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Shareholder Meetings of Public Companies: Proxy Materials, Shareholder Proposals, Governance Best Practices

Federal and State Law Requirements, Virtual Meetings, Rules of Proceeding and More

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August 8, 2018

Overview of Legal Requirements for Annual Shareholder Meetings

- State law requirements
- Charter/Bylaws requirements
- Stock exchange listing requirements
- Federal requirements

Annual Meeting Requirements

- Requirement to Hold an Annual Meeting: A Delaware corporation must hold an annual meeting for the election of directors unless:
  - Directors are elected by unanimous consent of stockholders.
  - Directors are elected by less than unanimous consent if all seats are vacant and the vacancies are filled by such consent.
- If the corporation fails to hold an annual meeting within thirty days after the date designated in the bylaws, or if no date has been designated for a stockholder meeting, within thirteen months of the last annual meeting, any stockholder or director may apply to the Delaware Court of Chancery for an order requiring the meeting to be held under Section 211 of the DGCL.
- The designation of a meeting date (as opposed to conducting a meeting) within the thirteen-month period does not satisfy the annual meeting requirement.
- Any stockholder, regardless of the size of his holdings, has the right to petition for judicial intervention. The failure to have complete audited financials as required by federal proxy rules is not a justification for the failure to hold an annual meeting.

Annual Meeting Requirements

- Location and Time of Meeting. The certificate of incorporation or the by-laws frequently provide that the board of directors may determine by resolution both the location and time of an annual meeting. Subject to equitable considerations, the board has broad latitude in setting a meeting date.
- Place of the Meeting. The board may determine that the meeting will not be held at a physical place but solely by means of remote communication (i.e., in cyberspace).
- Calling of Meetings. The by-laws or the certificate of incorporation usually determine who may call annual or special stockholder meetings. A stockholder may sue to compel officers to call a meeting when they wrongfully refuse to do so.

Annual Meeting Requirements

- Notice of the Meeting
  - Written notice of the meeting must be given to all stockholders entitled to notice, unless waived, or unless the stockholder has consented to the receipt of electronic notice pursuant to Section 232 of the DGCL. The written notice must specify the location, date, and time of the meeting. The notice of an annual meeting need not state its purpose.
  - Notice must be given not less than ten and no more than sixty days in advance of a meeting, unless another period is specified by another provision of the DGCL. In calculating time periods, the date notice is mailed is not counted, while the date of the meeting is counted.
  - If notice is mailed, notice is deemed to have been given when written notice is mailed via first-class United States mail to the stockholder at his or her address on the books of the corporation unless otherwise provided in the by-laws.

Annual Meeting Requirements

- Notice by Electronic Transmission.
  - Notice may be given by e-mail if the notice is directed to an e-mail address to which the stockholder has consented to receiving notice.
  - Notice may be given by posting the notice on an electronic network, when accompanied by a separate notice of the posting directed to the stockholder.
  - Any consent to the receipt of electronic notice given by a stockholder is revocable at any time.
- Householding. A single notice in writing to stockholders who share an address may be given with the consent of such stockholders. However, if stockholders fail to object in writing within 60 days of having been given written notice of the corporation's intention to send a single notice to stockholders sharing the same address, they shall be deemed to have consented. The consent is revocable.
- Record Date.
  - If fixed by the board, the record date for notice of the meeting shall be between 10-60 days before the date of the meeting.
  - If the board fixes the record date for notice, the record date for notice will be deemed to be the record date for voting, unless the board fixes as the record date for voting a later date occurring on or before the date of the meeting.
  - A split record date tackles "empty voting" by putting no limitation on how close the voting record date may be to the meeting date.

Stock Exchange Listing Requirements

NYSE	NASDAQ
Each listed corporation must hold an annual meeting of shareholders during each fiscal year	Each listed corporation must hold an annual meeting of shareholders no later than one year after the end of the corporation's prior fiscal year

Federal Securities Law

- Generally, Federal securities laws do not regulate annual meetings
- Federal securities laws do govern proxy solicitation process and what, how and when information is to be delivered to stockholders
- 14a-8 proposals

Virtual or hybrid meetings

- "Virtual Meetings" - a meeting of shareholders that is held exclusively through the use of online technology without a corresponding in-person meeting.

