The Legal 500 Country Comparative Guides

United States: Corporate Governance

This country-specific Q&A provides an overview to corporate governance laws and regulations that may occur in United States.

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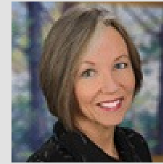

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1. **What is the typical organizational structure of a company and does the structure typically differ if the company is public or private?**

   In the United States, most public companies are organized as corporations. Private companies are typically organized either as a corporation or a limited liability company ("LLC"). Although the corporation was once the most common form of business entity in the United States, today in most states more LLCs are formed than corporations. A business entity may also be structured as a general partnership, a limited liability partnership or a sole proprietorship. However, those entity choices are far less common because of restrictions on transfers of equity and exposure to liability. In the remainder of the answers provided in this chapter of this guide, only corporations and LLCs will be addressed. Additionally, since about half of the U.S. companies listed on the New York Stock Exchange ("NYSE") are incorporated in Delaware and Delaware corporate law is the most developed, this chapter will focus on Delaware state law.

   There are two key differences between corporations and LLCs. First, they are taxed differently: corporations are subject to "double taxation," meaning that income is taxed at the company level and taxed again after it is distributed to shareholders. LLCs, on the other hand, can elect to be taxed like a corporation or to have "flow through taxation," meaning that there is no entity-level tax, but the members of the LLC are taxed on the income of the LLC on an individual level. The second material difference between the two types of entities relates to the requirements governing their operation. Corporations are required to comply with a rigid set of state laws and certain formalities. On the contrary, LLCs are subject to fewer formal requirements and are able to create a more flexible set of governing rules in their operating agreements. Private companies have more flexibility than public companies to choose between a corporation or a LLC structure.

   Corporations are created under state statutes. Corporations have a two-tier management structure consisting of the executive officers and the board of directors. The shareholders, or owners, of the corporation elect the board of directors to develop corporate strategy and oversee the executive officers. Meanwhile, the executive officers manage the corporation's day-to-day operations. This organizational structure shields the shareholders from personal liability for acts of the corporation. Like a corporation, an LLC is organized under state statutes and owners are not personally liable for the entity's obligations. Unlike a corporation, LLCs are frequently structured such that the members, either collectively or through a managing member, also manage the day-to-day operations of the company.

2. **Who are the key corporate actors (e.g., the governing body, management, shareholders and other key constituencies) and what are their primary roles? How are responsibilities divided between the governing body and management?**

   The key corporate actors and their roles vary significantly between corporations and LLCs. For corporations, there are three key actors: the board of directors, the management team and the shareholders. State corporate laws generally provide that the business and affairs of

the corporation shall be managed by or under the direction of the board of directors. Thus, the primary role of the board is one of oversight, including selecting the company's chief executive officer, developing (with management) the company's strategy and overseeing risk management. The management team is tasked with carrying out the strategy, managing risk and operating the company on a day-to-day basis. Shareholders generally own equity interests in the company and, among other rights, typically elect directors onto the board. Most shareholders of public companies are passive investors who are not employees and do not have a direct role in the company's operations while shareholders in smaller, private companies are sometimes employed in some capacity by the company.

While the exact structure and key actors for LLCs can vary widely based on the terms of the LLC's operating agreement, there are two typical LLC structures: manager-managed and member-managed. The key actors in a manager-managed LLC are the manager(s), executive officers and member(s). Subject to the terms of the governing documents, LLC manager(s) typically function like the board of directors of a corporation. Manager(s) appoint executive officers and oversee the executive officers' operation of the company. Members are the owners of the LLC and much like the shareholders of a corporation, they are sometimes passive investors who only elect the manager(s) or are also employed by the LLC in some capacity.

Member-managed LLCs, on the other hand, are owned and managed by the members themselves.

3. **What are the sources of corporate governance requirements?**

Corporations and LLCs are both formed and governed under state law. Each state has a set of laws that determine the rules for forming an entity, managing an entity and issuing equity interests of an entity. Delaware is the state of choice for most companies because Delaware case law is highly developed and a special court is dedicated to corporate law. Many other states model their corporate law after Delaware's and use Delaware case law to interpret their own statutory provisions.

In addition to state law, a variety of federal statutes provide corporate governance requirements for U.S. corporations. The Securities Act of 1933 and the Securities Exchange Act of 1934 impose requirements related to disclosures, audit committees and the process for offering and selling securities, which are generally regulated by the U.S. Securities and Exchange Commission ("SEC"). Record-keeping and accounting requirements for companies are also set forth in the Foreign Corrupt Practices Act of 1977. Pursuant to this federal statute, companies are required to maintain a system of internal accounting controls and monitor compliance within the company.

Further, public companies' shares are typically traded on a national stock exchange such as the NYSE or the National Association of Securities Dealers Automated Quotations ("NASDAQ"). These stock exchanges have their own listing requirements that regulate

corporate governance matters. For example, the stock exchanges require companies to adopt governance guidelines and certain codes of business ethics and conduct. The listing requirements also govern board and committee composition and charter requirements.

