

Corporate Alert

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Top 10 Topics for Directors in 2014

U.S. public companies face a host of challenges as they enter 2014. Here is our list of hot topics for the boardroom in the coming year:

1. Oversee strategic planning amid continuing fiscal uncertainty and game-changing advances in information technology
2. Address cybersecurity
3. Set appropriate executive compensation as shareholders increasingly focus on pay for performance and activists target pay disparity
4. Address the growing demands of compliance oversight
5. Assess the impact of health care reform on the company's benefit plans and cost structure
6. Determine whether the CEO and board chair positions should be separated
7. Ensure appropriate board composition in light of increasing focus on director tenure and diversity
8. Cultivate shareholder relations and strengthen defenses as activist hedge funds target more companies
9. Address boardroom confidentiality
10. Consider whether to adopt a forum selection bylaw

1. Strategic Planning Challenges

Directors recently ranked strategic planning as the number one topic to which they want to devote more time in 2014.¹ It's easy to understand why: gridlock in Washington is wreaking havoc on business planning. Throughout much of the fall, the American economy was held hostage as political brinkmanship in Washington partially shut down the federal government and brought the country to the edge of defaulting on its debt. Ultimately, Congress managed only to kick the can down the road by voting to reopen the government at current spending levels until January 15, 2014 and to raise the debt ceiling until February 7, 2014. During the interim, congressional leaders will try to hammer out a new budget before mandatory spending cuts agreed to in 2011 kick in. Fearing that "governing by crisis" is becoming the new norm, the business community remains skeptical that any meaningful long-term solution to the nation's fiscal woes will be reached before the country has to suffer through this fire drill again.

Adding to the uncertainty is growing concern over the Federal Reserve's massive bond buying program. Critics charge that the unprecedented stimulus program may be creating asset bubbles, and the financial markets have reacted strongly to any news about the Fed's future plans for the program. Hints this past summer that the Fed was eyeing a pull-back roiled markets around the world and dealt a serious blow to many emerging market economies.

It is no surprise that in a recent poll CEOs ranked the government's response to the fiscal deficit and debt burden as the top external threat to their company's growth prospects.² Economists estimate that uncertainty over fiscal policy has already shaved almost half a percentage point off GDP this year.³ In light of the uncertainty, companies have continued to stockpile cash and are now sitting on \$1.8 trillion in cash and other liquid assets.⁴ Corporate reluctance to spend in the face of all the uncertainty and tepid economic growth is placing increasing pressure on profits. Since the financial crisis profit growth has been driven largely by cost-cutting. While the profits of S&P 500 companies have doubled since June 2009 and are near a 60-year high,⁵ wages and salaries as a percentage of GDP have fallen to the lowest level on record and corporate capital expenditures are about one-third below the average in previous recoveries.⁶ With costs cut to the bone, many companies are now facing important strategic decisions about how best to deploy their assets to grow profits.

In addition to uncertainty over the nation's fiscal and monetary direction, management and boards face a host of other challenges as they plot their company's long-term strategic direction. CEOs around the world recently ranked technology as the single most important external factor that will shape their company's future in the next three to five years, even more so than market or economic factors.⁷ As the pace of technological change accelerates in an increasingly interconnected world, it becomes ever more difficult to stay abreast of the changes, much less grasp their implications.⁸ This poses significant challenges for management and the boards of directors overseeing management's strategic plans.

Perhaps nowhere are the advances in technology more prevalent than in the information domain. It is estimated that by 2020 there will be over 50 billion devices connected to the Internet.⁹ The explosion of mobile technologies and social media is changing the way companies compete. In a digital world where one tweet or one Facebook "like" regarding a company's products or services can go viral in a matter of seconds, the customer is king. One executive recently lamented "[a]s customers gain more power over the business via social media, their expectations keep rising and their tolerance keeps decreasing."¹⁰ In addition to changing the rules of customer engagement, advances in information technology offer significant new opportunities to cut costs through more efficient utilization of employees, office space, and supply chain and distribution channels.¹¹

Thanks to this ubiquitous interconnectivity, companies now have available to them a mind-boggling quantity of data. In fact, businesses will create more data in the next two years than in all of history.¹² "Big data" represents a vast wealth of useful information for those companies that can figure out how to mine it. A recent study showed that companies using data-driven decision-making are, on average, five percent more productive and six percent more profitable than their competitors.¹³ According to a recent report, 30 percent of companies have invested in big data technology and another 34 percent plan to invest within the next two years.¹⁴

Directors are becoming much more attuned to the important role that information technology will play in their company's future. Over half of directors responding to a recent survey said that effective use of IT is either critical or very important to the creation of long-term shareholder value, and almost 60 percent of directors responding want to devote more time in the coming year to the opportunities and risks posed by information technology.¹⁵

Overseeing IT strategy may be particularly challenging for the average director of a public company who, at 60-plus years of age, may not have embraced social media and mobile technologies to the same degree as his or her children. In a recent survey, almost one-third of directors responding said that their company's strategy was not adequately supported by a sufficient understanding of IT at the board level¹⁶ and, in another study, more than three-quarters of the directors responding said that they personally, as well as the boards on which they serve, need improvement in their understanding of IT risks.¹⁷ Perhaps in response to these deficiencies, over a third of boards engaged an outside consultant last year to advise the board on IT strategy and risk.¹⁸

2. Cybersecurity

Cybersecurity has become one of the hottest topics in the boardroom as companies wrestle with ever increasing threats to their information systems and intellectual property. A recent study by the Ponemon Institute found that in the past year the number of successful cyber attacks on companies surveyed jumped 42 percent compared to the prior year.¹⁹ According to the Department of Homeland Security, the number of cyber threats to critical U.S. infrastructure by mid-2013 had already exceeded the total number of incidents in 2012.²⁰

This dramatic rise in cyber attacks and data breaches has placed cybersecurity on the radar screen of virtually all companies. In addition to potential lawsuits, damage to reputation and loss of customers, companies are facing increasing regulatory scrutiny about the adequacy of their data security measures. The FTC has brought more than 40 actions against companies for data breach, claiming that failures to prevent unauthorized access to consumers' personal information constitute unfair or deceptive acts. In almost all instances, companies have settled by entering into consent decrees requiring them to implement better information security programs and obtain annual independent audits for 20 years. In one closely watched case, however, Wyndham Hotels is challenging the FTC's authority to impose cybersecurity standards.

The SEC has also made cybersecurity risk a top disclosure priority. In 2011, the SEC issued guidance regarding company disclosure obligations about material cybersecurity risks and cyber incidents. Since then, the SEC has sent comment letters to at least 50 companies regarding the adequacy of their disclosures. In May, SEC Chairman Mary Jo White instructed her staff to evaluate its current guidance and consider whether more stringent requirements are needed.

In February 2013, President Obama signed an executive order directing the National Institute of Standards and Technology to develop a voluntary cybersecurity framework for reducing cybersecurity risks to critical infrastructure. A preliminary draft of the framework was published for public comment on October 22, 2013, with the final version due early next year. Legislation essentially codifying President Obama's executive order is currently wending its way through Congress. While voluntary, the framework will likely influence "best practices" with respect to data security throughout corporate America.

