New York City Comptroller adopted 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 New York City Comptroller, provide shareholders the opportunity to engage with senior management and directors face-to-face at least once per year.[3]

Similarly, the 2018 corporate governance policy of the Council of Institutional Investors provides that companies should incorporate a virtual component as "a tool for broadening, not limiting" shareholder meeting participation, thus taking the view that virtual meetings should only supplement, not substitute, in-person shareholder meetings, to "facilitate the opportunity for remote attendees to participate in the meeting to the same degree as in-person attendees."[4]

In addition, Glass Lewis' 2019 proxy guidelines indicate that the proxy advisory firm will closely analyze the governance profile of companies that choose to hold virtual-only meetings. Glass Lewis also expects robust disclosures regarding the virtual-only meeting in a company's proxy statement to assure shareholders that they will be afforded the same rights and opportunities to participate as they would at an in-person meeting. Because Glass Lewis believes virtual-only meetings have the "potential to curb the ability of a company's shareholders to meaningfully communicate with the company's management," beginning in 2019, it will generally recommend voting against members of the governance committee of a company planning to hold a virtual-only meeting without providing such disclosure.[5] ISS has not published a policy regarding virtual meetings.

Matters to Consider

In addition to taking into account the important investor perspectives described above, companies considering whether to add virtual components to their annual shareholder meetings should review the 12 best practices recommended by the Best Practices Committee for Shareowner Participation in

Virtual Annual Meetings,[6] an industry working group representing retail and institutional investors, public companies and proxy service providers, including the following recommendations:

- Ensure all shareholders have equal access by providing technical support and allowing remote participants to test their virtual access prior to participation;
- Consider the items to be voted on at the meeting, as well as other issues that may be of current concern to shareholders (e.g., routine versus nonroutine matters, and whether a matter to be considered at the meeting may be subject to a counter-solicitation or a "vote no" campaign);
- Establish rules and reasonable time guidelines for shareholder questions, and communicate such rules to meeting participants in advance of the meeting; and
- Post questions from shareholders received online during the meeting, post the questions and answers on the company's website following the meeting, and archive the meeting webcast for future viewing.

Note Status of Dodd-Frank Act and Other SEC Rule-Making Matters

Long mired in delay, the SEC's work on the remaining Dodd-Frank Act corporate governance and disclosure rule-making mandates recently has shown at least one sign of life. Specifically, as discussed in **part 2** of this series, the SEC recently adopted final rules that would require companies to disclose whether they permit employees and directors to hedge the company's securities.

Because proxy advisory firms and many institutional investors recently have focused on hedging by insiders, many companies already have made voluntary disclosure of their hedging policies as a matter of good corporate governance. As such, the final rules amendments may have a limited impact. On the other hand, pay-versus-performance and clawback provisions were not similarly upgraded from the long-term rule-making agenda, which generally means the SEC does not intend to take action on the proposals in the next 12 months.

Outside of the Dodd-Frank Act mandates, the SEC near-term rule-making agenda is ambitious. Notable near-term final rule-makings include amendments to implement recommendations made in the staff's 2016 Report on Modernization and Simplification of Regulation S-K, a report to Congress mandated by provisions of the Fixing America's Surface Transportation Act, or FAST Act.[7] It remains to be seen whether the final rule amendments will go further than the modest proposals that were included in the 2017 proposed rule-making to implement the FAST Act report but, in any event, any changes will continue the push by the SEC to reduce costs and burdens on public companies while continuing to ensure all material information is provided to investors.

Notable near-term proposed rule-makings include:

- Amendments to Regulation A to extend the securities offering safe harbor to all issuers, as mandated by Section 508 of the Economic Growth, Regulatory Relief, and Consumer Protection Act.
- Amendments to permit all issuers, not just emerging growth companies, to use testing-the-waters communications to make oral and written offers to qualified institutional buyers and institutional accredited investors before or after the filing of a registration statement to gauge investors' interest in the offering.

- Amendments to Rule 3-05 of Regulation S-X to ease the disclosure requirements for financial information of acquired businesses.

- Amendments to the "accelerated filer" definition in Exchange Act Rule 12b-2 that would have the effect of reducing the number of registrants that are subject to the Sarbanes-Oxley Act Section 404(b) attestation requirement.

- Amendments to the requirements surrounding quarterly reporting obligations to ease companies' compliance burdens while maintaining appropriate levels of disclosure and investor protection.[8]

Notable near-term concept releases (a prelude to proposed rule-makings) intend to solicit public comment on amendments to Securities Act rules to harmonize and streamline the SEC's regulation of exempt offerings in order to enhance their clarity and ease of use.

Reconsider Company Policies Regarding Social Media Use

In an April 2013 Section 21(a) report of investigation,[9] the SEC made it clear that public companies may use social media, such as Twitter and Facebook, to announce information in compliance with Regulation FD. In issuing that report, the SEC encouraged companies to seek new forms of communication to better connect with shareholders and provided guidance, consistent with its 2008 Interpretive Release,[10] on the use of social media for that purpose, including that companies should sufficiently alert investors and the market to the channels it will use to disseminate material, nonpublic information. As a result, many companies that anticipated using social media to publish material information began identifying in their earnings releases and current and periodic reports specific forms of social media as methods for communicating important information.

