Cravath Quarterly Review
M&A, Activism and Corporate Governance

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Q3 2019

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Mergers & Acquisitions

TRENDS[1]

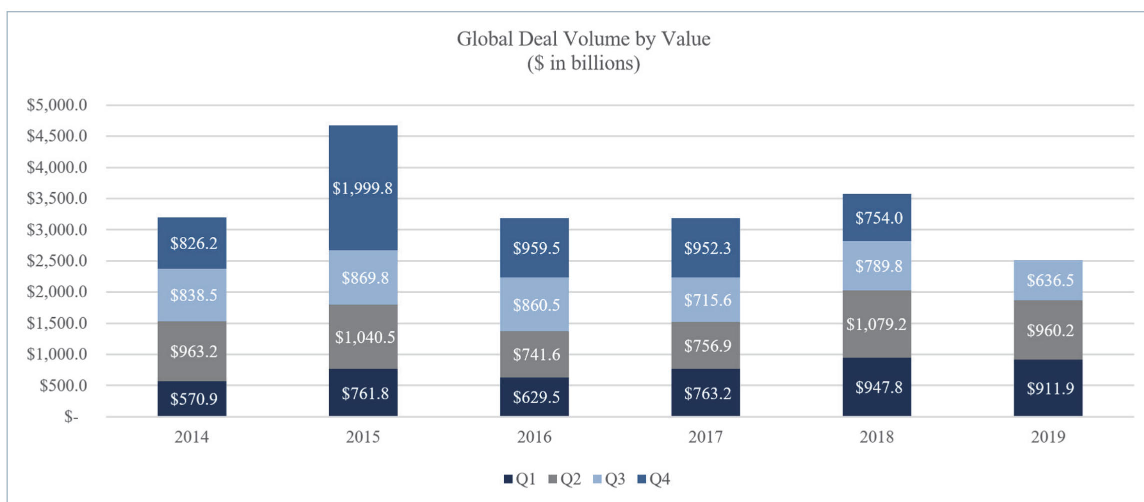
After a strong first half of the year, Q3 2019 saw particularly reduced levels of global M&A activity (both in terms of number of deals and total deal value), compared to Q3 2018, which itself was a relatively slow quarter for M&A. Due in part to a slowdown in the U.S. market—which through H1 2019 showed heightened levels of deal activity that drove the overall M&A market—Q3 2019 saw global deal value and total number of deals each drop by ~19% compared to Q3 2018. Relative to the third quarter of last year, U.S. M&A activity was down 29% and 19% in terms of deal value and deal count, respectively, and relative to quarterly averages since 2009, deal value was down by 8%. In terms of other regions, Europe, Asia Pacific (excl. Japan) and the Middle East and Africa all experienced lower M&A volumes, with total deal values declining 7%, 24% and 44%, respectively, compared to Q3 2018. In contrast, Latin America posted its strongest quarter of the year in terms of deal value, up 168% from Q3 2018's 10-year low. Japan also posted its strongest quarterly numbers of the year in terms of deal value, up 13% relative to Q3 2018.

Reduced M&A Activity in Q3 2019 Translates to YoY Declines, But Dealmaking Through Q3 Remains Above Average Historical Levels Due to a Strong 1H 2019; Deals Reach Record Sizes, with 2019 Proving to be a Banner Year for Megadeals

Q3 2019 featured $636.5 billion worth of deals across 4,197 transactions globally, a 19% reduction in terms of total deal value relative to already reduced quarterly levels of deal activity in Q3 2018. This translated to YoY declines of 11% relative to total global deal value in the first three quarters of 2018. However, buoyed by the strong first half of the year, M&A activity through Q3 remains ahead of historical levels—the $2.5 trillion worth of deals through the first three quarters of 2019 represents a 23% increase relative to the average from 2009-2019 YTD over that same time period. This figure also represents a 1% increase in total deal value relative to the 2014-2019 YTD average through the first three quarters, reflecting a small increase over a period in which there has been heightened M&A activity relative to historical figures.

Notably, the first three quarters of 2019 have featured fewer transactions overall—13,570 transactions relative to the 2014-2019 YTD average of 14,113 transactions over that same time period. This has translated into significant increases in average deal size—of deals with a disclosed value, average global deal size through the first three quarters of 2019 was ~$424.6 million, relative to ~$380.1 million in 2018. In the U.S. alone, the average deal size where the value was disclosed was an astounding ~$838 million. Both of these figures reflect record-level deal sizes for disclosed deals. Not surprisingly, this has also translated into a banner year for megadeals—through the first three quarters of 2019 there have been 31 deals greater than $10 billion, only the second time since 2008 there have been more than 30 megadeals in the first three quarters of the year.