As part of a board's risk management oversight function, directors should carefully assess the adequacy of their company's data security measures. Among other things, directors should address the following areas:

- *Oversight structure.* Directors should have a clear understanding of who has primary responsibility for cybersecurity oversight. In a recent survey, 54 percent of directors responding said that their company's audit committee had primary oversight of IT risks, while 26 percent said that primary oversight rested with the entire board and 10 percent indicated that primary oversight was delegated to a separate risk or IT committee.²¹
- *Board education.* Oversight of cybersecurity may be particularly challenging for directors in light of the rapid advances in information technology. Based on a recent survey, over one-third of boards engaged an outside consultant last year to advise the board on IT strategy and risk.²²
- *Cybersecurity risk profile.* Directors should understand the company's cybersecurity risk profile, including the potential likelihood, frequency and severity of cyber attacks and data breaches and the potential impact that such incidents could have on the company's business. For example, a real estate company may have a low cybersecurity risk profile, while a financial services or health care company would typically face much higher risks.
- *Risk management review.* The board or appropriate committee should review with management the adequacy of the company's cyber risk management practices. In particular, directors should probe whether the measures that management has put in place are appropriate in light of the company's cyber risk profile. Directors should

also inquire about the company's contingency plans for responding to a cyber breach, as well as steps the company has taken to monitor cybersecurity risks associated with vendors and other third-party service providers. The board or responsible committee should also review the adequacy of the annual IT budget.

- *Reporting processes.* Directors should ensure that they are getting the information they need to understand the company's cyber risks and the company's approach to managing those risks. The board or responsible committee should require regular reports from senior management and may wish to meet directly with the chief information officer. According to a recent survey, 31 percent of directors surveyed said that they meet at least twice a year with the company's chief information officer and 20 percent said that they meet with the CIO at every formal board meeting.²³
- *Insurance.* Another area of concern is the adequacy of the company's insurance coverage for data breaches. Some insurance companies have sought to deny coverage for cyber losses under traditional general liability policies. Consequently, many companies are purchasing separate cybersecurity risk insurance.

3. Executive Compensation

Executive compensation is a topic that just won't go away, particularly with pay disparity and pay for performance regulations still looming. We highlight below some of the matters directors should be considering as they craft executive compensation for 2014:

- *Say-on-Pay Vote.* Say-on-pay proposals, now in their third year, have led to what seems to be routine approval of C-suite compensation for the vast majority of companies, with shareholders at 97 percent of U.S. companies approving executive pay packages and 72 percent of such companies achieving more than 90 percent approval.²⁴ But boards are not letting down their guard. According to a recent survey, 70 percent of directors say their boards took some form of action in response to their company's most recent say-on-pay vote, with the most common being enhancing proxy statement disclosures, increasing the use of compensation consultants and making compensation more performance based.²⁵ But this does not mean that executive compensation is decreasing. Only three percent of directors surveyed say their company reduced executive compensation during 2013.²⁶
- *Proxy Advisory Firm Recommendations.* Proxy advisory firms can be a key driver to the outcome of a say-on-pay vote. Companies need to analyze their shareholder base to determine the level of influence proxy advisors have on their investors. And if a proxy advisory firm gives a negative recommendation, companies need to consider whether they want to refute the recommendation through supplemental proxy filings and shareholder outreach. Filing supplemental materials gives companies an avenue to address inaccuracies in the proxy advisory firm recommendation and to further strengthen their case. However, because supplemental filings cost money and draw unwanted attention, many companies opt for direct engagement with major shareholders, as discussed below.

Companies also need to stay abreast of any changes in the voting recommendation policies of proxy advisory firms. For 2014, ISS has simplified one of the methodologies used when analyzing pay-for-performance to evaluate a company's say-on-pay vote. Currently, ISS measures the relative degree of alignment between the company's total shareholder return rank and the CEO's total pay rank within a peer group, as measured over both a one-year and three-year period. For 2014, the one-year measurement period has been eliminated.²⁷

- *Shareholder Outreach.* Shareholder outreach is an effective way for companies to learn about, and address, shareholder issues and concerns, strengthen the company's relationship with its shareholders and lessen proxy advisory firm influence on investors. Much of the success that companies are having with say-on-pay can be attributed to an increase in this engagement between companies and their shareholders. But not all directors agree on whether they should be communicating with shareholders on executive compensation. According to a

recent survey, 34 percent of directors believe it is not appropriate for the board to engage in executive compensation discussions with shareholders, while 28 percent believe it is “very appropriate” and 37 percent believe it is “somewhat appropriate.”²⁸

- **Compensation Committee and Adviser Independence.** New stock exchange rules kicked in on July 1, 2013 requiring compensation committees to conduct an assessment of the independence of compensation consultants, legal counsel and other advisers before selecting, or receiving advice from, such advisers. The factors to be considered when determining independence are the same six factors that companies must consider when determining whether the company has a conflict of interest with any compensation consultant, which was a new proxy statement disclosure that took effect during the 2013 proxy season. Although the new listing standards make clear that a compensation adviser does not have to be “independent,” compensation committees should ensure that they engage in the proper independence assessment and record the assessment in their committee minutes.

Boards should also be reviewing the independence of their compensation committee members to ensure the members qualify under new stock exchange rules that will apply on the earlier of (a) the company’s first annual meeting after January 15, 2014 or (b) October 31, 2014. In addition to existing listing requirements, boards must also take into account all relevant factors when determining compensation committee independence, including –

- the sources of compensation for each compensation committee member, including any consulting, advisory or other compensatory fee paid by the company, and
 - whether the compensation committee member is affiliated with the company, or a subsidiary or affiliate of the company.
- **Pending Dodd-Frank Regulations.** Much to the delight of companies, the SEC continues to lag in its rulemaking on several provisions required by the Dodd-Frank Act. At a recent conference, SEC Chair Mary Jo White was noncommittal on the timing for these rules, but stressed the SEC’s commitment to deliver as quickly as possible. In any event, companies should begin planning how they will implement and comply with the new rules once adopted.
 - **Pay disparity disclosures.** The SEC finally proposed its long-awaited rules that would require public companies to disclose the ratio of a CEO’s annual total compensation and the median total annual compensation of all other employees of the company (including part-time, seasonal, temporary and foreign employees).²⁹ The proposed rule provides companies with flexibility in determining the median compensation for employees by permitting the use of statistical sampling in order to ease the compliance burden. This proposal sparked controversy even before it came out, with the SEC receiving nearly 23,000 pre-proposal comment letters. And this controversy is likely to continue – with detractors questioning the rule’s utility and bemoaning anticipated compliance burdens and proponents touting the rule as providing meaningful information to shareholders. Whatever the ultimate outcome, companies have some time to figure out how they will comply. If final rules are adopted in 2014, a company with a fiscal year ending December 31 would be required to comply with the rules starting with fiscal year 2015 and first include the necessary disclosures in its Form 10-K, annual meeting proxy statement or a registration statement filed in 2016.
 - **Pay for performance.** Another contentious provision in the Dodd-Frank Act calls for companies to disclose in their annual proxy statements the relationship between executive compensation and the company’s financial performance. Although the SEC has yet to propose rules on this topic, companies would be wise to begin laying the groundwork in their 2014 proxy statements by showing a strong link between pay practices and performance. Many companies have already begun drawing a stronger alignment between pay and performance by decreasing the use of options and increasing the use of

