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MAY 10, 2017

# GOVERNANCE AND DISCLOSURE: 2017 LESSONS, 2018 EXPECTATIONS

*Energy Finance Series*

velaw.com



# TODAY'S PANEL



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## DISCUSSION TOPICS

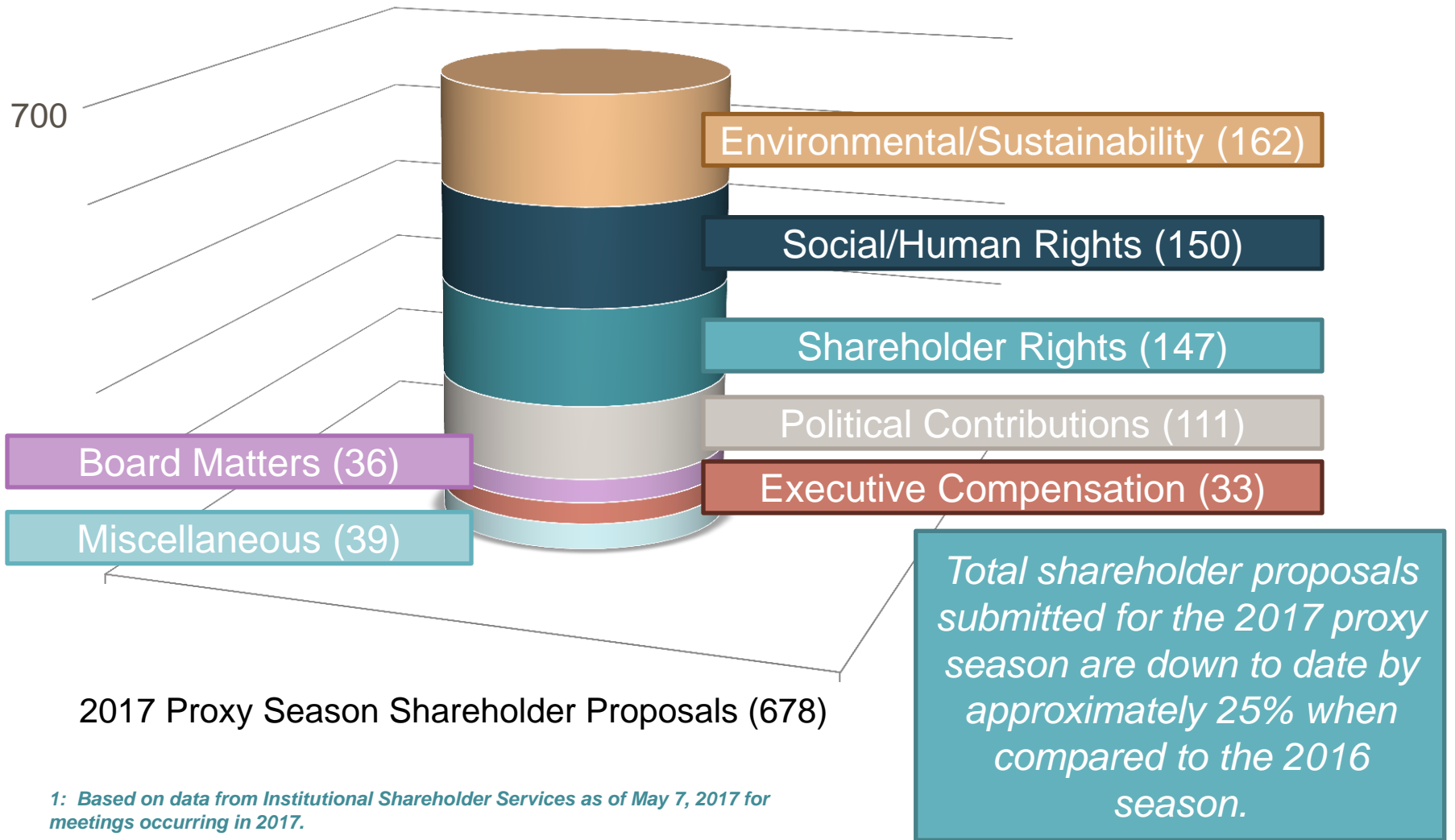
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# THE 2017 PROXY SEASON

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# SHAREHOLDER PROPOSALS UPDATE

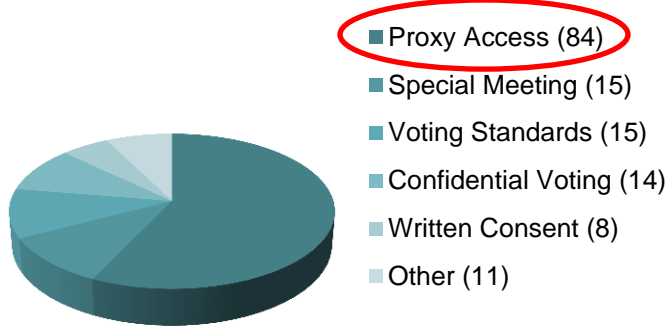
## SHAREHOLDER PROPOSALS FOR THE 2017 PROXY SEASON<sup>1</sup>