Corporations are also governed by their internal constituent documents, typically a certificate of incorporation and bylaws (together, the “Charter Documents”). Charter Documents define the authority and responsibilities of the board of directors and executive officers and the shareholders’ rights and powers. Similarly, the responsibilities of an LLC’s governing body and the rights and powers of its members are typically set out in an operating agreement. A corporation’s Charter Documents and an LLC’s operating agreement may enlarge the statutory corporate governance requirements, or opt out of certain corporate governance requirements if state law permits.

Two more recent federal statutes were passed in response to major corporate mishaps. The Sarbanes-Oxley Act of 2002 was adopted on the heels of widely publicized accounting scandals that occurred in the United States. This statute imposes heightened disclosure and governance requirements for publicly held companies. The more recent Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) followed the financial crisis in 2008 and 2009. The Dodd Frank Act gave the SEC the ability to promulgate additional rules regarding corporate governance matters. Many of these rules operate to give shareholders more power in governance matters. For example, one rule that arose out of the Dodd-Frank Act was “say-on-pay,” which gives shareholders of public companies the right to cast an advisory vote on the company’s executive compensation.

4. **What is the purpose of a company?**

Companies are typically formed for five main purposes. First, if properly established and operated, corporations and LLCs protect the equity holders (or owners) from liability for actions of or omissions by the company. Second, a well drafted set of governing documents and existing state and federal laws provide structure for operating the company and clearly define the rights of the owners and operators. Third, establishing a company can lead to tax savings on the business’ income. Fourth, forming an entity is the preferred method of aggregating capital to make investments. And finally, a properly formed entity can provide legitimacy to a business and encourage customer and shareholder confidence.

More broadly, there has been discussion and debate about whether the purpose of companies should be to maximize shareholder value or if instead companies should have a more general purpose to consider and balance the interests of all of the company’s stakeholders. While frequently presented as an either or choice, many believe that maximizing long-term shareholder value necessarily requires companies to consider the effect a company’s actions will have on other stakeholders, with the view that it is not possible to have sustainable long-term value creation without considering the interests of the company’s other stakeholders. In addition, most states have adopted so-called “constituency statutes,” which generally permit (but do not require) boards of directors to consider the interests of stakeholders other than

shareholders when making business decisions.

Many states also explicitly provide companies with the ability to be registered as benefit corporations, which are entities that have a stated purpose of creating public benefit in addition to maximizing shareholder value. There have been recent efforts to try an establish similar requirements at the federal level.

5. **Is the typical governing body a single board or comprised of more than one board?**

The typical governing body of a corporation is one board that oversees the management team's operation of the company. A board can consist of anywhere from 1 to 15 or more directors and is often comprised of individuals with a wide variety of skill sets that are relevant to the company. Currently, 72 percent of the boards of companies included in the S&P 500 Index have between 9 and 12 directors. Some boards elect all directors annually and others have longer, staggered terms (typically three years).

Manager-managed LLCs are governed by either a single manager or one board of managers. A member-managed LLC has no governing body but is instead managed by all of the members of the LLC or a managing member.

6. **How are members of the governing body appointed and removed from service?**

For corporations, a slate of directors is nominated by the current directors (and, under certain special circumstances, the shareholders) and then elected by shareholder vote. The terms for removal of a director vary by corporation and are governed by state law and the corporation's Charter Documents. Typically, directors can be removed by a vote of a majority (or supermajority) of shareholders. Most corporations allow for directors to be removed without cause so long as the requisite vote threshold is met, but some corporations, if state law allows, restrict removal to cause. In Delaware, a board must be elected to staggered terms in order to restrict removal of directors to cause.

The terms for appointing and removing managers of a LLC are determined by the company's operating agreement but tend to be similar to those of corporations.

7. **Who typically serves on the governing body and are there requirements that govern board composition or impose qualifications for directors regarding independence, diversity or succession?**

While there are no general laws imposing requirements for serving on the board of a corporation, certain stock exchange listing standards impact board composition for publicly traded companies and shareholder expectations significantly influence board composition for all companies.

For corporations with securities listed on either the NYSE or NASDAQ, the majority of the board must be comprised of independent directors. An independent director is generally a director who is not an employee or executive officer of the company and who has no current or prior relationship with the company that would interfere with an independent exercise of judgment. Additionally, it is common for the CEO to serve on the board as a non-independent director.

For all corporations, including those not listed on any exchange, shareholders' expectations and public opinion influence board composition. If ignored, corporations expose themselves to shareholder activism, negative public opinion and other consequences.

For example, there has been recent pressure from shareholders to increase board diversity, including diversity of the directors' experience, gender, age, ethnicity and tenure. Due in part to this pressure from shareholders, diversity on boards has increased over the last decade. The 2018 U.S. Spencer Stuart Board Index ("SSBI") reports that the percentage of new female independent directors joining S&P 500 boards increased from 18 percent in 2008 to 40 percent in 2018. Additionally, approximately 90.5 percent of the top 200 companies now have at least one minority director, defined as African-American, Hispanic/Latino and/or Asian.