- time-based and performance-based restricted stock. According to Equilar's 2013 equity trends report, the percentage of S&P 1500 companies using option grants decreased for the fifth year in a row, from 78.5 percent in 2007 to 75.2 percent in 2012, while companies using restricted stock during the same period have increased from 80.1 percent to 92.8 percent.³⁰
- *Clawbacks.* The Dodd-Frank Act also calls for the SEC and stock exchanges to implement rules requiring companies to develop and disclose clawback policies for the recovery of incentive-based compensation granted to any current or former executive officer during the three-year period preceding an accounting restatement that is based on erroneous data corrected in the restatement. The language in the statute is broader than the clawback provisions in the Sarbanes-Oxley Act, which apply only to the CEO and CFO, have only a one-year look-back and require misconduct. More and more companies are implementing some form of clawback policy in anticipation of the pending rules, and also to appease proxy advisory firms, which favor clawback policies.
 - *Lawsuits on Executive Compensation.* The plaintiffs' bar continued to torment companies throughout the 2013 proxy season by bringing lawsuits challenging the adequacy of a company's proxy disclosures on executive compensation. The lawsuits sought to enjoin either a shareholder say-on-pay vote or a vote to amend an equity compensation plan until the company makes additional disclosures. In response to these lawsuits, many companies agreed to provide supplemental disclosures, and ended up paying six-figure settlements to plaintiffs' attorneys to make them go away. But recent victories by companies that decided to fight it out in court may have helped put an end to this line of cases. Although these lawsuits will hopefully wane in 2014, companies would be wise to pay particular attention to their 2014 proxy disclosures to ward off whatever tactic the plaintiffs' bar dreams up next.

4. Compliance Oversight

Constantly changing and overlapping legislative and regulatory requirements are weighing down corporations and usurping more and more board time. It is a telling sign when, according to a recent survey, directors ranked over-regulation second only to the government's response to the fiscal debt and the debt burden as the greatest external threat to their company's growth prospects.³¹

Directors may well have reason for concern. Since 1993, 81,883 new federal rules have been issued,³² and the red tape keeps growing. A recent report of planned regulatory actions lists 2,305 rules in the pipeline, 131 of which are classified as "economically significant" and many of which derive from the Dodd-Frank Act and Obamacare.³³ For global companies the regulatory challenge is even more complex. They must expand their focus beyond the country in which they are headquartered, and understand, manage and comply with myriad rules and regulations in multiple jurisdictions.

Not surprisingly, directors are feeling the weight of this growing regulatory burden. In a recent survey, 56 percent of directors responding said that growing regulation and enforcement initiatives are putting excessive burdens on directors.³⁴ With the growing demands on directors' time, there is increasing temptation for directors to adopt a "check the box" approach to their legal and regulatory oversight responsibilities. Such an approach, however, would be a mistake. Among other things, having a strong compliance program in place can reduce a company's penalties under the Federal Sentencing Guidelines. In addition, enforcement agencies often consider the effectiveness of a company's compliance programs when deciding whether to bring charges or settle an enforcement action. Further, last year the SEC and Department of Justice jointly issued guidance on what they consider to be an effective compliance program for purposes of the Foreign Corrupt Practices Act (FCPA). Among other things, the guidance cautions against a "check the box" approach to compliance and emphasizes that the SEC and DOJ will consider whether senior executives and the board of directors have set the right tone at the top and demonstrated a commitment to a "culture of compliance" that is reinforced and implemented throughout the organization.³⁵ In a 2013 survey, 60 percent of directors responding said that their board had held discussions regarding tone at the top this

year, up from 46 percent in 2012,³⁶ and 46 percent said they had increased their interactions with members below the executive level as part of their compliance oversight, a 15 percent increase over 2012.³⁷

Having a strong and effective compliance program in place is even more important with the increasingly vigorous enforcement of regulations. The SEC and the Department of Justice have been ramping up their enforcement efforts under the FCPA over the past several years. Two-thirds of the top 20 largest criminal FCPA case resolutions have occurred in the last three and one-half years, and three of the top five largest penalties ever issued have been in the last year.³⁸ The price for violating the FCPA can be very high, involving not only significant fines and penalties, but also reputational damage, criminal prosecution and investor lawsuits.

In addition, the SEC's new Chairman, Mary Jo White, promised Congress that she would pursue a "bold and unrelenting" enforcement program, and with just over seven months at the helm, she appears to be fulfilling her promise. In Chairman White's short tenure, the SEC has changed its "neither admit nor deny" settlement policy to require admissions of wrongdoing from certain defendants when settling enforcement actions. The SEC has already applied its new policy in two high profile cases this fall — one involving Philip Falcone and his hedge fund firm, Harbinger Capital Partners LLC, and the other involving J.P. Morgan Chase & Co. The SEC has also begun imposing more significant monetary penalties, and has announced new initiatives to target fraudulent and improper financial reporting, abusive trading and fraudulent conduct in securities of microcap companies.

Although the SEC is utilizing increasingly sophisticated and powerful technology and tools to assist in its enforcement efforts, the agency is also getting help from whistleblowers. The SEC received over 3,000 tips in the first two years of its new whistleblower program. The announcement of a recent award of \$14 million to a single whistleblower will likely spur even more tips.

5. Health Care

Despite the continuing legal challenges and political hardball, as well as the delays and technical glitches, it appears that the Patient Protection and Affordable Care Act, more commonly known as Obamacare, is here to stay. As such, companies need to be prepared for certain key provisions of the statute that are scheduled to take effect in 2014 and beyond. Because these provisions will have a major impact on most companies, boards of directors need to be planning how their companies will comply with these regulations and the effect such compliance will have on their company's cost structure and strategy going forward.

Set forth below is a brief summary of certain key provisions of health care reform that are looming, followed by actions for boards to consider.

State Insurance Exchanges. By January 1, 2014, each state must either (i) implement its own state-run health insurance exchange, (ii) let the federal government run the health insurance exchange for them or (iii) partner with another state or the federal government to implement a health insurance exchange. These health insurance exchanges, among other things, will facilitate the purchase of and make available "qualified health plans" to qualified individuals and employers. Employees of companies with fewer than 50 full-time employees will generally be eligible to purchase insurance within the state insurance exchange (or federally facilitated exchange) and possibly receive a federal subsidy without any penalty to the company. But, as discussed below, larger companies with employees who purchase insurance through these exchanges will be required to pay a penalty. Enrollment under these health insurance exchanges, which began on October 1, 2013, has been anything but smooth, with technical glitches and delays frustrating the masses who have tried to enroll. Because of these issues, the deadline for the uninsured to sign up for health care coverage and avoid paying a penalty has been extended until March 31, 2014.

Play or Pay. Employers are not required under health care reform to provide health insurance to employees. However, employers with 50 or more full-time employees, referred to as "large employers," will have to pay a penalty if (i) they do not offer health insurance to employees or (ii) they offer health insurance to employees, but the

insurance does not meet certain affordability or benefit requirements. This employer mandate, often referred to as the Play or Pay rule, was originally scheduled to kick in January 1, 2014, but has been delayed until January 1, 2015, giving employers an additional year to prepare to provide health care coverage to employees or pay a penalty.

If a large employer does not offer health insurance, and one or more of its employees enroll in a state insurance exchange and receive a federal government subsidy, the employer will be required to pay a fee of \$166.67 per month (\$2,000 annually) for each full-time employee, excluding the first 30 full-time employees. If a large employer does offer health insurance, but one or more of its employees nevertheless enroll in a state insurance exchange and qualify for a federal government subsidy, the employer will be required to pay the lesser of (i) \$166.67 per month (\$2,000 annually) for each full-time employee, excluding the first 30 full-time employees, and (ii) \$250 per month (\$3,000 annually) for each full-time employee who receives the subsidy.

Excise Tax on High-Cost "Cadillac" Plans. Beginning January 1, 2018, certain high-cost group health plans, both insured and self-insured, will be subject to an excise tax of 40 percent on the amount by which the health plan's annual cost for coverage, including both employer and employee contributions, exceeds \$10,200 for single-only coverage and \$27,500 for family coverage.