- "Hybrid Meetings" - in-person meeting in which shareholders are permitted to participate online.

The Debate

Proponents	Critics
• Allows shareholders to participate in shareholder meetings without incurring the cost and inconvenience of traveling to the meeting	• Opportunity to address corporate management and directors in person is an important shareholder right
• Technology has improved to permit better communication	• Technology can fail
• Can increase the number of participants	• Can reduce the level of participation by requiring questions to be submitted in advance or cutting off lines
• Virtual-only meetings are less costly and time consuming for corporations	• Can erode shareholders' ability to hold management accountable

Virtual Meetings – Delaware Law

- Section 211 of the DGCL permits a meeting of stockholders to be held solely by means of "remote communication" —i.e., by meetings held over the internet.
- Participation by remote communication is permitted, and a stockholder or proxy may be deemed to be "present" for purposes of a quorum or voting at the Meeting if:
  - The corporation has implemented "reasonable measures" to verify that each person deemed to be present or permitted to vote at the meeting is in fact a stockholder or proxy holder.
  - The corporation has implement reasonable measures to provide stockholders or proxy holders "a reasonable opportunity to participate in the meeting and to vote on matters submitted to stockholders, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings."
  - If any stockholder or proxy holder votes or takes action at a meeting by remote communication, the corporation is required to keep a record.
  - The stock list must be open for examination on an electronic network during the whole time of the meeting and the stockholders must be given instructions on how to access the list with the notice of meeting.

Virtual Meetings – Delaware Law

- Verification Requirement
  - The DGCL does not define what "reasonable measures" entail.
  - Often stockholders are given a unique identification number or pin that must be used in order for the stockholder to transmit voting instructions by proxy over the internet or by phone. The instructions are only accepted if the unique identifier is submitted and verified.

  Reasonable Opportunity to Participate in the Meeting
  - The DGCL does not dictate what technology the corporation must use to satisfy the requirement.
  - The range of permissible mechanisms for remote participation includes methods that do not provide for completely simultaneous participation, so long as the opportunity to read or hear is "substantially concurrent."
  - The reference to "read" permits text as well as video mechanisms for remote communication.
  - Voting during the meeting could be done through a webpage or via fax and a verification process (whether through a pin or other control number).

Virtual-Only Backlash

- New York City Comptroller — recommended that the NYC Pension Funds vote against directors whose corporations continue to hold virtual-only meetings – April 2017.
- The Council of Institutional Investors — stated that corporations "should hold shareowner meetings by remote communication (so-called 'virtual' meetings) only as a supplement to traditional in-person shareowner meetings, not as a substitute."
- Shareholder proposals have been submitted, calling for in-person meetings only
  - The SEC has excluded some of these proposals under the ordinary business exception (EMC Corp 2002, HP Inc. 2016)
- Nonetheless, virtual-only meetings have increased each year.
  - Glass Lewis reported 163 meetings held in 2017, up from 122 in 2016
  - ISS reported 127 virtual-only U.S. meetings taking place from January to May of 2018, compared to 99 virtual-only meetings during the same period last year.

Contested Elections

- Generally, corporations will hold in-person meetings when there is a contested election
- Contested elections are more complex, there are generally more votes cast during the meeting and greater chance that meeting could be adjourned.
- Some providers of virtual meeting platforms will not host contested shareholder meetings
- Institutional investors may object to virtual only meetings when election is contested (and not when routine)
- On the flip side, shareholders argue that virtual-only meetings could be used by management during a contested meeting to obtain an unfair advantage over the dissident by taking complete, unfettered control over all meeting and voting mechanics.