Directors can come from a variety of backgrounds depending on a corporation's needs. Typical backgrounds include current or retired corporate or financial executives, academics, consultants or, increasingly, individuals with careers in the technology or telecommunication sector.

Whether there are requirements or qualifications for serving as a manager of a LLC is governed by the terms of the LLC operating agreement. Typically, LLCs are not subject to the same constraints as corporations in selecting managers.

8. **What is the common approach to the leadership of the governing body?**

For corporations, there are two common approaches to board leadership. Some corporations have an independent or non-executive director serve as the chairman. Other corporations have the CEO serve as the chairman. Corporations that choose to combine the CEO and chairman roles typically appoint a lead independent director to serve as the representative of the independent directors with specific duties and responsibilities. Regardless of which approach a corporation adopts, the chairman of the board is elected by the directors to serve as the board's leader, to run meetings and to serve as the liaison between the board and management.

LLCs may choose to structure the governing body's leadership in any way. The leadership structure is determined by the LLC operating agreement and can vary widely for each LLC.

9. **What is the typical committee structure of the governing body?**

    Most corporate boards have various supporting committees comprised of directors that make recommendations to the entire board. The typical standing committee structure for a public company includes an audit committee, a nominating and corporate governance committee and a compensation committee. In some cases, the board of directors may choose to add a finance committee, a public responsibility committee or other specialized committee and, occasionally, an executive committee. These committees are most often comprised of directors who have professional experience related to the topic of the committee. The Securities Exchange Act of 1934 and stock exchange listing standards require certain committees to have at least one expert on the committee's subject matter (i.e. a financial expert on the audit committee) or a certain number of independent directors.

    An LLC may or may not have the same committees as a corporation. Whether an LLC has committees will depend on the size of the LLC and the purpose of the LLC. Generally, an "operating" LLC will have a more developed board or committee structure than an LLC created simply to hold the assets of other legal entities. As is the nature of LLCs, an LLC governing body and its committees can be set up as the members see fit.

10. **How are members of the governing body compensated?**

    Directors of corporations are normally compensated through cash payments, equity awards and/or a combination of the two. Most commonly, a company will set an annual cash retainer for directors. This retainer may be supplemented by additional payments for meeting attendance and chairing the board or a committee. Often, directors are also compensated through equity grants, including stock options in order to align the directors' interest with those of the corporation's shareholders. Many boards require directors to hold a certain multiple of their cash retainer in the company's equity, and some companies require recently elected directors to hold their entire annual retainer as equity in the company until the director meets the mandated equity threshold.

    Compensation practices for the governing body of an LLC may reflect those of a corporation, or the members of the governing body may establish alternative compensation structures.

11. **Are fiduciary duties owed by members of the governing body and to whom are they owed?**

    Directors on a corporate board owe fiduciary duties of care and loyalty to the corporation. This generally means that directors have a duty to act in a reasonably well-informed manner in the best interests of the corporation and its shareholders. Directors are entitled to rely on information from management and on the opinions of experts in reaching their decisions.

    In ordinary circumstances, business decisions made by the board or individual directors are subject to what is known as the "business judgment" rule. This means that courts will not

second guess the decisions of a director or board if the decisions were made in good faith, with the care that a reasonably prudent person would use and with a reasonable belief that the decision was in the best interests of the corporation and its shareholders. While there are heightened standards of review that apply to decisions or actions that entrench directors or disenfranchise equity holders, in ordinary circumstances, courts are generally very deferential to the business judgment of a board. Depending on the circumstances, the heightened standards of review require that the director's decisions be reasonable in relation to the threat posed or offer a compelling justification if the primary purpose of an action is to interfere with a shareholder vote.

The duty of loyalty requires directors to be disinterested and to perform their duties independently. Additionally, all director action must be supported by a good faith and honest belief that it is in the best interest of the corporation and the corporation's shareholders. If an action implicates the duty of loyalty, the director must demonstrate that the action was entirely fair to the corporation and its shareholders. If a director intends to act, but may have a conflict of interest, the duty of good faith or candor requires the director to fully and accurately disclose the conflict.

Whether a manager or member owes a duty of care to an LLC is governed by the terms of the LLC operating agreement. Unlike corporations, LLCs can explicitly state that managers or members do not owe any duties to the company, including the duty of care and the duty of loyalty.

12. **Do members of the governing body have potential personal liability? If so, what are the key means for protecting against such potential liability?**

Corporate directors may face personal liability for their actions on behalf of the corporation if they breach the duty of loyalty, act in bad faith, engage in intentional or illegal misconduct or conflicted transactions. Directors may be sued directly by a shareholder, or a shareholder may bring a derivative suit against them. A derivative suit is a lawsuit brought on behalf of the corporation.