[1] All data regarding M&A activity from Mergermarket unless otherwise indicated. Deal values and volume may vary across our newsletters due to continuous updates to the M&A activity sources.



Source: Mergermarket

Cross-Border Deals See Continued Declines, Contributing to M&A Declines in Non-U.S. Regions

The first nine months of 2019 have seen a sustained reduction in cross-border M&A due to a number of factors, in particular the effect of uncertain political and geopolitical conditions. Through Q3 2019 there were ~$911 billion worth of cross-border deals, a ~14.6% reduction relative to the first three quarters of 2018. Deal activity also reflected this trend on a regional basis. Relative to Q3 2018, the dollar value of dealmaking in Europe ($159 billion), Asia Pacific (excl. Japan) ($121 billion) and the Middle East and Africa ($9.6 billion) declined 7%, 24% and 44%, respectively, in Q3 2019. This general decline in non-U.S. dealmaking is reflected over a longer timeframe as well—deal values were down 16%, 8% and 41% in Europe, Asia Pacific (excl. Japan) and the Middle East and Africa, respectively, in Q3 2019 compared to quarterly averages from 2009-2019 YTD. Overall, this has contributed to reduced non-U.S. M&A activity through the first three quarters of the year—deal values are down 30% and 28% in Europe and Asia Pacific (excl. Japan), respectively, relative to the first three quarters of 2018. The decline in deal value in Asia Pacific (excl. Japan) is driven in large part by major declines in deal activity in China, which posted a 37% decline in terms of deal value in both Q3 2019 and the first three quarters of the year, relative to the third quarter and the first three quarters of 2018, respectively.

In contrast, despite the slow third quarter, the Middle East and Africa has shown a particularly strong year for M&A—the first three quarters of the year have included $125 billion worth of deals, eclipsing last year's total through the first nine months of the year by 142%. However, this was driven in large part by Saudi Aramco's $70.4 billion acquisition of 70% of Saudi Basic Industries Corporation (Sabic) in the first quarter of the year. Latin America has also had a strong showing for the year in terms of deal value—for the quarter, deal value is up 168% relative to Q3 2018's 10-year low, and through the first three quarters of the year deal values are up 9% relative to the first three quarters of 2018. Japan has also been somewhat of a bright spot—Q3 2019 deal values were its strongest for the year (and up 13% relative to Q3 2018), and through Q3 2019 total deal value is up 9% relative to the first three quarters of 2018. However, for both Latin America and Japan, the first three quarters of the year have seen significant declines relative to historical figures. Through the first three quarters of the year total deal values are down 14% and 19% in Latin America and Japan, respectively, relative to the average for the first three quarters from 2009-2019 YTD.

Another Strong Quarter for Private Equity Acquisitions; Europe, Middle East and Africa (EMEA) and the United States Lead Regional Private Equity Activity

Despite another quarter of reduced private equity acquisitions globally by value in Q3 2019 relative to heightened levels in Q3 2018, as well as an overall decline in private equity acquisitions globally by value in the first three quarters of 2019 relative to the first three quarters of 2018 by 14%, the strength of the global private equity market continued to fuel M&A activity in the third quarter of the year. For the quarter, total deal value of private equity acquisitions was $108 billion globally, 17% greater than quarterly averages from 2009-2019 YTD. This translated into $393 billion

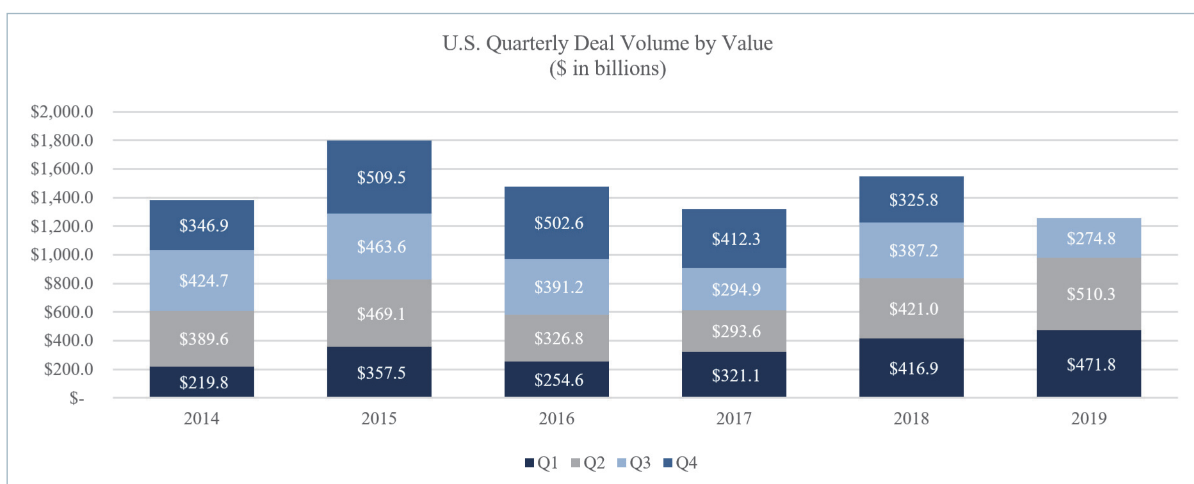
worth of private equity deals through the first three quarters of 2019—42% greater than the average through the first three quarters from 2009-2019 YTD, and the third-highest total for the first three quarters of the year since 2009. Not surprisingly, this resulted in private equity acquisitions accounting for a larger percentage of overall deal value—globally, private equity acquisitions accounted for 17% of total deal value in Q3 2019, relative to a quarterly average of 13% from 2009-2019 YTD. The total number of private equity deals (805) similarly accounted for a larger percentage of total deal count in Q3 2019, accounting for 19% of the total number of deals, relative to a 2009-2019 YTD quarterly average of 16%.