Virtual Meetings and 14a-8 Proposals

- Rule 14a-8 requires that either the proponent or his or her qualified representative present the proposal at the shareholder meeting.
- Corporations that hold virtual-only meetings must determine how shareholder proposals will be presented. Options include:
  - a dedicated dial-in number for the shareholder;
  - allow an audio or video recording by the shareholder, which would play during the meeting; or
  - designate a representative to read the proposal or an introduction to the proposal submitted in advance by the shareholder.
- Corporations should have a backup plan if technology fails for a shareholder to present the proposal

Best Practices for Conducting Virtual or Hybrid Meetings

- Corporations should determine on a case-by-case basis whether in-person, hybrid or virtual-only meetings are most appropriate under the circumstances
- Confirm state statutes, like Delaware, permit the holding of virtual-only meetings.
- Must confirm charter/bylaws permit virtual-only meetings. If needed, may need to amend bylaws to permit the holding of a meeting and have Board specifically authorize a virtual-only meeting.
- Engage outside service provider (assist with secured voting)
- Decide on audio only verses video
- Test the technology in advance and have a workaround ready in case of an outage
- Due to potential technological failure, corporations are advised to bring matters to a vote, close the polls, and adjourn the formal part of the meeting as quickly as possible.

Shareholder Engagement at Virtual Meetings

- Live questions
- Questions via text
- Pre-submitted questions
- Critics argue corporations can "cherry pick" questions
- Corporations can take steps to combat this criticism
  - Be transparent in how shareholder questions are selected
  - Commit to answer all reasonable questions
  - Post responses to all questions on a website if receive too many questions to answer during meeting

Proxy Statements and Required Disclosures

- SEC proxy rules require companies to provide certain disclosures in a proxy statement to its shareholders, together with a proxy card in a specified format, when soliciting authority to vote the shareholders' shares.
- Proxy statements describe matters up for shareholder vote, and include management and executive compensation information if the shareholders are voting for the election of directors.
- If shareholders will take action on a matter but management is not soliciting proxies, the company must provide shareholders with an information statement that is similar to a proxy statement.
- SEC proxy rules require companies to send an annual report to shareholders if the shareholders are voting for directors.
- Exchange Act Rule 14a-9 prohibits use of false and misleading statements (particular focus in contested elections)

Proxy Statements and Required Disclosures

- When directors seek or recommend stockholder action, they must disclose all information material to the action being requested.
- The Delaware courts use the same materiality standard used by the U.S. Supreme Court: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." That is, directors are only required to disclose facts that significantly alter the "total mix" of information available to the stockholder.
- Delaware disclosure issues in annual meeting proxy statements:
  - Voting Standards
  - Executive Compensation

Voting Standards and Effect of Broker Non-Votes and Abstentions

- The affirmative vote of the majority of the shares present in person or represented by proxy and entitled to vote on the subject matter:
  - Broker Non-Votes = No effect
  - Abstentions= Votes against
- The plurality of the votes cast:
  - Broker Non-Votes = No effect
  - Abstentions=No effect
- A majority of the outstanding stock entitled to vote thereon:
  - Broker Non-Votes = Votes Against
  - Abstentions= Votes Against
- A majority of the votes cast:
  - Broker Non-Votes = No effect
  - Abstentions=No effect
- Stock Exchange Votes

SEC Proposed Amendments to Voting Options and Standards

- SEC's proposed amendments to Rule 14a-4(b) would:
  - require that proxy cards include an "against" voting option for the election of directors when state laws give effect to such a vote "against" a nominee
  - include an "abstain" voting option where majority voting standards are in effect.
  - eliminate current ability to provide a "withhold" voting option when an "against" vote has legal effect.
  - require disclosure in the proxy statement to further clarify the effect of a "withhold" vote in an election of directors.

New Disclosure Requirement – CEO Pay Ratio

- Item 402 of Regulation S-K requires most public companies, beginning with 2018 proxy statements, to disclose the pay ratio between the annual total compensation of all employees (other than CEO) and the annual total compensation of the CEO
- SEC issued guidance in September 2017 on using reasonable estimates, assumptions, methodologies, statistical samplings and internal records, as well as tests for determining independent contractor status, to assist companies in their efforts to comply with the new pay ratio disclosure requirements.
- Companies should provide context for ratio which could impact say-on-pay advisory votes or other compensation-related proposals
- ISS, Glass Lewis and most large institutional investors have announced that CEO pay ratios will have little impact on their say-on-pay vote recommendations and decisions. Some institutional investors like pension plans may use pay ratio results for activism efforts

SEC Guidance on Proxy Card Clarity

- Rule 14a-4(a)(3) requires that the form of proxy "identify clearly and impartially each separate matter intended to be acted upon."
- The proxy card should clearly identify and describe the specific action on which shareholders will be asked to vote. This same principle applies to both management and shareholder proposals.
- The following descriptions of shareholder proposals would not satisfy Rule 14a-4(a)(3):
  - A shareholder proposal on executive compensation;
  - A shareholder proposal on the environment;
  - A shareholder proposal, if properly presented; and
  - Shareholder proposal #3.