There are three ways a director may be protected from personal liability. First, under the laws of some states, a company can implement an exculpation provision in its Certification of Incorporation that eliminates personal monetary liability for breaches of the duty of care. Second, a corporation can implement an indemnification provision in its Certificate of Incorporation, in its bylaws, by contract or by shareholder vote that mandates that the company repay the indemnitee for liability associated costs and costs of defense. Indemnification provisions generally only apply to actions in good faith that are reasonably believed to be in the best interests of the company. In the case of claims by or on behalf of the company, indemnification is limited to the cost of a successful defense. Third, a corporation may obtain liability insurance on behalf of its directors and officers.

LLC management may face the same issues as directors on a corporate board. An LLC can

apply any of the same limitations on its managers that a corporation may place on personal liability of directors.

13. **How are managers typically compensated?**

The management team or officers of both corporations and LLCs are typically compensated with a mix of three different types of compensation: base salary, bonuses and equity awards.

Members of management usually receive a fixed, annual salary for their efforts on behalf of the company. In smaller corporations and LLCs, this method is the most common as it does not dilute or weaken the equity ownership of the original owners or ownership group. In addition to the annual salary, members of management are often granted bonuses at the end of the company's fiscal or calendar year. Bonuses can be subject to the board's discretion or based on specific, clearly defined targets. Bonuses may be paid in cash, equity or a combination of the two.

Equity compensation may include, among other items, stock options, restricted stock awards, restricted stock units or stock appreciation rights. Equity awards can be short-term or long-term and typically incentivize management to maximize share (or, in the case of LLCs, membership interest) value. Stock options and stock appreciation rights are viewed as further incentivizing value expansion and shareholder maximization since these awards usually correspond directly to the growth of equity value. Finally, restricted stock awards and restricted stock units grant stock to a member of management upon completion of certain benchmarks such as continued employment with the company or achievement specified performance goals.

14. **How are members of management typically evaluated?**

Management is evaluated in a number of ways, ranging from quantifiable, data-driven metrics to more qualitative metrics. The board usually evaluates the CEO and the CEO typically evaluates the other executive officers. Generally, a company will take into account some combination of bottom-line impact, operational results and leadership value. Bottom-line effect is the most common way management is evaluated. Management will be given a target (usually a financial target) for corporate performance and will be measured based on progress toward achievement of that target. Management may also be evaluated based on operational results, such as "increase in customer engagement" or "expansion into new markets," which are not necessarily directly correlated with a clear financial or performance target. In addition, management may be evaluated based on leadership value. Companies may reward members of management for qualitative metrics, such as building new business, developing subordinate employees or generating long-term growth.

15. **Do members of management typically serve on the governing body?**

One or more members of management generally serve as a member of the governing body in

both corporations and LLCs. In LLCs and smaller corporations, it is not uncommon for the CEO (or a similarly responsible party by a different name) to serve as the chair of the board as well. In large or publicly traded companies, the CEO typically serves on the board and may also serve as the chair of the board, however, many companies have begun to separate these responsibilities and appoint an independent or non-executive director as the chair of the board. According to the SSBI, in 2018, 50 percent of S&P 500 boards split the CEO and chair roles, and 30 percent of S&P 500 boards had a director who met applicable independence requirements as chair. In instances where the CEO serves as the chair of the board, the company will typically appoint a lead independent director.

16. **What are the required corporate disclosures, and how are they communicated?**

Public companies are required to make disclosures based on rules and regulations promulgated by the SEC and the applicable stock exchange. These required disclosures are intended to timely provide investors with information that would be material to an investment or voting decision and include annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements related to annual and special meetings of shareholders and certain other reports disclosing changes in beneficial ownership of company equity securities. The required disclosures are publicly filed with the SEC and are also available on the company's website.

Companies, both private and public, may also be required to make certain disclosures in accordance with the terms of debt and equity financings. These disclosure requirements are set forth in the applicable transaction documents (i.e. credit agreements, indentures and stock purchase agreements) and typically include providing investors with periodic financial statements and disclosure of material events.

17. **How do the governing body and the equity holders of the company communicate or otherwise engage with one another?**

In recent years, there has been a significant increase in the number of U.S. companies reporting shareholder engagement, with only 6 percent of S&P 500 companies reporting engagement with shareholders in 2010, compared to 72 percent in 2017. This engagement takes a variety of forms.

A primary way shareholders engage with a company's governing body is by submitting proposals for consideration by other shareholders at annual and special meetings of the equity holders and voting on matters put to a vote of the equity holders. As discussed in more detail in response to Question 21, subject to meeting certain requirements, shareholders may present proposals for consideration at shareholders meetings. Shareholders use the proposal process as an avenue to communicate to the governing body and other shareholders about a wide variety of matters related to, among other things, corporate governance, executive compensation, director elections and more general environmental and social issues.

In addition, public companies are required to present certain matters to their shareholders for approval, including, among other things, election of directors, certain material transactions and changes to Charter Documents and non-binding approval of executive compensation (known as “say-on-pay” votes). Some votes by shareholders are binding on the company, while others are non-binding. In either case, the voting results help inform the governing body with respect to the wishes of the equity holders of the company.