In light of these provisions, there are several actions boards should be taking to prepare their companies for what is to come. These actions include the following—

- **Assess strategy and costs relating to play or pay.** Most companies that currently offer health benefits to employees are expected to continue to do so for the foreseeable future. Because health benefits are often viewed as an important part of an employee's compensation package, eliminating health care coverage for employees and paying the penalty may not be a viable option for companies. But it will be important for the board of directors to know the company's options and responsibilities under the statute to best determine whether the company should take the "play" or "pay" approach in 2015. In making this determination, the board should consider, among other things, (i) the costs of the company's health care programs and what steps the company can take to manage these costs, (ii) the amount of any penalties the company would have to pay under the statute if it eliminated health care coverage for its employees and (iii) the actions taken with respect to health care by other companies in the industry. If the company does elect to "pay" instead of "play," it will need to carefully consider how to explain its decision to employees and inform them of their options.
- **Review and redesign, if necessary, current health care programs.** The cost for employer health care is high and it is expected to increase another 5.2 percent in 2014.³⁹ Many companies are using health care reform as a catalyst to review and redesign their health care programs as necessary to slow these rising costs. A growing number of companies are considering private online exchanges to deliver their health care benefits. Some companies, including Walgreens, Sears Holding Corp. Petco, Kinder Morgan and Darden Restaurants, have announced programs where they will give employees a fixed sum of money and require the employee to shop for insurance coverage on a private online exchange. And it looks like more companies are going to jump on the private exchange bandwagon. Accenture PLC projects that approximately one million Americans will get employer health coverage through these private exchanges in 2014, and expects that number to increase to 40 million by 2018.⁴⁰

Companies are also taking other steps to manage health care costs. UPS recently announced that it is eliminating health care coverage for employee spouses who have other available coverage, and beginning next year, Trader Joe's and Home Depot are dropping health insurance for their part-time workers and steering them toward the state insurance exchanges. Other actions that companies are taking include increasing the share employees and their dependents pay in premium contributions, implementing higher medical and pharmacy deductibles, eliminating retiree health benefits, encouraging enrollment in high-deductible health plans, providing wellness programs and reviewing the company's relationship with its providers.

Managing costs will become even more significant for companies as 2018 approaches and the excise tax kicks in for high-cost plans. More than 60 percent of employers believe that they will be subject to the excise tax in 2018 if they don't make adjustments to their current benefit strategy.⁴¹ As such, companies need to review their health care plans in the coming years to control their costs and avoid the excise tax.

- *Stay abreast of developments.* Because of the statute's sheer volume and complexity, as well as the continuing legal challenges and politics surrounding Obamacare, education is key to ensuring that directors understand the statute's relevant provisions, their effective date(s) and the implications they will have for the company. While the U.S. Supreme Court largely upheld the constitutionality of Obamacare last year, the health care law is now facing new legal challenges that directors should follow. These new lawsuits, among other things, focus on language in the statute that says subsidies for qualified individuals are available for those who purchase insurance through an exchange "established by the state." Because many states did not create their own exchange, but instead opted for the federally run exchange, these lawsuits claim that the statute's wording precludes individuals who have to purchase insurance through a federally run exchange from receiving subsidies.⁴²

Boards also need to be fully informed of any evolving guidance and interpretive regulations relating to the implementation of the law so they can effectively formulate a strategy for dealing with it going forward. Federal agencies have already begun issuing guidance addressing certain aspects of the legislation, and much more is expected.

- *Encourage a healthy workforce.* Having a healthy workforce can give a company a competitive advantage. Attempting to reduce health care costs and improve the health of their workforce, many companies are offering employee wellness programs. These programs, in general, either use financial incentives to motivate employees to participate, or use penalties, such as an increase in premiums and deductibles, for certain unhealthy behaviors, such as smoking, or having high cholesterol or a high body mass index. According to a recent survey by Aon Hewitt, 83 percent of employers offer incentives for participation in health and wellness programs, but only a small percentage exclusively use penalties or offer a mix of rewards and penalties.⁴³ But this is about to change. According to this survey, 58 percent of employers intend to impose penalties in the next three to five years on employees who "do not take appropriate actions for improving their health."⁴⁴

6. Split Decision: Whether to Separate the CEO and Board Chair Positions

Whether to separate the CEO and chairman positions is one of the most hotly debated issues in corporate governance. During the 2013 proxy season, calls for an independent board chair were the second most frequent proposal submitted to companies.⁴⁵ Even though JPMorgan Chase managed to win highly publicized battles in each of the last two years against activists seeking to separate the top posts currently held by Jamie Dimon, board leadership structure will likely continue to be a top priority for activists in 2014.

Proponents of separating the CEO and chair positions typically argue that splitting the roles strengthens the independence of the board, thereby improving the board's oversight function. Proponents also contend that separation can free the CEO to focus on running the company. Opponents generally counter that a separate chair can undermine the CEO's authority and result in inefficiency.

Despite pressures to separate the positions, a board should carefully determine the optimum leadership structure for its particular company in light of the company's unique circumstances and CEO and board dynamics. Because these circumstances and dynamics can change over time, most boards preserve flexibility with respect to the leadership roles: only four percent of S&P 500 companies have adopted a formal policy requiring separation of the CEO and chair roles.⁴⁶ Some factors that boards may wish to consider when evaluating their leadership structure include:

- *Recent trends.* According to the 2013 Spencer Stuart Board Index, 45 percent of S&P 500 companies split the CEO and chairman roles, up from 23 percent a decade ago.⁴⁷ At slightly more than half of these companies, an independent director fills the chairman's post. Consequently, only 25 percent of all S&P 500 companies have a truly independent chair (up from 16 percent in 2008).⁴⁸ In most instances where the chairman is separate but not independent, the former CEO serves as the chair during a transition period before the new CEO takes the reins.⁴⁹
- *Rise of the lead director.* Ninety percent of S&P 500 companies have an independent lead or presiding director⁵⁰ who, among other things, helps set board agendas, runs executive sessions of the independent directors and serves as a liaison between the independent directors and management. NYSE-listed companies are required to have a non-management director preside over executive sessions of the non-management directors, but the same director is not required to preside at all such sessions. Of the 446 boards that have a lead or presiding director, 61 percent have lead directors (up from 28 percent in 2004) and 39 percent have presiding directors (down from 72 percent in 2004).⁵¹

A lead independent director is often viewed as an acceptable alternative to an independent board chair. Even though JPMorgan Chase successfully fended off a shareholder proposal seeking to split the CEO and chairman roles, it subsequently acquiesced to shareholder pressure by elevating its presiding director, Lee Raymond, to a newly created position of lead independent director.⁵² Similarly, in 2012, Goldman Sachs managed to negotiate the withdrawal of a shareholder proposal seeking to separate its chairman and CEO roles by creating a lead independent director position, and the firm averted a similar proposal in 2013 by strengthening the powers of the lead independent director.⁵³

Historically, Glass Lewis and ISS have strongly supported shareholder proposals calling for an independent board chair. Prior to the 2013 proxy season, ISS changed its position and now it may not support such a proposal if the company has a lead director with certain specified duties, the company is performing adequately, and the company satisfies certain other corporate governance requirements.⁵⁴ Specifically, to gain ISS support, the lead director must be charged with the following duties:

- preside at all board meetings at which the chairman is not present, including executive sessions of independent directors
- serve as liaison between the chairman and the independent directors
- approve board meeting agendas and schedules, as well as information sent to the board
- have the authority to call meetings of the independent directors, and
- if requested by major shareholders, be available for consultation and direct communication.