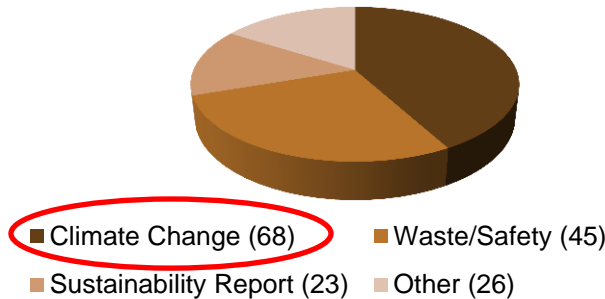
# SHAREHOLDER PROPOSALS UPDATE

## TOP PROPOSAL TOPICS OF THE 2017 PROXY SEASON<sup>1</sup>

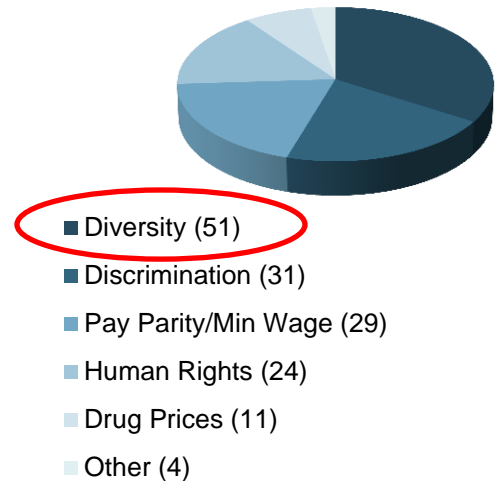
### Shareholder Rights (147)



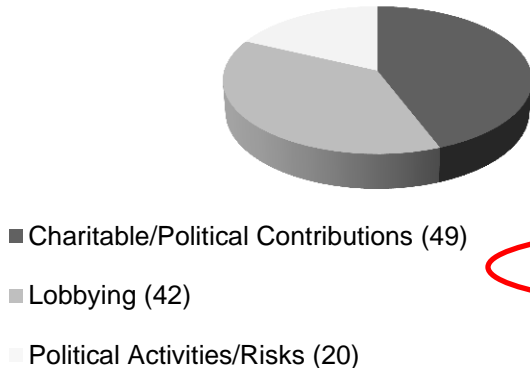
### Environmental/ Sustainability (162)



### Social/Human Rights (150)



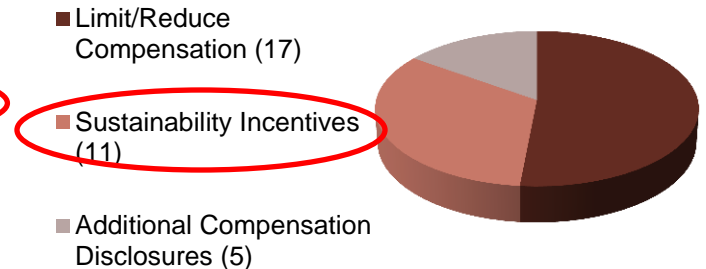
### Political Contributions/ Lobbying (111)



### Board Matters (36)



### Executive Compensation (33)



<sup>1</sup>: Based on data from Institutional Shareholder Services as of May 7, 2017 for meetings occurring in 2017.

# EXXON MOBIL PROXY STATEMENT

## ITEM 8 – RESTRICT PRECATORY PROPOSALS

### Resolved:

That the Company amend its bylaws to no longer permit shareholders to submit precatory (non-binding or advisory) proposals for consideration at annual shareholder meetings, unless the board of directors takes specific action to approve submission of such proposals.

### Supporting Statement:

Stock ownership has become politicized. Many shareholders own stock in publicly-owned corporations for the sole purpose of advancing the shareholders' own social or political agendas, while simultaneously assailing the corporations' legitimate business operations. These activist shareholders are "nuisance shareholders."

A primary tool of nuisance shareholders is the submission of non-binding precatory (advisory) proposals for discussion and vote at annual meetings of shareholders. Proposals from nuisance shareholders can coerce management into making decisions not in the best interests of the Company and its bona fide shareholders, and turn the annual meeting into a media-activist circus. . . .

The overarching purpose of these proposals is to harass and intimidate the Company into actions that it would not normally undertake and that, in fact, may be harmful to the company and its bona fide shareholders.