Companies also engage with shareholders on a more informal basis by participating on investor calls and in one-on-one meetings with investors. This engagement historically was concentrated in the proxy season, but now takes place year round, and there has been a significant increase in engagement in the proxy “off season,” when companies often engage with investors on the results of the most recent meeting of shareholders, continuing issues of importance to the shareholders and matters likely to be presented at the next meeting of shareholders.

Outside of the proxy process, SEC rules require public companies to disclose in their proxy statements how security holders can communicate with a company’s board of directors (or the company website where such information may be accessed) or, if there is no such process in place, why the board of directors believes not having such a process is appropriate. In addition, companies listed on the NYSE are required to disclose a method for interested parties to communicate directly with the presiding director or with non-management or independent directors as a group. The SEC, NYSE and NASDAQ also require audit committees to maintain procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters and the submission by employees of concerns regarding such matters on a confidential, anonymous basis.

18. **Are dual or multi-class capital structures permitted and how common are they?**

Dual- or multi-class capital structures are permitted in the United States. Dual-class structures divide a company’s equity into two or more different classes with distinct rights and characteristics. Typically, one class of shares will have significantly more voting power than the other. In comparison, the more common single-class structure gives all shareholders equal equity and voting power.

The vast majority of U.S. publicly listed companies have a “one share, one vote” structure. However, a growing number of companies are going public in the United States with dual-class structures. Nearly 20 percent of U.S. companies going public in 2017 had a dual-class share structure, compare to just 1 percent in 2005.

However, there have been recent efforts to curtail the use of dual and multi-class structures for public companies in the United States. In 2017, S&P Dow Jones banned companies with dual- or multi-class capital structures from being listed on many of its indices (although companies currently on the indices are permitted to be grandfathered) and the FTSE Russell announced it would begin excluding companies that have a public float constituting less than

5 percent of the company's total voting power. In October 2018, the Council of Institutional Investors ("CII") petitioned both the NYSE and NASDAQ to amend their listing standards to require listed companies to provide in their charters that the share structure will convert automatically to a one-share, one-vote structure no more than seven years after the date of a company's initial public offering, subject to extension by a vote of a majority of the outstanding shares of each share class, voting separately, on a one-share, one-vote basis.

19. **What percentage of public equity is held by institutional investors versus retail investors?**

Ownership of public corporations has changed dramatically in the past few decades. In 1970, private individuals held approximately two-thirds of U.S. equities. In 2017, two-thirds of total outstanding U.S. equities were controlled by institutional investors like BlackRock, Vanguard and State Street. Currently, institutional investors own about 78 percent of the market value of the U.S. broad-market Russell 3000 index, or about $21.7 trillion. Likewise, institutions own about 80 percent of the market cap of the large-cap S&P 500 index, or $18 trillion, and between 70 and 85.8 percent of the market cap of the 10 largest U.S. companies. In addition, 42 percent of all U.S. stock fund assets as of June 30, 2017 were held in index funds.

20. **What matters are subject to approval by the shareholders and what are the typical quorum requirements and approval standards? How do shareholders approve matters (e.g., voted at a meeting, written consent)?**

Common stock ownership in a publicly-traded company typically comes with the right to vote on certain corporate matters pursuant to state law, stock exchange listing requirements and the company's Charter Documents. While the nature of the rights and the specific issues shareholders are entitled to vote on can vary from company to company, shareholder approval is typically required to:

- elect the board of directors;
- amend organizational documents, such as the Certificate of Incorporation;
- enter into fundamental corporate transactions, such as a proposed merger or acquisition;
- alter certain stock ownership rights, such as establishing or amending stock option plans or stock splits;
- permit interested director transactions;
- set certain executive compensation packages; and
- make fundamental structural changes or shifts in corporate aims.

Shareholders can exercise their voting rights by attending the company's annual meeting of shareholders or at a special meeting convened in accordance with the company's organizational documents. Alternatively, shareholders can appoint a proxy to vote their shares by completing and returning the proxy cards provided to them by the company by mail or electronically prior to the meeting date. Corporate bylaws typically require a quorum for shareholder action to be taken at a meeting. A quorum generally means that the shareholders present or represented at the meeting own over half of the company's shares. A simple

majority (i.e., more than 50 percent of outstanding shares voting or present at the meeting) is the most common requirement to approve a resolution. A company's organizational documents may require a greater percentage of votes to approve certain exceptional resolutions, such as a merger or amending the organizational documents. A company's organizational documents may also require a plurality vote for director elections (i.e., a nominee only needs to get more votes than a competing candidate, not a majority of the votes cast in his or her election).

Shareholders may also act by written consent under certain circumstances as described below.

21. **Are shareholder proposals permitted and what requirements must be met for shareholders to make a proposal?**

Shareholder proposals are resolutions proposed by a shareholder to be presented and voted on at a meeting of the company's shareholders. Shareholder proposals are permitted in the United States, and are frequently submitted on many governance topics (including board declassification and shareholder rights to act by written consent and call special meetings) as well as social topics (such as sustainability reporting, gender pay gaps and board and employment diversity).