SEC's Cybersecurity Guidance

- February 2018, the SEC published interpretive guidance to assist public companies in preparing disclosures about cybersecurity risks and incidents.
- The SEC requires disclosure of material cybersecurity risks and incidents, and advises companies to ensure that their disclosure controls and procedures take account of cybersecurity risks
- SEC guidance notes the requirement to disclose in proxy statements the board's role in risk oversight - Item 407(h) of Regulation S-K and Item 7 of Schedule 14A
- The SEC stated that disclosure of how the board engages with management on cybersecurity issues will allow investors to better assess how a board is discharging its risk oversight responsibilities.

Potential: Cybersecurity Disclosure Act of 2017

- Cybersecurity Disclosure Act of 2017— bill first introduced in the Senate in March 2017 would require disclosure of cybersecurity experience at the board level.
- Bill would direct the SEC to issue rules requiring an issuer to:
  - disclose in its annual report or proxy statement whether any member of its governing body has expertise or experience in cybersecurity, including details necessary to describe fully the nature of that expertise or experience, and
  - if no member has such expertise or experience, describe what other company cybersecurity steps were taken into account by the persons responsible for identifying and evaluating nominees for the governing body.
- Given recent SEC cybersecurity guidance, it may be unlikely the bill will be enacted. The same was introduced in 2015 and failed.

Elimination of Delivery of Paper Copies of Proxy Statements

- On March 1, 2018, the SEC approved the NYSE's proposal to eliminate the requirement for listed companies to provide to NYSE paper copies of definitive proxy materials.
- NYSE-listed companies are no longer required to submit hard copies of definitive proxy materials, provided that such proxy materials are included in an SEC filing (e.g. Schedule 14A).
- Any NYSE-listed company whose proxy materials are not made on Schedule 14A but are available on EDGAR, such as foreign private issuers that file proxy materials under Form 6-K or 8-K, or U.S. issuers that file proxy materials on Form S-4, must inform the NYSE of the information needed to identify the filing as containing proxy materials.
- Any NYSE-listed company not required to file proxy materials on EDGAR or whose materials are not filed in their entirety on EDGAR will continue to be required to provide three physical copies to the NYSE. Nasdaq-listed companies are not obligated to mail proxy materials to Nasdaq.

SEC Proposals: Universal Proxy Card

- In October 2016, the SEC proposed "universal proxy" rules.
- The proposed rules would require the inclusion of the names of both registrant and dissident nominees on a universal proxy card in order to more closely resemble how shareholders can vote in person to elect directors at shareholder meetings.
- After Trump administration took office, universal proxy card proposal fell off SEC's agenda.
- Company defense firms have begun embedding in questionnaires and representation agreements, that are commonly required to submit a shareholder nomination, to obtain the written consent of dissident nominees to be named as nominees in the company's proxy materials. There are strategic advantages to a company to include one or more dissident nominees on its proxy card. Shareholders who wish to mix and match their votes among all the candidates may be inclined to complete the company's proxy card instead of the dissident's card.
- Sandridge used a universal proxy card when faced by Icahn Capital. Icahn continued to use his own proxy card. May see more companies voluntarily agreeing to use a universal proxy card in the future.

Procedures and Rules Regarding Shareholder Proposals

- Shareholder proposals are matters that shareholders of a public company seek to have acted on at an annual or other meeting of the company.
- 14a-8 proposals
- Proposals permitted under state law and charter/bylaws

14a-8 Proposals

- Eligibility and Procedural Requirements:
  - One proposal per meeting
  - Own at least $2,000 or 1% of securities entitled to vote on the proposal continuously for one year and continue to hold such securities through meeting date
  - 500 word limit
  - Submit the proposal at least 120 days before the anniversary date of the company's proxy statement for the previous year's annual meeting
- Company must generally notify you in writing of any procedural or eligibility deficiencies within 14 calendar days of receiving proposal. Shareholder response is due no later than 14 days from receipt of company's notification.
- No notice required if deficiency cannot be remedied.