On a regional basis, Europe, the Middle East and Africa (EMEA) led the way in terms of private equity deal count, accounting for ~43% of all private equity acquisitions through the first three quarters of the year, but the United States led the way in terms of deal value, with ~$166 billion worth of private equity acquisitions through the first three quarters of the year. In particular, private equity was a key driver in the otherwise slow European M&A market, accounting for a near-record 22.4% of total deal value in the region, somewhat making up for lower activity from European corporates. The Middle East and Africa in particular also saw a major surge in private equity activity, with $10.7 billion worth of private equity acquisitions through the first three quarters of 2019—greater than full-year 2017 and 2018 figures. Finally, the value of private equity acquisitions in Japan also surged, jumping to $5.3 billion in the first three quarters of 2019 relative to $719 million through the first three quarters of 2018, a trend that is expected to continue as top-tier private equity firms raise funds to focus on Japanese investments.

U.S. M&A Market Continues to Claim Outsized Share of Global Deal Volume, But Feels the Effects of the Slowdown in Global M&A

In the United States, Q3 2019 featured $275 billion worth of deals across 1,275 transactions, a ~29% decrease by value relative to Q3 2018 and a ~44% decrease relative to the first-half quarterly average of $491 billion worth of deals in 2019. Despite the slow third quarter, the strong first half to the year has fueled an M&A market in the U.S. that has seen $1.25 trillion worth of deals across 4,156 transactions, roughly equal to the $1.22 trillion worth of deals through the first three quarters of 2018, and 45% greater than the 2009-2019 YTD average of $866 billion worth of deals through the first three quarters of the year. As a result, the U.S. market continued to be the dominant region for M&A, accounting for ~50% of global deal value. However, the slowdown in the third quarter was pronounced, and it seems as though the U.S. M&A market may be finally feeling the effects of tariffs and geopolitical tensions that have appeared to be hampering M&A activity outside the United States for the past few quarters.