In the 2018 proxy season, the overall number of shareholder proposals submitted decreased 5 percent to 788, but the average support for proposals voted on increased by almost 4 percent to 32.7 percent, in part due to increased institutional investor support. In recent years, more shareholder proposals have focused on environmental, social and corporate governance issues, as well as investment policies and practices and corporate strategy and operations.

The SEC has established rules governing the submission and inclusion of shareholder proposals in a company's proxy materials (Rule 14a-8, promulgated under the Securities Exchange Act of 1934). To be eligible to submit a proposal under Rule 14a-8, a shareholder must satisfy certain minimum share ownership requirements leading up to and through the date of the meeting. In addition, the shareholder must properly submit the proposal to the company within a certain timeframe. The SEC rules require a company to provide submission deadlines, proposal requirements and contact information for submitting a shareholder proposal in the company's proxy statement for its most recent annual meeting. Once a proposal is properly submitted, the SEC rules require the company to add the proposal to the agenda for the next annual meeting of shareholders, unless the proposal is excludable based on one of thirteen possible bases for exclusion specified in Rule 14a-8. The company has the burden of demonstrating that it is entitled to exclude the proposal. If the proposal is included in the proxy statement, the submitting shareholder or a designated representative must personally present the proposal at the shareholders' meeting.

Shareholders who do not want to, or are not able to, use the company's proxy materials may

circulate their own proxy statement and proxy card at their own expense. Shareholders must give the company at least 120 days advance notice of their proposal.

Under state law, shareholders also typically have the right to present a shareholder proposal for consideration at a shareholder meeting (rather than including the proposal in the company's proxy materials) if the advance notice and other requirements of the company's Charter Documents or operating agreement are met. Shareholders of public companies, however, do not typically make a proposal from the floor since nearly all public company shareholders vote by proxy and the proxy holders (generally members of management) have the right to vote in their discretion on any matter that properly comes before the meeting but is not set forth in the proxy statement.

22. **May shareholders call special meetings or act by written consent?**

A special meeting is a meeting of shareholders outside the usual annual meeting cycle that is called to discuss specific matters stated in the notice of the meeting. Under the laws of certain states, special meetings may only be called by the board of directors, unless otherwise provided by the certificate of incorporation or the bylaws. Most organizational documents also give the chairman of the board and the CEO the right to call a special meeting. Companies' Constituent Documents can also allow shareholders to call a special meeting, typically by requiring the CEO or corporate secretary to call a special meeting upon the written request of the holders of a certain percentage of outstanding shares. Other states are more permissive. California, among others, requires its corporations to allow shareholders to call a special meeting upon the demand of a certain percentage of outstanding shares, frequently 10 percent. Once called, the company can schedule a meeting at its convenience, subject to most of the same notification requirements for a regular annual meeting.

In certain states, including Delaware, shareholders may act by written consent, without a meeting, if the consent is signed by the holders of shares having at least the minimum number of votes that would be necessary to authorize the action at a meeting. Companies may preclude shareholders from taking action by written consent by explicitly prohibiting shareholder written consents, or requiring unanimous written consent, in their certificate of incorporation.

23. **Is shareholder activism common and what are the recent trends?**

Shareholder activism is a way that shareholders can influence a corporation's behavior. Activism can range from proxy contests to replace the entire board to shareholder proposals to requests for dialogue or meetings with management or the board.

Shareholder activism reached record levels in the first half of 2018 in terms of board seats gained, capital deployed and number of campaigns mounted. While well-known activist investors like Elliott Management and Icahn Partners continued to account for a large portion

of activist campaigns, a wider group of investors have begun to employ activist techniques. In particular, institutional investors are becoming central and vocal players in efforts to influence corporate governance policy and decision-making.

Activist campaigns often focus on one or more of the following objectives:

- Capital reallocation: The return of capital to shareholders through a share repurchase or dividend;
- Business transaction: The sale of the company or spin-offs or divestitures; also mergers with desired targets (sometimes other holdings of activist);
- Governance change: Change of CEO or board of directors; and
- Operational change: Improvements in cost profile and other metrics; often coupled with proposed change in target leadership

24. **What is the role of shareholders in electing the governing body?**

Shareholders are entitled to elect the board, although a nominating committee or entity of the company is typically responsible for selecting and nominating directors for election by shareholders. A shareholder who disagrees with the board's strategic direction and management of the company may nominate an alternative slate of director nominees to try to install its own board members and take control of the board. In a contested director election, the company and the activist shareholder compete for the proxy votes of the other shareholders.

Generally, a company's bylaws establish requirements for director elections. Directors are typically elected by a majority voting standard or a plurality voting standard. Under a majority voting standard, each director must receive the support of more than 50 percent of the shares voting or present at the meeting. Under a plurality voting standard, a director only needs to receive more votes than a competing candidate to be elected, even if he or she does not get a majority vote.