As Nobel laureate Milton Friedman wrote, "The social responsibility of business is to increase its profits." Businesses accomplish this vital role by providing the goods and services that society needs and wants in compliance with the law.

Businesses are society's wealth generators. This wealth fuels the rest of society via salaries, taxes, dividends, and stock price appreciation. Businesses should not be distracted and hijacked by social and political activists seeking to change perceived shortcomings of society, which are issues better and more appropriately managed by governments and charities. . . .

# ENVIRONMENTAL AND SUSTAINABILITY PROPOSALS<sup>1</sup>

- Proposals regarding environmental and sustainability matters have consistently been among the most frequently submitted proposals over the past ten years.
- Among the various topics covered by these proposals, climate change is one of the most frequently addressed topics (68 proposals for 2017 meetings). Climate change proposals submitted for 2017 meetings include, among others:
  - 26 proposals requested an assessment of the impact on the company’s asset portfolio of adopting policies to meet the “2 Degree Scenario.”
    - Both Chevron and Exxon Mobil received proposals requesting that they annually assess the portfolio impacts of policies to meet the “2 Degree Scenario.”
    - Chevron also received a proposal requesting an assessment of the feasibility of shifting the company’s energy mix towards low carbon assets, and Exxon Mobil received a proposal requesting a report on the company’s methane emissions management and a proposal requesting a report on the company’s strategy to align the company’s business operations to a low carbon economy.
  - 29 proposals requested the company report on or adopt goals regarding the reduction of greenhouse gas emissions.

<sup>1</sup>: Based on data from Institutional Shareholder Services as of May 7, 2017.



# ENVIRONMENTAL AND SUSTAINABILITY PROPOSALS<sup>1</sup>

- To date, none of the proposals regarding environmental and sustainability matters submitted for 2017 meetings that have already been voted on have passed; however, a few have received significant support (*i.e.*, 40% of votes cast or more):
  - A proposal submitted to Ameren Corporation requesting an assessment of the impact of a “2 Degree Scenario” received the support of 47.5% of votes cast;
  - A proposal submitted to Marathon Petroleum Corporation requesting a report on the company’s strategy for aligning with the “2 Degree Scenario” received the support of 40.9% of votes cast; and
  - A proposal submitted to The AES Corporation requesting an assessment of the impact of a “2 Degree Scenario” received the support of 40.1% of votes cast.

<sup>1</sup>: Based on data from Institutional Shareholder Services as of May 7, 2017.

# ENVIRONMENTAL AND SUSTAINABILITY DISCLOSURE<sup>1</sup>

- Another frequent topic of environmental and sustainability proposals is the request for a sustainability report (23 proposals for 2017 meetings).
- In response to the increasing interest of investors and other stakeholders, many companies have begun providing more detailed and lengthy environmental, sustainability and social impact disclosures.
- Several lawsuits have been filed during the last two years challenging companies' social impact and sustainability statements as false and misleading. The statements that have been challenged in recent cases include statements regarding the treatment of employees, compliance with applicable laws and regulations, and the quality and safety of company products and services.
- Thus far, the majority of these claims have been unsuccessful. However, in a few instances, where companies have made more measurable, specific statements, cases have survived an initial motion to dismiss.

**Practical Tip:** Consider having counsel review your sustainability disclosures for the types of statements that have triggered litigation. Review reasonableness of and support for statements in sustainability disclosures.

<sup>1</sup>: Based on data from Institutional Shareholder Services as of May 7, 2017.

## PROXY ACCESS RECAP

- By late December 2016, over 50% of S&P 500 companies had adopted proxy access. Many mid and small cap companies have also adopted proxy access provisions.
- Under the most frequently adopted parameters, shareholders holding 3% of the company's outstanding common stock continuously for 3 years may nominate up to 20% of the board (usually the greater of two directors or 20%), with the group of shareholders permitted to aggregate their shares limited to 20.
- Other key terms include:
  - The treatment of loaned shares;
  - How individual funds within a fund family are counted for purposes of the aggregation limit;
  - Restrictions on third-party compensation (NASDAQ's new golden leash disclosure rule has reduced the degree to which this is considered an issue);
  - Independence standards and other qualifications for shareholder nominees;
  - The interplay between the proxy access and advance notice provisions;
  - How the maximum number of shareholder nominees may be reduced; and
  - The approach to resubmissions.