In response to the ISS policy change, many companies strengthened their independent chair position. As a consequence, ISS supported fewer calls for an independent chair in 2013 (47%) than in 2012 (75%), which also contributed to lower voting support.⁵⁵ Shareholder support for resolutions seeking separation of the top roles averaged 31 percent in 2013, compared to 34 percent in 2012.⁵⁶

- *The Academic Literature.* Studies comparing the effect on company performance of the two leadership structures have been inconclusive.⁵⁷ A new study released in 2013,⁵⁸ however, lends support to opponents of the "one-size-fits-all" approach advocating an independent chair. After studying the financial performance of 309 companies following the separation of their CEO and board chair, the authors concluded that a board should separate the two roles only when the company is performing poorly. Even then, the separation should occur in such a manner that the CEO retains that role but an independent chair is appointed. Based on the results of

their study, the authors conclude that it would be a mistake for boards to succumb to pressure from activist investors or corporate governance watchdogs to separate the CEO and chair positions simply because it is considered a “best practice.”⁵⁹

As the study indicates, whether and when to separate (or recombine) the CEO and chair positions is a complex issue. In addition to financial performance, boards often need to weigh myriad other factors, including the dynamics of the CEO’s interaction with the board, the company’s history and culture, the length of the CEO’s tenure with the company, and any corporate governance or oversight issues that have raised concerns among directors or shareholders.

7. Board Composition

The Wall Street Journal recently highlighted director tenure in an article titled “The 40-Year Club: America’s Longest Serving Directors.”⁶⁰ While the article noted that fewer than 30 public company directors have at least 40 years’ tenure,⁶¹ the article also made clear that many public company boards are having difficulty refreshing their ranks. According to the latest Spencer Stuart Board Index, the boards of S&P 500 companies elected 339 new independent board members this past proxy season, down 11 percent from five years ago and 14 percent from 10 years ago.⁶² Last year they elected just 291 new directors, the smallest number in more than a decade.⁶³ At the same time, the average age of directors continues to climb. The average S&P 500 director is now 62.9 years old, compared to 60.3 ten years ago.⁶⁴ In addition, mandatory retirement ages keep rising. Of the 72 percent of S&P 500 boards that have a mandatory retirement policy, 88 percent now set their retirement age at 72 or older (compared to just 46 percent a decade ago) and almost a quarter set the retirement age at 75 or older (compared to just 3 percent ten years ago).⁶⁵ At 20 percent of S&P 500 companies, the average board tenure is 11 years or more.⁶⁶

Low director turnover is drawing the attention of activist investors and governance advocates who question whether aging boards are keeping pace with the rapid technological advances and other new challenges companies face. Critics also charge that the limited availability of new board seats hampers opportunities for achieving greater racial and gender diversity on boards and compromises board oversight since long-serving directors are more likely to align with management.⁶⁷ The Council of Institutional Investors, whose members consist of pension funds with more than \$3 trillion of assets under management, recently revised its best-practices corporate governance policies to include tenure as a factor boards should consider when determining whether a director is independent.⁶⁸ In addition, while ISS decided not to revise its 2014 proxy voting guidelines to add tenure to the factors it considers when assessing director independence, 74 percent of institutional investors responding to ISS’ request this past summer for comment on its guidelines viewed long tenure as problematic.⁶⁹ In sharp contrast, 84 percent of responding issuers said that long tenure was not problematic.⁷⁰

Recent academic research lends some credence to the critics’ position. According to a recent study, the value of companies rises as the average tenure of outside board members increases to nine years, after which company value begins to decline.⁷¹ The study’s author posits that as directors gain firm-specific knowledge early in their tenure, their companies experience better performance, but once a threshold is reached, director oversight declines and company value slips. The author notes, however, that a one-size-fits-all approach to board tenure may not be appropriate since the relation between board tenure and firm performance varies across industries and firm characteristics. For example, at companies with complex operations and many intangible assets, the study found that optimal average board tenure is closer to 11 years.⁷² Earlier studies, however, on the effect of board tenure on corporate performance or governance have reached conflicting results.⁷³

While term limits and mandatory retirement age policies facilitate board refreshment, they do so at the risk of loss of directors with highly valued firm knowledge, expertise or perspective. Even boards that have set a mandatory retirement age implicitly acknowledge that the key focus should be on performance rather than age as the board typically retains discretion to waive the requirement in order to retain a valued director.

Of course, addressing an underperforming director, whether it be due to age or some other factor, is a delicate issue. Nearly half of directors responding to a recent survey cited difficulties in replacing an underperforming director, with the most common reason being unwillingness on the part of board leadership to deal with the issue.⁷⁴ To align board composition with company needs, a board's nominating and governance committee should determine the optimal mix of talents and experiences that will help the company achieve its strategic plan and manage its risk profile and then identify any gaps in board composition. By focusing on the company's future and the attributes and skills needed to get the company there, this approach avoids criticism of any individual director's experiences or skill set and provides a clear path towards achieving greater board competency.⁷⁵ A robust board evaluation process that includes individual director assessments can help identify any performance issues.

In addition to heightened focus on director tenure, companies are facing increasing pressure to diversify their boards. The SEC requires companies to disclose whether and how the board or nominating committee considers diversity in identifying candidates. Last year, after public outcry over its all-male board, Facebook added a woman director shortly after its IPO. Twitter is facing similar criticism this year.⁷⁶ During the 2013 proxy season, shareholders submitted 27 proposals to companies seeking to ensure that women and minorities are considered for board positions, up from only eight such proposals in 2012.⁷⁷ The vast majority of these proposals were withdrawn after proponents and companies reached a resolution. The three proposals that went to a vote averaged 35.8 percent shareholder support, with one proposal winning majority approval.⁷⁸ The dramatic increase in the number of diversity proposals submitted in 2013 was largely to the efforts of the Thirty Percent Coalition,⁷⁹ an organization composed of national women's organizations, institutional investors, senior business executives, some major accounting firms, statewide elected officials and others, whose goal is 30 percent female representation on U.S. public company boards by the end of 2015.⁸⁰ In early 2013, the organization also sent letters to 127 companies that did not have any women on their boards, urging them to embrace gender diversity.⁸¹

The push towards greater gender diversity on boards is also picking up steam internationally. Several countries in Europe already impose mandatory gender quotas on public company boards, and the EU is considering a European-wide initiative to address gender imbalance in the boardroom. In addition, in recent years many countries, including Australia, Ireland and the United Kingdom, have implemented disclosure requirements regarding gender diversity,⁸² and the Ontario Securities Commission is currently considering adding disclosure requirements for listed companies. This summer India enacted legislation requiring listed companies to have at least one woman director.⁸³

Several recent studies show a positive correlation between women in the boardroom and company financial performance, particularly during times of economic stress.⁸⁴ Other recent studies show that diverse groups make better decisions than homogeneous groups,⁸⁵ and that companies with women in the boardroom have stronger corporate governance practices.⁸⁶ Consumer products companies may particularly benefit from the input of women in the boardroom since it is estimated that women control about 70 percent of global consumer spending.⁸⁷

8. Dealing with the Activist Investor

Shareholder activism is on the rise. Through the first three quarters of 2013, activist investors submitted 91 initial Schedule 13D filings, well on pace to eclipse the 109 filings made in all of 2012.⁸⁸ In addition, proxy fight announcements are at their highest level since 2009.⁸⁹

So far in 2013, 60 percent of activists' campaigns have focused on boosting earnings at companies or shaking up their boards.⁹⁰ And companies with a lot of cash on their balance sheets better beware. With companies sitting on more than \$1.8 trillion in cash, 41 activist campaigns this year have demanded that companies return cash to shareholders through either dividends or stock buybacks.⁹¹

Activists are increasingly drawing larger companies into their crosshairs. In 2013, activists have gone after such large-cap companies as Apple, Dell and Hess Corporation. According to FactSet SharkWatch, as of October 2013, 50 value maximization and board seat campaigns had been announced against companies with a market value

exceeding \$1 billion, the most in any comparable period since they started tracking this information in 2005.⁹² And this trend is likely to continue. Not only are new activist funds emerging, but their assets under management are rising and an increasing number of mutual funds and institutional investors are siding with activists, thereby allowing activists to go after these larger companies with some success.⁹³ In addition, many larger companies have become more vulnerable to an activist attack after having acceded to shareholder demands to destagger boards, eliminate poison pills and give shareholders the right to vote by written consent and call special meetings.