Directors may be elected on an annual or staggered basis. A staggered board of directors, or "classified" board, has separate "classes" of directors who are elected for multiple-year terms, with one class coming up for re-election each year.

25. **Are shareholder meetings required to be held annually or otherwise, and what information needs to be presented?**

Every state requires a corporation to have an annual shareholders' meeting. In addition, the NYSE requires its listed corporations to hold an annual shareholders' meeting during each fiscal year, and NASDAQ requires its listed corporations to hold an annual shareholders' meeting no later than one year after the end of the corporation's prior fiscal year. Typically, a company's organizational documents will also require an annual meeting and designate the time and place of the meeting. The annual meeting is necessary to elect the board of

directors and conduct other business on behalf of the company.

A public company must comply with the SEC's proxy rules when its management submits proposals to a shareholder vote. Typically, companies provide a proxy card to shareholders, which, when executed, grants to the company the authority to vote the shareholders' shares at the meeting as designated on the card. The proxy card must be accompanied by certain disclosures in a proxy statement, including a description of matters to be submitted to a shareholder vote (including properly submitted shareholder proposals) and management and executive compensation information. The proxy rules also require the company to send an annual report to shareholders if there will be an election of directors at the meeting. If a shareholder vote is not being solicited and action has been taken by the written consent of a majority of shareholders instead of voting at an shareholder meeting, the company must instead provide shareholders with an information statement that is similar to a proxy statement. Lastly, the proxy rules also require the company to provide shareholder lists to investors.

26. **Do any organizations advise or counsel shareholders on whether to approve matters?**

A proxy advisory firm is an organization that provides to its shareholder clients data and analytics services, as well as recommendations on certain voting decisions. Two prominent proxy advisory firms are Institutional Shareholder Services ("ISS") and Glass, Lewis & Co. ("Glass Lewis"). Certain shareholders, namely smaller and medium-sized institutional investors, rely on proxy advisory firms to help them determine how to vote on proposals in company proxy statements. A recent study conducted by Harvard Law School indicates that institutions vote in accordance with ISS and Glass Lewis recommendations more than 80 percent of the time (on average) when the proxy advisors both recommend in favor of a proposal. The role of proxy advisors has been somewhat controversial in recent years as concerns have arisen over their significant impact on investor voting, factual errors in their voting reports and potential conflicts of interest.

The SEC has adopted rules under the Investment Company Act requiring investment advisers to vote securities in the best interest of their clients. Previous no-action letters from the SEC Staff have suggested that investment companies can rely on proxy advisory firm recommendations to fulfill this obligation to their clients. Recently, these no-action letters have been rescinded, but the impact of this development remains unclear.

27. **What role do other stakeholders, including debt holders, employees, suppliers and customers and the government, typically play in the corporate governance of a company?**

Companies have many constituencies other than their equity holders, including debt holders, employees, suppliers, customers and the community in which the company does business. The role these other stakeholders play in corporate governance varies from company to

company, but having policies and practices in place that help ensure companies treat their employees, customers and suppliers fairly and equitably and encourage companies to be good corporate citizens are generally thought to be important corporate governance practices to help achieve long-term value creation. Such policies and practices with respect to different stakeholders and the role those stakeholders may play in the corporate governance of a company include, among other things, the following:

Employees. In order to foster a productive work environment and a culture of compliance, companies should provide employees with effective methods of alerting management and the board to misconduct without the fear of retaliation. Companies also should communicate honestly with employees about the company's operations and financial performance and should fully inform employees about the benefits the company provides to them.

Suppliers and Customers. Companies generally have policies setting forth the requirements for engaging with suppliers and customers in a compliant and fair manner. These relationships can be vitally important, because, depending on the industry, customers and suppliers can be the driving force in product innovation, competition and price fluctuations.

Communities. While external stakeholders, such as the community in which the company operates, may have less of an influence on the company, they can be a valuable resource and the sustainability and success of these stakeholders can also be important to the long-term success of the company. Therefore, companies generally try to maintain open communications with local members of the community and to conduct their business with regard to the environmental, health, safety and other sustainability issues relevant their operations.

Debt Holders. Depending on the applicable debt agreement, debt holders can impact a company's ability to make distributions to shareholders or enter into new transactions, including creating additional debt obligations on the company, which may affect the corporate governance practices of a company.

28. **What consideration is given to environmental and social issues, including climate change, sustainability and product safety issues, and are there any legal disclosure obligations regarding the same?**

Companies should strive to be good corporate citizens, including being responsible stewards of the environment and considering other relevant sustainability and societal issues in operating their businesses. Many companies in the United States voluntarily publish annual sustainability reports or corporate responsibility reports, which typically give information about a company's environmental, social and governance objectives and performance.

The focus on such reporting has increased in recent years as shareholders and other stakeholders have pressed companies, through the use of shareholder proposals and other

engagement, to focus on more environmental and social issues. The issues companies are now facing and addressing are as diverse as deforestation, corporate clean energy goals, climate change, the uses of antibiotics and pesticides, political contributions, human rights risks through the supply chain, indigenous rights and human trafficking, cybersecurity, the development and reporting of sustainability metrics, and tax fairness.