## PROXY ACCESS

### “FIX PROXY ACCESS” PROPOSALS

- Beginning in the 2016 proxy season and gaining momentum in the 2017 proxy season, investors submitted “fix proxy access” proposals to companies. “Fix proxy access” proposals request that a company make surgical changes to a previously adopted proxy access provision.
  - In February and March 2017, the staff of the SEC’s Division of Corporation Finance (the “Staff”) responded to a number of “fix proxy access” proposals. The Staff, except in a few limited circumstances, permitted exclusion on the grounds of “substantial implementation.”
  - Companies that deviate materially from the generally accepted terms are at higher risk of receiving “fix proxy access” proposals and also are at risk of not being able to exclude the proposals based on “substantial implementation.”

**Practical Tip:** For companies that have adopted proxy access, consider having a strategy identified in advance for assessing a “fix proxy access” proposal. For companies that have not adopted, consider discussing with counsel the implications of a pre-proposal adoption versus a wait-and-see approach.

# POLITICAL CONTRIBUTIONS/LOBBYING PROPOSALS<sup>1</sup>

- Political contributions and lobbying proposals submitted for the 2017 season (111 proposals) represented a slight increase over the number submitted for the 2016 season (approximately 105 proposals).
- To date, none of the proposals regarding political contributions and lobbying matters submitted for 2017 meetings that have already been voted on have passed, and none have received significant support (*i.e.*, 40% of votes cast or more). However, a few have received nontrivial support (*i.e.*, 30% of votes cast or more):
  - A proposal submitted to AT&T requesting a report on political contributions received the support of 30.0% of votes cast, and another proposal submitted to AT&T requesting political lobbying disclosure received the support of 35.5% of votes cast;
  - A proposal submitted to NRG Energy requesting a report on political contributions received the support of 30.8% of votes cast;
  - A proposal submitted to Honeywell International requesting a report on lobbying payments and the company's policy received the support of 36.4% of votes cast; and
  - A proposal submitted to The Walt Disney Company requesting political lobbying disclosure received the support of 36.8% of votes cast.
- We expect the number of these proposals to increase during the 2018 proxy season.

<sup>1</sup>: Based on data from Institutional Shareholder Services as of May 7, 2017.

# DIVERSITY

- Diversity initiatives regarding gender, ethnicity and LGBT-status not only with respect to the board composition, but also with respect to management and the general workforce, have been a focus of activist shareholders this past season.
- According to a January 2017 study by the Investor Responsibility Research Center Institute and Institutional Shareholder Services (ISS), women now hold 17.8% of S&P 1500 board seats up from 11.8% in 2008, and ethnically-diverse directors hold 10.4% of board seats up from 8% in 2008.
- Catalyst recently reported that across S&P 500 firms, women make up only 5.8% of CEOs and 25.1% of executive and senior-level managers, but constitute 44.3% of all employees.
- In early March, both BlackRock and State Street disclosed plans to promote greater gender diversity on boards through active dialogue and engagement with companies.
- To date,<sup>1</sup> only one of the proposals regarding diversity matters submitted for 2017 meetings that have already been voted on has passed, and one has received nontrivial support (*i.e.*, 30% of votes cast or more):
  - A proposal submitted to Cognex Corporation requesting the adoption of a policy on board diversity received the support of 62.8% of votes cast; and
  - A proposal submitted to T. Rowe Price Group, Inc. requesting an employment diversity report and report on diversity policies received the support of 36.9% of votes cast.

<sup>1</sup>: Based on data from Institutional Shareholder Services as of May 7, 2017.

## VIRTUAL MEETINGS

- The number of companies holding virtual-only or hybrid meetings has slowly been growing. Currently, these companies include: HP Inc., Comcast Corporation, GoPro, Inc., Intel Corporation, PayPal Holdings, Inc., SeaWorld Entertainment, Inc., FitBit, Inc., Yelp Inc., Vonage Holdings Corp., and SB Financial Group, Inc.
- There has been some resistance to virtual meetings among investors and investor interest groups, including:
  - The Council of Institutional Investors;
  - New York City Comptroller, Scott M. Stringer;
  - California Public Employees' Retirement Systems; and
  - ISS.
- Although virtual meetings received renewed attention during the 2017 proxy season, it is not the first time the topic has arisen. In 2012, California State Teachers' Retirement System and other investor groups issued a report discussing best practices for companies using online meeting technology.

***Practical Tip:*** If you are considering whether to hold a virtual-only meeting, consider having counsel review with you (1) your shareholder base, (2) procedures for meaningful shareholder participation, (3) applicable state law and your bylaw provisions, and (4) trends in your industry.