14a-8 Proposals – Substantive Bases for Exclusion

- Improper under state law
  - Not proper subject for shareholder action (e.g. if proposal is binding)
- Violation of law
  - Implementation of proposal would result in a violation of any state, federal or foreign law
- Violation of proxy rules
  - Either proposal or supporting statement violates any of the proxy rules (including Rule 14a-9 regarding false and misleading statements)
- Personal grievance or special interest
  - Relates to a personal claim or grievance or it is designed to benefit one in a manner not shared by all shareholders
- Lack of relevance
  - Relates to operations that account for less than 5% of the company's total assets and less than 5% of its net earnings and gross sales; not significantly related to company's business
- Absence of power/authority
  - Company lacks power or authority to implement proposal
- Management functions
  - Deals with a matter relating to the company's ordinary business operations

14a-8 Proposals – Substantive Bases for Exclusion

- Director elections
  - Cannot disqualify a nominee standing for election; remove director from office; question competence of nominees/directors; seek to elect a director nominee; affect outcome of election
- Conflicts with company's proposal
  - Conflicts with one of the company's own proposals being submitted
- Substantially implemented
  - If the company has already substantially implemented the proposal
- Duplication
  - If proposal substantially duplicates another proposal submitted to company by a separate shareholder for same meeting
- Resubmission
  - If proposal deals with substantially same subject matter as another proposal that was included in the company's proxy materials within preceding 5 years, company has grounds to exclude it from any meeting held in next 3 years depending on the outcome of the prior vote
- Specific amount of dividends
  - If proposal relates to specific amounts of cash or stock dividends

SEC Guidance – November 2017

- Ordinary Business Exclusion
  - Rule 14a-8(i)(7) - a company is allowed to exclude a shareholder proposal that addresses "a matter relating to a company's ordinary business operations."
  - Proposals that raise matters that are "so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight" may be excluded, unless such a proposal focuses on policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a shareholder vote
  - Whether the significant policy exception applies depends, in part, on the connection between the significant policy issue and the company's business operations
  - Going forward, the SEC will expect a company's no-action request to include a discussion that reflects the board's analysis of the particular policy issue raised and its significance to the company.
  - SEC will give a deferential view toward the board's judgment
  - No action relief has been granted to exclude proposals that include extraordinary and ordinary business operations

SEC Guidance – November 2017

- Economic Relevance Exclusion
  - Rule 14a-8(i)(5), permits a company to exclude a proposal that "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business."
  - Historically, the "economic relevance" basis for exclusion has had limited application, because the Staff tended to find relevance where a company conducted any amount of business related to the issue in the proposal, and the issue had significant social impact.
  - Going forward, the SEC will place renewed focus on the second prong, whether a proposal is "otherwise significantly related to the company's business".
  - Implication of social or ethical issues alone is not enough to withstand exclusion. Issue must be tied to a significant effect on the company's business.

Other Exclusions

- Conflicting proposal
  - Some companies attempted competing management resolutions to eliminate shareholder proposals.
    - SEC granted no-action relief to AES Corp. who submitted a proposal ratifying existing bylaw to call a special meeting of shareholders by 25% of the shareholders
    - John Chevedden's proposal to lower that threshold to 10% was excludable
  - ISS and Glass Lewis have viewed these tactics negatively, recommending against the management advisory resolutions and, in many cases, the governance committee chairs
- Duplication

  - Conservatives attempt to make proposals to preempt liberal proposals by utilizing the SEC's "first-to-file" rule for similar resolutions, which results in the later-dated proposal being excludable.