In addition to the increased pressure on companies to provide more disclosure, there has been increased pressure on the SEC to require more disclosure addressing environmental and social issues. Currently, companies must disclose when they face material risks or known liabilities (including certain environmental litigation) as a result of environmental and social issues and they must include in their proxy materials eligible shareholder proposals that address environmental and social issues. However, there are no other specific disclosure requirements with respect to environmental and social issues mandated by the SEC. There have been several petitions to the SEC in recent years to request more required disclosures regarding environmental and social matters, including a petition filed with the SEC in October 2018 calling for the SEC to develop a comprehensive framework requiring public companies to disclose identified environmental, social, and governance aspects of the company's operations.

29. How are the interests of shareholders and other stakeholders factored into decisions of the governing body?

Public companies are focusing much of their resources to identifying and understanding their shareholders, particularly large institutional investors. In recent years, large institutional investors have come to expect that boards of directors maintain a formal shareholder engagement policy in addition to shareholder engagement plans. Companies are also playing close attention to their retail investors by establishing policies and plans that are inclusive of all shareholders and broadening their scope to go beyond shareholder meeting agendas or large transactions.

With policies and plans in place, companies use their engagement efforts to determine the level of disclosure, beyond what is required by the SEC, to include in their SEC filings, and how they will report on recent transactions and company benchmarks, whether that be through investor meetings, investor calls, webcasts, or other use of social media platforms.

Beyond voluntary shareholder engagement, boards of directors owe specific fiduciary duties to their shareholders. In fulfilling their managerial responsibilities, boards of directors are charged with certain fiduciary duties, primarily the duty of care and the duty of loyalty, which focus on the best interests of the shareholders. Courts, however, have generally held that board of directors generally do not owe fiduciary duties to other constituencies, like creditors, whose rights are contractually based. An exception arises when a company nears insolvency or becomes insolvent, in which case, directors may owe fiduciary duties to creditors. Additionally, some states have adopted statutes focusing on "other constituencies," which allow directors to consider the interests of non-shareholder constituencies, such as

creditors, employees, suppliers and others in making corporate decisions.

30. **Do public companies typically provide earnings guidance on either a quarterly or annual basis?**

Many public companies provide earnings guidance on a quarterly basis. Earnings guidance are forecasts issued by companies about how they expect to perform in the next quarter. The goal of earnings guidance is to provide shareholders and investors with helpful insight that they can use to evaluate the company's earnings potential. Company-issued earnings guidance is different from required quarterly reporting, which is reporting of a company's results for a completed quarter, or consensus estimates, which are reports of earnings performance forecasts from external analysts.

Recently, there have been a growing number of calls for companies to stop providing quarterly earnings guidance in an effort to mitigate the effects of "short-termism," which prioritizes short-term goals over a focus on long-term results. Others have gone further calling for the end of all quarterly reporting. Despite this recent focus on quarterly reporting, the pace of quarterly earnings guidance does not appear to have slowed as of yet. In 2017, 146 companies in the S&P 500 provided earnings guidance 444 times, and through September 12, 2018, 128 companies in the S&P 500 had provided earnings guidance 321 times. In December 2018, however, the SEC issued a request for comment on earnings releases and quarterly reporting, which may result in changes to the quarterly reporting regime.

31. **May public companies engage in share buybacks and under what circumstances?**

Yes. A share buyback refers to the repurchasing of shares on the open market, or from company shareholders directly, by the company that issued them. While the SEC imposes liability for fraudulent practices, including share buybacks, Rule 10b-18 promulgated under the Exchange Act offers a safe harbor for companies seeking to repurchase their own shares. To be eligible for the safe harbor, the company must meet four conditions: (1) the company must purchase all shares from a single broker or only deal during a single day; (2) the company, with an average trading volume of less than $1 million per day or a public float of less than $150 million, cannot trade within the last 30 minutes of trading on a given trading day (companies above these amount can trade until the last 10 minutes); (3) the company must repurchase the shares at a price that does not exceed the highest independent bid or the last transaction price quoted (whichever is higher); and (4) the company cannot purchase over 25 percent of the average daily volume. Typically, the company pays the shareholders, with company profits, cash reserves, or borrowed money, the market value per share and re-absorbs that portion of its own ownership that was previously distributed among outside investors.

In recent years, companies have been more likely to choose share buybacks instead of issuing dividends to distribute cash to shareholders. Although this process, generally, can be viewed

as redistribution, rather than additional distribution of cash away from the companies, some have argued that share buybacks are neither good for the companies nor the economy.

32. **What do you believe will be the three most significant issues influencing corporate governance trends over the next two years?**

We believe corporate governance trends will focus on the following issues over the next two years: (1) corporate social responsibility and environmental matters, with a particular emphasis on sustainability, (2) board diversity, (3) management accountability and continued transparency and shareholder engagement from boards of directors, (4) the role of index funds in governance, and (5) a continued focus on long-term perspectives over short-term goals.