## ISS POLICY UPDATES

- Effective February 1, 2017, ISS adopted the following policies:
  - Generally recommend votes against or withhold from member of the governance committee if the company’s charter imposes “undue” restrictions on shareholders’ ability to amend the bylaws;
  - Generally recommend votes against or withhold from individual directors who:
    - Sit on more than five public company boards; and
    - Are CEOs of public companies who sit on the boards of more than two public companies besides their own (withhold only at their outside boards);
  - Generally recommend votes for company proposals to increase the common share authorization for stock split or stock dividend, provided that the effective increase in authorized shares is equal to or is less than the allowable increase calculated in accordance with ISS' Common Stock Authorization policy; and
  - Take a case-by-case approach on company proposals seeking ratification of non-employee director compensation and on compensation plans for non-employee directors, in each case, based on a number of enumerated factors.
- ISS also clarified its position with respect to bylaw/charter amendments at IPO companies and made changes to aspects of its “Equity Plan Scorecard,” which is part of its voting policy for equity-based incentive plans.



# ISS POLICY UPDATES

## EXECUTIVE COMPENSATION UPDATES

- **Equity Plan Scorecard.** ISS has revised their policy regarding dividends payable prior to award vesting. This new policy falls under the plan features category. A company will earn full points if a plan specifically prohibits for all awards the payment of dividends before the vesting of the award. ISS has also revised their minimum vesting policy. This likewise falls under the plan feature category. To earn full points under the equity plan scorecard analysis, a long term incentive plan must specify a minimum vesting period of at least one year for all awards under the plan. Previously, full points could be earned for limiting this restriction to a single award type. ISS does allow for limited exceptions to the minimum vesting requirement.
- **Pay For Performance.** ISS has now provided that the qualitative performance analysis will encompass an evaluation of a company's performance relative to peers on six financial metrics:
  - Return on invested capital;
  - Return on assets;
  - Return on equity;
  - Revenue growth;
  - EBITDA growth; and
  - Growth in cash flow from operations.

## GLASS LEWIS POLICY UPDATES

- In late 2016, Glass Lewis released its updated proxy voting policy guidelines for 2017, including, among others, the following policies:
  - Generally recommend votes against or withhold from individual directors who:
    - Sit on more than five public company boards; and
    - Are executive officers of public companies who sit on the boards of more than two public companies including their own; and
  - Take a case by case approach on shareholder proposals that request increased disclosure concerning efforts taken to ensure gender pay equity.
- In addition, Glass Lewis clarified its position with respect to corporate governance at newly public entities, and its approach to board refreshment (including with respect to age or tenure limits).

**Takeaway:** ISS and Glass Lewis policies continue to become more complex and burdensome. Companies with ISS and/or Glass Lewis sensitivity may want to consider having counsel review proxy statements and other disclosures early for potential issues.

## BLACKROCK 2017 LETTER TO LEADING CEOS

*“There is little doubt that globalization’s benefits have been shared unequally . . . [BlackRock] will be looking to see how your strategic framework reflects and recognizes the impact of the past year’s changes in the global environment.”*

*“A long-term approach should not be confused with an infinitely patient one. . . . Environmental, social, and governance (ESG) factors relevant to a company’s business can provide essential insights into management effectiveness and thus a company’s long-term prospects.”*

*“Companies have begun to devote greater attention to these issues of long-term sustainability, but despite increased rhetorical commitment, they have continued to engage in buybacks at a furious pace.”*

*“In order to fully reap the benefits of a changing economy – and sustain growth over the long-term – businesses will need to increase the earnings potential of the workers who drive returns, helping the employee who once operated a machine learn to program it.”*

## DISCLOSURE UPDATES AND TRENDS

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## DISCLOSURE UPDATES AND TRENDS

### SEC'S DISCLOSURE EFFECTIVENESS EFFORTS

- In connection with its “Disclosure Effectiveness Initiative” the SEC recently has:
  - *April 2016*: Issued its Concept Release on “Business and Financial Disclosure Required by Regulation S-K”;
  - *June 2016*: Proposed revisions to the property disclosure requirements for mining companies;
  - *July 2016*: Proposed a rule on disclosure updates and simplification of Commission disclosure requirements that overlap with, but require information that is incremental to, GAAP;
  - *August 2016*: Requested comments to Subpart 400 of Regulation S-K;
  - *November 2016*: Issued its “Report on Modernization and Simplification of Regulation S-K”; and
  - *March 2017*: Published final rules requiring certain companies to provide a hyperlink to each exhibit listed in the exhibit index to their SEC filings.
- Although significant strides have yet to be made by the SEC in implementing many of the discussed changes, some companies are finding ways to update or redesign their disclosure to be more effective and transparent and less redundant.