With activism on the rise, cultivating good shareholder relations is critical. Directors need to understand who their company's shareholders are and what they care about. Boards also need to make sure that their remaining defenses, including advance notice and director qualification bylaws and "on the shelf" poison pills, are state-of-the-art. Some specific steps companies need to be taking include –

- *Know and engage your shareholders.* First, companies need to understand the breakdown of their shareholder base and monitor trading of the company's shares. Companies also need to reach out to significant shareholders. This is not only a good way to find out what they want, but also helps build credibility and stronger relationships. According to a recent survey, nearly 30 percent of boards stepped up their communications with institutional investors this past year.⁹⁴ In addition to cultivating relationships with major investors, companies need to make sure that they are effectively communicating their business strategies to the marketplace, and they should also be taking advantage of the power of the Internet by making sure their Web sites are up-to-date and fully communicating the company's message. In addition, companies should be actively monitoring shareholder concerns and opinions that are expressed through blogs and other shareholder forums and proactively responding to any shareholder issues before they escalate.
- *Send a consistent message.* While it is important to be receptive to shareholder concerns, companies also need to make sure that everyone in their organization is on the same page when communicating with shareholders. Sending a clear and consistent message not only proves to shareholders that the company has thoughtfully discussed and considered the issues, but also brings credibility to both the company and its spokespersons.
- *Watch what you say.* Those charged with communicating with shareholders must understand the legal limits on what they can say. Regulation FD prohibits the selective disclosure of material nonpublic information to certain market participants and to shareholders who are likely to trade.

The SEC's recent Regulation FD enforcement action against the head of investor relations at First Solar is a reminder that company spokespersons must be careful about what they say, not only in conversations and meetings with analysts and investors, but also in other settings – including social media such as blogs, Twitter and Facebook. In addition to Regulation FD limitations, companies need to be mindful that certain types of corporate disclosures must be accompanied by specific cautionary language, and if the communication involves a forward-looking statement, it should provide sufficient reference to factors that could cause actual results to differ materially.

- *Determine director involvement.* Companies need to determine whether, and to what extent, directors should be authorized to communicate directly with shareholders on the company's behalf. There are divergent views among directors on whether it is appropriate for directors to communicate about governance issues with shareholders. According to a recent survey, just over 60 percent of directors communicate with institutional investors; however, one-third of directors surveyed said the board "does not and should not" communicate with institutional investors.⁹⁵
- *Update advance notice and director qualification bylaws.* Companies should carefully review and, if necessary, update their advance notice bylaws. As more and more companies dismantle their takeover defenses, having an effective advance notice bylaw is even more important. Many of the updates that companies made to their advance notice bylaws this year include increasing the minimum amount of time for a shareholder to submit a

director nomination or proposal to be considered at a shareholder meeting and increasing disclosure requirements regarding derivative positions held and any compensation arrangements the director nominee may have with third parties.⁹⁶ To counteract an increasing practice whereby hedge funds pay dissident directors a large bonus payment if they are elected or other goals are met, some companies have also added director nomination and qualification bylaws that would render a director nominee ineligible to be nominated and, if elected, ineligible to serve if the individual is a party to any such compensatory arrangements.⁹⁷ This type of bylaw provision has spurred some debate in connection with a recent annual meeting, for which ISS recommended that shareholders vote against the directors who adopted the bylaw for their company. In making its recommendation, ISS took issue with the broad scope of the provision, which ISS believes could ultimately exclude qualified individuals from the board, and the fact that the directors did not allow shareholders to vote on the bylaw.⁹⁸

- *Consider putting a poison pill “on the shelf.”* The use of poison pills as a takeover defense has been falling out of favor for several years, with less than 15 percent of U.S. companies having a poison pill in force.⁹⁹ But an increasingly popular alternative is to have a poison pill “on the shelf.” In this situation, a board reviews and approves a form of poison pill that would be ready for adoption on short notice in response to a potential threat. The board then reviews the poison pill periodically to ensure that its terms are appropriate in light of potential threats and current market practices. Taking this “on the shelf” approach has several advantages. First, it gives the board more time for a thoughtful and effective evaluation of the poison pill in the absence of a pending threat. Also, having the poison pill ready to go enables the board to act quickly in response to an activist attack. Further, because there are no public disclosure requirements for merely having a poison pill “on the shelf,” the board is not pressured to include the shareholder-friendly provisions recommended by ISS, but instead can ensure the poison pill is sufficiently potent to adequately protect the company.

9. Behind Closed Doors: Boardroom Confidentiality

Bill Ackman’s public disclosure earlier this year of confidential JC Penney board deliberations not only outraged his fellow directors but also stunned the corporate community. His actions, however, were not without precedent. In 2006, a Hewlett-Packard director leaked confidential corporate information to the press and the company came under attack for methods used to ferret out the source of the boardroom leaks. As hedge funds and other shareholder activists increasingly succeed in gaining seats on corporate boards, boardroom confidentiality is an issue that no board of directors can afford to ignore.

Unfortunately, case law regarding a director’s obligation to maintain the confidentiality of corporate information is limited. Under Delaware law, a director’s fiduciary duty of loyalty requires directors not to misuse or disclose confidential corporate information to others to further their own private interests rather than those of the corporation.¹⁰⁰ While a director may believe that conveying confidential corporate information to the press is in the best interests of the corporation, a court will decide with 20-20 hindsight whether the disclosure was consistent with the director’s fiduciary duties. In the JC Penney incident, the board reportedly was considering pursuing legal action against Ackman, whose disclosures the company’s chairman characterized as “disruptive and counterproductive.”¹⁰¹ According to at least one report, Ackman sought, in connection with his ultimate resignation from the board, a release from any potential liability.¹⁰²

Short of pursuing legal action, boards are limited in their ability to sanction a rogue director. Under Delaware law, directors cannot remove a fellow director from the board, nor can they simply exclude the director from board meetings. A board of directors, however, can form a special committee that does not include the offending director and conduct delicate board business through the special committee. One court recently noted, however, that “the degree to which such a committee would need to provide some form of update periodically or upon request to other directors or the board has not been fully determined and is likely fact-dependent.”¹⁰³ Because of these difficulties, the most likely remedy a board will pursue is to simply not re-nominate the director when he or she stands for re-election.