As many will recall, in August 2018, the chairman and CEO of Tesla Inc. tweeted, among other things, that he could take the company private at $420 per share and that funding had been secured. While he and Tesla were both sued by, and settled with, the SEC following these tweets, the SEC implicitly acknowledged in its complaint that the company had laid the groundwork for publishing material information on social media by filing a Form 8-K in November 2013 "stating that it intended to use [the chairman and CEO's] Twitter account as a means of announcing material information to the public about Tesla and its products and services and has encouraged investors to review the information about Tesla published by [him] via his Twitter account." Accordingly, neither the chairman and CEO nor Tesla were sued by the SEC for violations of Regulation FD. Instead, the SEC sued the chairman and CEO primarily for making alleged false and misleading statements and Tesla for alleged insufficient disclosure controls and procedures.

From the perspective of companies that use social media to disseminate material information, we believe that there are two primary takeaways here. First, when determining whether Regulation FD is satisfied, the SEC will continue to consider the steps a company has taken to alert investors to its potential use of social media as a means of communicating company information. Second, companies should ensure that they have appropriate disclosure controls and procedures (e.g., social media policies) in place to review and confirm the accuracy of all communications prior to their dissemination, as well as assess whether such information is required to otherwise be disclosed in their SEC filings.

Reassess Disclosure Controls and Procedures

It has been over 15 years since the SEC adopted the requirements for public companies to establish disclosure controls and procedures, and for CEOs and CFOs to quarterly certify that such disclosure controls and procedures have been designed to ensure that material information is made known to them, and that they have evaluated the effectiveness of the company's disclosure controls and procedures and presented their conclusions. The SEC has not provided specific guidance on how best to establish those controls and procedures. However, we believe companies should consider a number of recent SEC enforcement matters involving alleged disclosure violations, and determine whether any potential changes in their disclosures controls and procedures are advisable.

In September 2018, the SEC settled two disclosure-related matters. One of those matters was settled with an entertainment company and its CEO,[11] and the other matter was settled with a retail pharmacy company and its CEO and CFO.[12] Each of these matters involved disclosures by companies dealing with extraordinary events. The entertainment company was facing a high-profile publicity campaign against its core business, and the pharmacy company was involved in a significant merger transaction. Notwithstanding the unique nature of the facts involved, we believe there are potential lessons to be learned.

In the pharmacy merger case, the key concern alleged by the SEC was that the disclosed combined projections expected as a result of the merger were materially misleading, because the company did not update its disclosures when new information was identified that challenged the reliability of the projections. The company, however, publicly affirmed the initial projections. When the revised projections were announced, the company's stock price dropped over 14 percent on the day of announcement.

In the entertainment company case, the key concern alleged by the SEC was that the company's disclosures did not properly address risks to the company's reputation and business. Instead, the SEC alleged that insiders at the company remained silent regarding the potential negative impact to the company's business — even though those insiders were knowledgeable and considered the impact. In a statement about the settlement, the co-director of the SEC's Enforcement Division stated, in part, that "[t]his case underscores the need for a company to provide investors with timely and accurate information that has an adverse impact on its business."

Both of these matters, and the matter involving the technology company described in the section above titled "Consider SEC Cybersecurity Guidance and Enforcement Actions," are important reminders for companies that the SEC believes companies need to remain vigilant about their disclosure obligations. They also serve as an important reminder that, when the SEC believes companies have not satisfied their disclosure obligations, it will take enforcement action. We believe that companies should reassess their disclosure controls and procedures to ensure that they are designed to address, not just the specific SEC line item disclosure requirements, but also to more broadly consider the impact of evolving events on the prior and current disclosures of the company. The company's key risks should be monitored and analyzed by company personnel responsible for SEC disclosure decisions.

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[1] EY's survey "Improving Board Performance Through Effective Evaluation" (Oct. 2018) is available here.

[2] ISS' summary "2017-2018 ISS Global Policy Survey Summary of Results" is available here.

[3] New York City Comptroller's press release "Comptroller Stringer: Virtual Only Meetings Deprive Shareowners of Important Rights, Stifle Criticism" (April 2, 2017) is available here.

[4] Council of Institutional Investors' "Policies on Corporate Governance" (Oct. 24, 2018) are available here.

[5] Glass Lewis' proxy paper, "2019 Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice — United States" (2018) is available here.

[6] The Best Practices Committee for Shareowner Participation in Virtual Annual Meetings publication "Principles and Best Practices for Virtual Annual Shareowner Meetings" (April 2018) is available here.

[7] See our April 20, 2016, client alert "SEC Issues Concept Release Seeking Feedback on Business and Financial Disclosure Requirements" available here.

[8] See our Dec. 20, 2018, client alert "SEC Requests Public Comment on Earnings Releases and Quarterly Reports" available here.

[9] See the SEC's "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix Inc. and Reed Hastings" (April 2, 2013), available here.

[10] See SEC's "Commission Guidance on the Use of Company Web Sites" (Aug. 1, 2008), available here.

[11] The SEC's press release "SeaWorld and Former CEO to Pay More Than $5 Million to Settle Fraud Charges" (Sept. 18, 2018) and related complaints are available here.

[12] The SEC's press release "SEC Charges Walgreens and Two Former Executives With Misleading Investors About Forecasted Earnings Goal" (Sept. 28, 2018) and related order are available here.