## EMERGING PRACTICES IN PROXY DESIGN

- More detailed table of contents, and separate table of contents for the executive compensation section;
- Chairman/lead independent director substantive introduction letter;
- Q&A with chairman/lead independent director;
- Voluntary disclosure on strategic priorities and board oversight;
- Voluntary disclosure of financial measures;
- Graphic representation of board composition matters;
- Voluntary disclosure on board evaluations and refreshment;
- Qualification graphics that tie board/committee lists with director biographies and the nomination process;
- Voluntary disclosure on board meeting schedules and content;
- Voluntary disclosure regarding compensation actions taken by the board/compensation committee in the first quarter of the new fiscal year;
- Graphic representation of pay-for-performance alignment;
- “What we do” versus “what we don’t do” charts; and
- Realized summary compensation tables.

## DISCLOSURE UPDATES AND TRENDS

### SEC NON-GAAP INTERPRETATIONS

- The Staff issued new Compliance and Disclosure Interpretations (“C&DIs”) on the use of non-GAAP financial measures last year. Pursuant to the new C&DIs:
  - The “equal or greater prominence “ requirement under Item 10(e) of Regulation S-K (which requires that when a company presents a non-GAAP measure it must present the most directly comparable GAAP measure with equal or greater prominence) will not be met where (for example) a non-GAAP number (1) precedes the GAAP number, (2) is presented with more prominent descriptive characterization than the GAAP number, or (3) is presented using a style of presentation that emphasizes it more than the GAAP number (C&DI 102.10);
  - Companies should provide income tax effects on their non-GAAP measures depending on the nature of the measures (C&DI 102.11); and
  - The following presentations of non-GAAP financial measures may be misleading:
    - Certain adjustments, although not explicitly prohibited, including presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant’s business (C&DI 100.01);
    - A non-GAAP measure presented inconsistently between periods (C&DI 100.02);
    - A non-GAAP measure that excludes charges but not gains (C&DI 100.03); and
    - Non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP (C&DI 100.04).
- The Staff also updated a number of C&DIs relating to the presentation of non-GAAP measures (102.01, 102.02, 102.03, 102.05, 102.07, 103.02).

## DISCLOSURE UPDATES AND TRENDS

### SEC NON-GAAP COMMENT LETTERS

- Although there has been a significant uptick in the number of SEC comment letters addressing non-GAAP issues since May 2016, the comments received since May 2016 are conceptually similar to comments made in the SEC's new guidance.
- Beginning mid-year last year, there have also been a number of companies that received inquiries from the SEC's Enforcement Division. The most common questions relate to the "equal or greater prominence" standard.
- **Practical Tips:**
  - Review CEO/Chairman letters and quotes for the use of non-GAAP measures;
  - When providing a reconciliation of GAAP to non-GAAP, the Staff seems to prefer reconciliations that begin with the GAAP measure;
  - When presenting forward-looking non-GAAP measures, disclosure regarding reliance on the "unreasonable efforts" exception should be included and crafted thoughtfully, but generally you should expect to have to include a reconciliation;
  - Review for derivative non-GAAP measures, such as margins, ratios and per-share metrics, which may require separate reconciliations and presentations of the comparable GAAP measure; and
  - Be aware of how measures based on modified methods of revenue recognition are presented.
- **Additional guidance?** In a January 2017 comment letter to Allergan PLC, the Staff criticized the company's use of an adjusted EPS measure and stated that the Staff would review financial reporting practices in the pharmaceutical industry.



## DISCLOSURE UPDATES AND TRENDS

### CONFLICT MINERALS

- In January 2017, SEC Acting Chair Piwowar directed the Staff to reconsider the appropriateness of the SEC's 2014 guidance on conflict minerals disclosure and specifically, whether additional relief from the rule might be appropriate.
- On April 3, 2017, The U.S. District Court for the District of Columbia entered a final judgment in the conflict minerals case that had been remanded to the SEC. The court held that the Conflict Minerals rule violated the First Amendment right of free speech to the extent that it compelled an issuer to report to the SEC and post on its website that its products "have not been found to be 'DRC conflict free.'"
- In response, the Staff released a statement on April 7, 2017 announcing that, pending further review, the Division of Corporation Finance would not recommend enforcement action to the SEC if a company fails to comply with the requirements of Item 1.01(c) of Form SD (*i.e.*, the source and chain of custody requirements).
- ***What does it mean?*** For the disclosure due May 31, 2017, companies should note that the SEC's announcement pertains only to SEC enforcement action.

## EXECUTIVE COMPENSATION TRENDS

- **Shareholder Outreach.** A discussion of shareholder outreach efforts in the proxy statement is becoming a best practice. ISS and Glass Lewis have noted that they look for these statements.
- **Director Compensation Focus.** Director compensation programs are receiving heightened scrutiny from proxy advisory firms. While this increased focus may not be cause for concern for many companies, developing a framework regarding how director compensation decisions are made will allow companies to ease into the world of heightened scrutiny.
- **TSR.** While total shareholder return is still a key metric that many companies will continue to use, we now know that ISS and Glass Lewis have increased focus on other metrics.
- **Say-On-Pay Votes.** To date only a small number of companies have failed their say-on-pay votes. However, in today's world success has become a function of a percentage of the vote the company garnered as opposed to whether it passed the 50% threshold. To date, votes at or below 70% have occurred at approximately 18% of companies. ISS has set the 70% line as a benchmark as to when a company's pay practices warrant heightened scrutiny.