Despite these limited remedies, there are some steps that a board can take to help preserve boardroom confidentiality:

- *Adopt robust confidentiality policy.* While almost all public companies have adopted insider trading policies prohibiting the disclosure by insiders of material nonpublic information about the company, few companies expressly restrict the disclosure of boardroom deliberations and other information learned by directors in the course of their service to the company. Companies should review and revise their corporate governance guidelines or other appropriate policies to expressly prohibit such disclosure unless required by law or approved by the board. The policy should clearly identify as “confidential information” any nonpublic information about discussions and deliberations at the board level, as well as information relating to board dynamics and company personnel. Boards should also make sure that their Regulation FD disclosure policy and/or corporate governance guidelines squarely address who is authorized to speak on behalf of the company. If nothing else, a robust confidentiality policy will impress upon directors the importance that the company places on boardroom confidentiality and foster voluntary compliance. Also, Delaware courts do give weight to board confidentiality policies when analyzing confidentiality claims, at least when ruling on shareholder demands to inspect company books and records.¹⁰⁴
- *Expressly address disclosure by designated directors to their sponsors.* The extent to which a director serving at the behest of a hedge fund or other sponsor may convey confidential corporate information to the sponsor is not clearly established under Delaware law. However, in a 2013 decision, the Delaware Chancery Court declared in dicta that “[w]hen a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder’s representative, then the stockholder is generally entitled to the same information as the director.”¹⁰⁵ To negate any implicit understanding or confusion in this regard, a company’s director confidentiality policy should expressly prohibit disclosure to a director’s sponsor unless the company otherwise expressly agrees. In addition, designated directors often gain their board seats through a negotiated settlement between the company and the sponsor in connection with a pending or threatened proxy fight. The settlement agreement should clearly address the extent to which the director may share confidential information with his sponsor and should impose confidentiality restrictions on the sponsor.
- *Consider confidentiality requirements for nomination and qualification of directors.* Many companies have adopted “second generation” advance notice bylaws that provide, among other things, that a shareholder nominee for election to the board must, as a precondition to nomination, agree in writing to comply with all company policies that are applicable to directors. When combined with a robust director confidentiality policy as discussed above, this type of bylaw can help deter confidentiality breaches. A company may also wish to consider adding a director qualification bylaw that would render a director ineligible to serve if the director violated the company’s confidentiality policies. Alternatively, a company could require a director to agree in advance to resign from the board if the director violates the policy. Although Delaware law contemplates that a resignation conditioned upon a director failing to receive a specified vote for reelection may be irrevocable,¹⁰⁶ it is not clear whether advance resignations given in other contexts may be irrevocable. In any event, these types of mechanisms would need to be carefully crafted to ensure that the procedure for determining a violation is fair and does not unduly restrict a director’s disclosure of information that is consistent with the director’s fiduciary duties.
- *Send periodic reminders.* To enhance compliance, the company should periodically remind directors of their confidentiality obligations under the company’s insider trading, Regulation FD and boardroom confidentiality policies.

The preservation of boardroom confidentiality is critical to the effective operation of a board. Directors cannot be open and honest in their discussions if they fear that their comments or positions will appear in tomorrow’s newspaper. With the increasing success of hedge funds and other special-interest investors in placing directors on boards, there will be less collegiality in the boardroom and a greater risk of leaks. Directors who serve on a board at

the behest of special-interest investors must not lose sight of the fact that they nevertheless owe their fiduciary duties to the stockholders as a whole.

10. Forum Selection Bylaws

The boards of all public companies should consider adopting a forum selection bylaw, if they have not already put one in place. The purpose of such a provision is to designate an exclusive venue for stockholder derivative suits and certain other stockholder suits, thereby reducing the high cost of duplicative, multi-forum suits challenging corporate actions. Delaware corporations typically designate the Delaware Court of Chancery, which confers the added benefit of ensuring that the matters in dispute will be heard relatively swiftly by a knowledgeable and highly regarded judiciary. In June 2013, the Delaware Court of Chancery rendered an important decision¹⁰⁷ holding that such bylaw provisions are within the power of the board of directors to adopt under Delaware law and are enforceable under Delaware law to the same extent as contractual forum selection provisions.¹⁰⁸ Prior to the Chancery Court's decision, the validity of such bylaw provisions had not been addressed by a Delaware court and at least one other court had questioned their validity.¹⁰⁹ In the wake of the Chancery Court's decision, over 100 companies have adopted exclusive forum bylaws.

While the Chancery Court's decision resolves the core issues of the facial statutory validity and contractual enforceability of forum selection bylaws under Delaware law, there are nevertheless several considerations that boards of directors should take into account in deciding whether to move forward with the adoption of such a provision:

- *Reaction of Courts in Other Jurisdictions.* It remains to be seen whether courts in other jurisdictions will honor forum selection bylaws adopted by the boards of Delaware corporations and dismiss intra-corporate suits brought in non-Delaware jurisdictions. In 2011, a federal court in California refused to enforce such a provision that had been adopted by a board without stockholder approval.¹¹⁰ That decision, however, was made without the benefit of the precedent of the recent Delaware decision. In addition, the board in that case was seeking to invoke the bylaw with respect to claims regarding events that occurred prior to the bylaw's adoption. In a recent ruling, the Delaware Chancery Court declined to temporarily enjoin a suit brought in Louisiana against a company whose charter contained a provision designating Delaware as the exclusive forum, citing potential issues of interforum comity and preferring that such a provision be first considered by the court where the plaintiff filed its litigation.¹¹¹ The court also expressed concern about a potential lack of personal jurisdiction over the plaintiff, noting that the company's forum selection provision did not specify that shareholders were deemed to have consented to personal jurisdiction in Delaware.¹¹² In light of this ruling, it would be prudent for companies to include in their forum selection provisions a shareholder consent to jurisdiction.
- *Stockholder Reaction.* It may be difficult to gauge stockholder reaction to the adoption of a forum selection provision. Since the beginning of the 2011 proxy season, fewer than 15 management proposals to amend corporate charters to add exclusive forum provisions have gone to a vote, and in almost all instances the amendments passed, generally by a narrow margin, except where there was sizable insider ownership. In addition, in 2012, two stockholder proposals seeking repeal of forum selection bylaw provisions went to a vote and both proposals failed. Now that opponents of forum selection provisions have lost on key challenges in the Delaware Chancery Court, they may focus more of their efforts on introducing stockholder proposals seeking repeal of such provisions during next year's proxy season. The Council of Institutional Investors and the AFL-CIO both have policies against the adoption of forum selection provisions.¹¹³
- *Proxy Advisory Firm Positions.* The major proxy advisory firms generally oppose forum selection provisions. In late 2012, Glass Lewis, which historically had uniformly opposed such provisions, revised its policy to provide that it will consider recommending in favor of a forum selection provision if the company (i) has a compelling argument as to why the provision would directly benefit stockholders, (ii) provides evidence of abuse of legal process in other, nonfavored jurisdictions and (iii) maintains a strong record of good corporate governance

practices. However, Glass Lewis' 2013 guidelines also provide that Glass Lewis will recommend a vote against the governance committee chair if the board adopted a forum selection provision without shareholder approval in the past year. ISS states that it reviews forum selection proposals on a case-by-case basis, taking into account whether the company has a specified set of good governance practices¹¹⁴ and whether the company discloses in its proxy statement that it has been materially harmed by stockholder litigation outside its jurisdiction of incorporation. Notwithstanding its stated policy indicating that, at least in some circumstances, a forum selection proposal can pass muster, it is clear that ISS sets a high bar. For example, in 2012, ISS supported a stockholder proposal to repeal a forum selection bylaw at United Rentals, Inc., even though the company had good corporate governance practices and included disclosure in its proxy materials about prior and pending multi-jurisdictional lawsuits. ISS stated that it was unable to determine whether the company had been "materially" harmed by the litigation.