Shareholder Proposals and Nominations

- Advance Notice Bylaws
  - Typically require a stockholder intending to nominate a director for election or to propose new business to notify the corporation during a specified window in advance of the meeting.
  - The purpose of the advance notice provision is to provide both adequate time and relevant information to the board. Standard information requirements include:
    - The proponent's name, address and record and beneficial ownership (including derivative positions)
    - The same information with respect to the person (if any) on whose behalf the proposal is being made.
    - A description of any agreement, arrangement or understanding between or among such stockholder and/or such beneficial owner, any of their respective affiliates or associates, and any others acting in concert with any of the foregoing (i.e. wolf packs).
    - A representation as to whether the stockholder or the beneficial owner, if any, intends or is part of a group which intends (a) to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the corporation's outstanding capital stock required to approve or adopt the proposal or elect the nominee and/or (b) otherwise to solicit proxies or votes from stockholders in support of such proposal or nomination.
    - The name of any nominees submitted as a candidate for election as a director and such nominee's consent to be named in the proxy statement.
    - A representation that the stockholder intends to appear in person or by proxy at the meeting to propose such business or nomination.
    - A description of the proposal and a copy of any proposed bylaw amendments.

Shareholder Proposals and Nominations

- When Are Advance Notice Bylaws Inequitable—when they have the effect of impeding or interfering with the stockholder franchise
  - Precludes or impairs a stockholder from conducting a proxy contest.
    - Icahn Partners LP v. Amylin Pharmaceuticals, Inc.
    - AB Value Partners, LP v. Kreisler Manufacturing Corporation.
  - Ambiguous or unduly burdensome requirements imposed
    - Deadline or informational requirements unclear
    - Too much information required

Shareholder Activism: Issuer Tips

- Advancing the Meeting Date. Attempting to prevent or thwart a proxy contest or takeover generally is not a legitimate use of the board's discretion.
  - *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437, 439 (Del. 1971).
  - *Airgas, Inc. v. Air Products & Chemicals, Inc.*, 8 A.3d 1182 (Del. 2010).
  - *NL Indus., Inc. v. Lockheed Corp.*, No. CV90-1950 (C.D. Cal. Mar. 14, 1991).
  - *Goggin v. Vermillion, Inc.*, C.A. No. 6465-VCN (Del. Ch. June 3, 2011).
- Postponements and Adjournments. Delaying the meeting to solicit more votes in a contested election or vote may be problematic if the delay is used to manipulate the outcome of the vote.
  - *Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43* (Del. Ch. 2008).
  - *Aprahamian v. HBO & Co.*, 531 A.2d 1204 (Del. Ch. 1987).
  - *Mercier v. Inter-Tel, Inc.*, 929 A.2d 786, 819 (Del. Ch. 2007).

Nomination Deadlines – Xerox Case

- New York State Supreme Court enjoined Xerox from enforcing its original nomination deadline because of a "series of very significant decisions and disclosures"
- There is already case law in Delaware holding that it is inequitable for directors to refuse to grant a waiver of an advance notice deadline under such circumstances.
  - *Hubbard* focused on the following three questions: (1) Did a change in circumstances occur after the nomination deadline? (2) Was the change "unanticipated" and "material"? and (3) Was the change caused by the board?
- The Court concluded that Xerox's refusal to waive the nomination deadline was "without justification" and the defendants "likely breached their fiduciary duty of loyalty by refusing to waive the advance notice bylaw deadline to allow a competing slate of candidates so as to protect and secure their existing Board positions."

Best Practices – Shareholder Engagement

- Transparency
  - Good and thoughtful disclosure – provide insight into board processes, particularly around executive pay, strategy, board composition and board engagement
  - Use visuals to communicate important information
  - Go beyond compliance to tell company story
- Continued and consistent engagement
  - Year round communications and opportunities for engagement
  - Commitment to interactive dialogue
  - Use of social media can be an effective tool
- Responsiveness
  - Direct contact with management and board depending on topic verses investor relations contact
  - Feedback reflected in policy
- Inclusive
  - Place value on all shareholders - registered, retail and institutional investors

Best Practices – Corporate Governance

Voluntarily turn attention to Environmental, Social & Governance issues

- Increased focus of major investors like Blackrock, State Street, Vanguard and public pension funds
- Surge of 14a-8 proposals and voting standards to hold board accountable
- Board skills and diversity
- Sustainability/climate change
- Workplace safety

Thank You

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