**Practical Tip:** Companies should consider reaching out to large investors as early as possible, since large institutions may be inundated with meeting requests close to proxy season. Companies should not be discouraged by investors that are not willing to meet; if a company wishes to cut down on these results, it should consider working with a solicitor to determine who is likely to be receptive to a meeting request.

## EXECUTIVE COMPENSATION TRENDS

### COMPENSATION LEVELS AT ENERGY COMPANIES

- Salaries for those energy companies reporting to date has remained relatively flat from 2015 to 2016.
- Annual incentive payouts were strong for 2016. Specifically, most energy companies reporting to date are paying out above target with a healthy fraction paying out significantly above target. One of the most noticeable developments with regard annual incentive pay has been the switch from production and return metrics to safety and expense metrics.
- Long term incentive grants underwent some design changes for energy companies in 2016. The majority of energy companies reviewed to date reduced award values from 2015 to 2016. However, there does appear to be an increase in the desire to use performance shares with the possible belief that eventual payouts under these awards will be significant when compared to their grant date value.
- An increasing number of energy companies are reporting the use of shareholder outreach. Generally, the response has been positive and companies are reporting that they believe these engagements have led to direct positive results.

## DISCLOSURE UPDATES AND TRENDS

### CEO PAY RATIO DISCLOSURE RULE

- On February 6, 2017, SEC Acting Chair Piowar released a statement soliciting comment from companies subject to the SEC’s “pay ratio” disclosure rule regarding any unexpected difficulties they are experiencing in preparing the disclosure. Piowar also has directed the Staff to reconsider the implementation of the rule based on the comments and to assess whether additional guidance or relief might be appropriate.
- The Financial CHOICE Act, which passed the House Financial Services Committee last week, would repeal the pay ratio provision set forth in the Dodd-Frank Act, and has effectively kept alive the legislative discussion regarding the relevance and usefulness of the pay ratio rule.
- ***What does it mean?*** For calendar year companies, the first pay ratio disclosure is due in their spring 2018 proxy statements. Although statements by members of the current administration have indicated that the pay ratio disclosure is a target for repeal, companies should consider moving ahead with implementation until more is known.

## DISCLOSURE UPDATES AND TRENDS

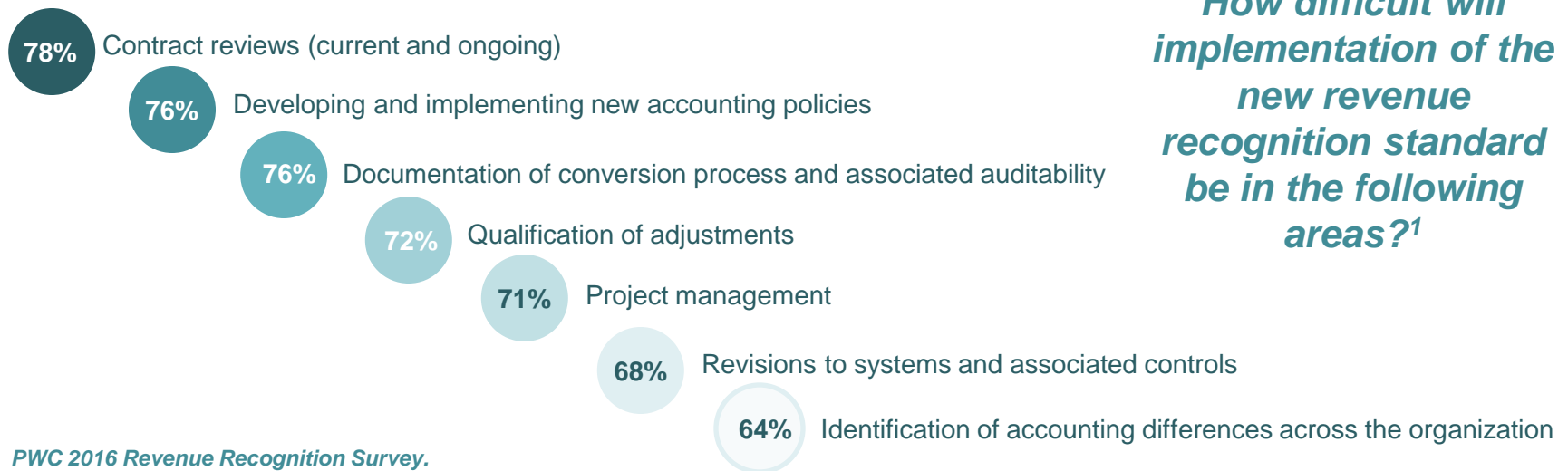
### CLAWBACK, PAY FOR PERFORMANCE, HEDGING