- *Documentation.* In light of the risk of potential litigation, a board of directors adopting a forum selection bylaw should make sure that the board minutes accurately and fully reflect the board's deliberations and the reasons why the board believes the provision is in the best interests of the corporation and its stockholders.

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⁴⁹ *Id.* at p. 5.

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- Two-thirds independent board;
- Fully independent key committees;
- Established governance guidelines;
 - A company in the Russell 3000 universe must not have exhibited sustained poor total shareholder return (TSR) performance, defined as one- and three-year TSR in the bottom half of the company's four-digit GICS industry group (using Russell 3000 companies only), unless there has been a change in the Chairman/CEO position within that time. For companies not in the Russell 3000 universe, the company must not have underperformed both its peers and index on the basis of both one-year and three-year total shareholder returns, unless there has been a change in the Chairman/CEO position within that time;
- The company does not have any problematic governance or management issues, examples of which include, but are not limited to:
 - Egregious compensation practices;
 - Multiple related-party transactions or other issues putting director independence at risk;
 - Corporate or management scandals;
 - Excessive problematic corporate governance provisions; or
 - Flagrant actions by management or the board with potential or realized negative impacts on shareholders.

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⁷¹ S. Huang, *Zombie Boards: Board Tenure and Firm Performance* (July 2013), available at Social Science Research Network.

⁷² *Id.* at pp. 17-18.

⁷³ See summary of studies in G. Berberich & F. Niu, "Director Busyness, Director Tenure and the Likelihood of Encountering Corporate Governance Problems" (Jan. 2011) and in S. Huang, *supra*.

⁷⁴ PwC's 2013 Annual Corporate Directors Survey at p. 7.

⁷⁵ See Deloitte, "Creating the board your company deserves: The art – and science – to choosing directors."

⁷⁶ See, e.g., N. Kristoff, "Twitter, Women and Power," *The New York Times* (Oct. 23, 2013).

⁷⁷ ISS, 2013 U.S. Proxy Season Review: E&S Issues (Sept. 2013).

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ ISS, *supra*; The Thirty Percent Solution – Members.

⁸¹ The Thirty Percent Solution "Coalition contacts 127 Russell 100 Companies" (Feb. 5, 2013).

⁸² Catalyst, "Increasing Gender Diversity on Boards: Current Index of Formal Approaches" (2013).

⁸³ KPMG, "New Companies Act, 2013" Insight Series – Vol. V (Sept. 2013).

⁸⁴ See, e.g., Thomson Reuters, "Mining the Metrics of Board Diversity" (July 2013); Credit Suisse Research Institute, "Gender Diversity and Corporate Performance" (Aug. 2012); M. Schwartz-Ziv, "Does the Gender of Directors Matter?" (Sept. 7, 2012); Catalyst, "The Bottom Line: Connecting Corporate Performance and Gender Diversity" (2007).

⁸⁵ See Ernst and Young, *Groundbreakers Study, Diversity an Equation for Success* (2009); Credit Suisse Research Institute, *supra*.

⁸⁶ See studies cited in Credit Suisse Research Institute, *supra*.

⁸⁷ Boston Consulting Group, press release (Sept. 8, 2009).

⁸⁸ Activist Insight, "Review: a busy third quarter and a corporate fightback?," *Activist Monthly* (October 2013) at p. 1; Activist Insight, *Shareholder Activism Review 2012*, at p. 2.

⁸⁹ J. Laide, "Top Takeover Defense Changes – Companies Prepare for Most Likely Threats," *SharkRepellent.net* (Oct. 3, 2013).

⁹⁰ "Activist Investors Go Big," CFO Journal, *The Wall Street Journal* (Oct. 1, 2013).

⁹¹ *Id.*

⁹² J. Laide, *supra*. See also "Activist Investors Go Big," CFO Journal, *The Wall Street Journal* (Oct. 1, 2013).

⁹³ J. Laide, *Activists Continue to Target Larger Companies*, *SharkRepellent.net* (April 24, 2013).

⁹⁴ PwC's 2013 Annual Corporate Directors Survey at p. 9.

⁹⁵ *Id.* at 9.

⁹⁶ J. Laide, *Top Takeover Defense Changes – Companies Prepare For Most Likely Threats*, *SharkRepellent.net* (October 3, 2013).

⁹⁷ See, e.g., amendments to bylaws of McGraw Hill Financial Inc. reported on a Form 8-K filed June 26, 2013, Marathon Oil Corp. reported on a Form 8-K filed May 31, 2013 and Wynn Resorts Ltd. reported on a Form 8-K filed September 12, 2013.

⁹⁸ D. Benoit and J. Lublin, "'Golden Leash' Payments Fuel Debate," *The Wall Street Journal* (Nov. 25, 2013).

⁹⁹ Based on data provided by *SharkRepellent.net*.

¹⁰⁰ See *Hollinger International Inc. v. Black*, 844 A.2d 1022, 1061 (Del. Ch. 2004).

¹⁰¹ "J.C. Penney Mulls Action Against William Ackman," *The Wall Street Journal*, Aug. 12, 2013.

¹⁰² M. De La Merced, "Ackman Resigns From Penney's Board," *The New York Times*, Aug. 13, 2013.

¹⁰³ *Kalisman, et al. v. Friedman, et al.*, Del. Ch. Ct., C.A. No. 8447-VCL (April 17, 2013), at p. 6.

¹⁰⁴ See *Disney v. The Walt Disney Co.*, 2005 Del. Ch. LEXIS 94 (Del. Ch. June 20, 2005) (in denying access to certain documents sought by a former director exercising shareholder inspection rights under Section 220 of the Delaware General Corporation Code, the court gave "significant weight" to a written board confidentiality policy barring present and former directors from disclosing information entrusted to them by virtue of their positions, including non-public information about board discussions and deliberations).

¹⁰⁵ See *Kalisman*, *supra* at p. 8.

¹⁰⁶ Delaware General Corporation Law Section 141(b).

¹⁰⁷ *Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corporation, et al.*, C.A. No. 7220-CS, and *IClub Investment Partnership v. FedEx Corporation, et al.*, C.A. No. 7238-CS (Del. Ch. June 25, 2013). The plaintiffs appealed the decision to the Delaware Supreme Court but dropped their appeal in October 2013.

¹⁰⁸ This means that a forum selection bylaw will be enforced in accordance with the principles set forth by the U.S. Supreme Court in *The Bremen v. Zapata Off-Shore Co.* Under *Bremen*, forum selection clauses are valid provided they are “unaffected by fraud, undue influence, or overweening bargaining power” and should be enforced unless shown to be “unreasonable.” In addition, the application of a forum selection bylaw remains subject to challenge in any specific situation on grounds that the board breached its fiduciary duties.

¹⁰⁹ In 2011, a federal court in California applying federal common law refused to enforce an exclusive forum provision that was adopted by the board of directors of a Delaware corporation without stockholder approval. *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (Jan. 3, 2011).

¹¹⁰ *Id.*

¹¹¹ See transcript of Vice Chancellor Travis Laster’s decision in *Edgen Group Inc. v. Genoud*, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013).

¹¹² *Id.*

¹¹³ Council of Institutional Investors Corporate Governance Guidelines Section 1.9; AFL-CIO Proxy Voting Guidelines Section D.16 (2012).

¹¹⁴ Specifically, an annually elected board, majority voting and the absence of a non-shareholder approved poison pill.