- The Commission proposed rules on July 1, 2015, that would require publicly-listed companies to adopt broad clawback policies and make certain clawback-related disclosures.
- The Commission proposed rules on April 29, 2015, that would require publicly-listed companies to disclose (1) a new compensation table setting forth five years of data on executive compensation actually paid, total compensation as disclosed in the Summary Compensation Table, total shareholder return (TSR), and peer group TSR, and (2) a clear description of the relationship between executive compensation actually paid and the company's TSR, and a comparison of the company's TSR and the TSR of a peer group chosen by the company.
- The Commission proposed rules on February 9, 2015, that would require publicly-listed companies to disclose whether the company permits employees (including officers), directors, or their designees to engage in transactions to hedge or offset any decrease in the market value of equity securities that are granted to the employee or director as compensation or otherwise held, directly or indirectly.
- ***What does it mean?*** We think it is unlikely that the Commission will issue final rules on any of these matters soon. However, companies may still receive shareholder proposals and requests addressing similar issues.

# DISCLOSURE UPDATES AND TRENDS

## NEW GAAP

- Several new GAAP standards will require implementation over the next few years: revenue recognition (to be effective for fiscal years beginning after December 15, 2017; early adoption permitted), leases (to be effective for fiscal years after December 15, 2018), and financial instruments/credit losses (generally effective for fiscal years after December 15, 2019 or 2020, depending on the entity).
- According to a recent survey,<sup>1</sup> over 20% of companies have yet to begin their assessment for implementing the new revenue recognition standard. Approximately 65% of respondents were in the assessment phase, and only 13% were in the process of implementation.
- For many companies, changes made to comply with the new standards will be material.



1: PWC 2016 Revenue Recognition Survey.

## DISCLOSURE UPDATES AND TRENDS

### WHISTLEBLOWERS AND CONFIDENTIALITY

- On April 1, 2105, the SEC settled an enforcement action against KBR Inc. alleging that confidentiality provisions with certain employees violated whistleblower protection Rule 21F-17 enacted under the Dodd-Frank Act because those agreements allegedly required the employee to notify the company's legal department before engaging in whistleblower activity.
- In 2016, the SEC issued cease and desist orders against Merrill Lynch, BlueLinx, NeuStar and SandRidge Energy based on confidentiality provisions in severance agreements.
- Plaintiff firms have sent demand letters to several companies on behalf of shareholders alleging that confidentiality agreements with employees, including releases in severance agreements, and non-disparagement clauses violate Rule 21F-17 and demanding remediation of those agreements (and, of course, attorneys' fees).

**Takeaway:** Review confidentiality and non-disparagement provisions in all documents, particularly those filed as exhibits to SEC reports and registration statements, to assess risk of regulatory or plaintiff action. Consider actions to clarify their inapplicability to whistleblower situations. Consider how those actions will be made known publicly to avoid nuisance demands.

## SUMMARY AND TOP TEN GOVERNANCE AND DISCLOSURE TO-DOS

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# SEC VERSUS ACTIVIST INVESTOR EXPECTATIONS

## SEC Focus

- New GAAP
- Non-GAAP
- Traditional securities violations (e.g., insider trading, fraud)
- Whistleblower protections
- Individuals rather than companies

## Activist Investor Focus

- Environmental and sustainability disclosures
- Political contributions
- Diversity (gender, ethnicity, LGBT)
- Wage parity
- Pay-for-performance disclosure
- Board composition/tenure
- Voluntary additional audit disclosure
- Expanding shareholder rights

# TOP TEN GOVERNANCE AND DISCLOSURE TO-DOS

## UTILIZING YOUR OFF-SEASON

- 1 Consider preparedness for new GAAP and CEO pay ratio
- 2 Review use of and disclosure about non-GAAP metrics
- 3 Benchmark peer voluntary disclosures
- 4 Benchmark peer shareholder proposals
- 5 Review risk factors for key areas of investor concern
- 6 Review confidentiality and release language for whistleblower issues
- 7 Update board evaluation/refreshment procedures
- 8 Review sustainability disclosures for potential litigation triggers
- 9 Review key governance documents (e.g., bylaws—especially advance notice, exclusive forum, voting standards and proxy access; committee charters; governance guidelines; codes of conduct; board calendar; D&O questionnaires)
- 10 Consider a refresh of proxy statement, annual report and meeting script and rules



# THANK YOU

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