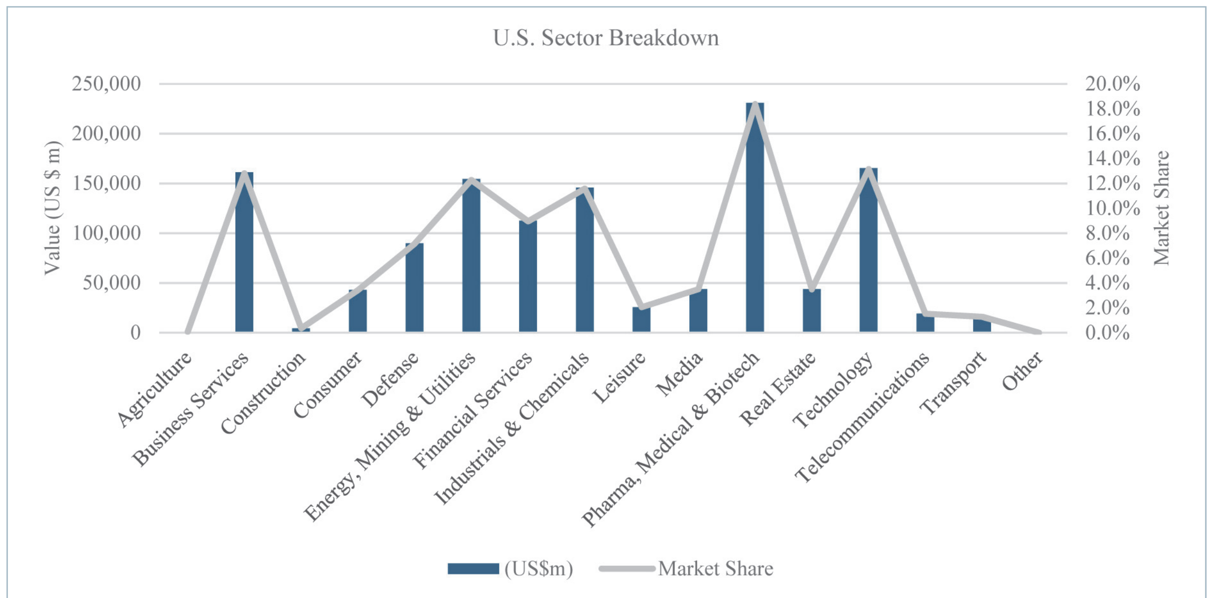
As previously mentioned, M&A activity in the U.S. was driven by megadeals (greater than $10 billion), which resulted in significantly higher average deal sizes. Average deal size where the value was disclosed was ~$838 million in the U.S. through the first three quarters of 2019, relative to an average deal size of $596 million for disclosed deals through the first three quarters of 2018. Not surprisingly, this translated into fewer small and mid-market deals, with over 75% of deal value in the U.S. in Q3 2019 coming from deals worth at least $1 billion. In addition to megadeals, inbound investment continued to drive overall deal volume, with inbound M&A in the U.S. up ~8% by value in the first three quarters of 2019 relative to the same period in 2018, accounting for ~18% of overall deal value in the U.S. through the first three quarters of the year.



Source: Mergermarket

Major Activity in Certain Sectors

In terms of global deal value, Pharma, Medical & Biotech led the way in 2019, posting ~$409.5 billion worth of deals, accounting for ~16% of global deal value and including two of the five largest deals so far this year—Bristol-Myers Squibb's $89.5 billion acquisition of Celgene Corporation and AbbVie's $86.3 billion acquisition of Allergan—as well as other transformative deals such as Mylan's $50 billion combination with Upjohn, a division of Pfizer. Industrials & Chemicals was a close second featuring ~$383.7 billion worth of deals and accounting for ~15% of global deal value through the first three quarters of 2019, of which Saudi Aramco's $70.4 billion acquisition of 70% of Sabic was the largest deal in the sector. Energy, Mining & Utilities was in the top five of sector activity for the first three quarters of the year, featuring ~$338 billion of transactions (~13.5% of deal value), of which Occidental Petroleum's $54.4 billion acquisition of Anadarko Petroleum in Q2 2019 was the largest deal in the sector for the year. Technology and Business Services were the two other most active sectors in terms of deal value through Q3 2019, featuring ~$286.9 billion (11.4% of deal value) and ~$227 billion worth of deals (9% of deal value), respectively. Finally, while not in the top five sectors in terms of deal value through the first three quarters of the year, Q3 2019 featured another major media deal with the re-combination of CBS and Viacom, as traditional players in the space continue to pursue scale in response to consolidation in the industry and to compete with digital offerings from Netflix, Amazon and other streaming service providers.



Source: Mergermarket

LEGAL DEVELOPMENTS

Cases

Q3 2019 featured a number of notable cases in the M&A space.

- ***Genuine Parts Company v. Essendant Inc.***, C.A. No. 2018-0730-JRS (Del. Ch. September 9, 2019). In this case, the Delaware Court of Chancery declined to dismiss a breach of contract claim brought by Genuine Parts Company ("GPC") against Essendant Inc. ("Essendant") that arose after Essendant terminated its merger agreement with GPC in order to sign up a deal with interloper Sycamore Partners ("Sycamore"), whose portfolio companies include Staples, Inc. ("Staples"). GPC and Essendant—two wholesale office supply distributors—signed a merger agreement on April 12, 2018 (the "Agreement"). Pursuant to the Agreement, GPC would spin off its wholesale office supply business to merge with Essendant, after which GPC's shareholders would own 51% of Essendant's common stock. The Agreement contained a typical non-solicitation provision under which Essendant agreed to terminate any discussions for a competing transaction and not pursue or engage in any negotiations that could result in a competing transaction unless the board, "in its good faith judgment" determined that the competing transaction constituted (or was reasonably likely to lead to) a "Superior Proposal." In the event Essendant chose to pursue a Superior Proposal, it could terminate its agreement with GPC by paying a termination fee.

  According to GPC, Essendant was approached three days prior to executing the Agreement by Sycamore (acting on behalf of Staples), who also expressed an interest in acquiring the company. GPC was not informed of this initial approach until May 31, 2018, and allegedly Essendant assured GPC prior to executing the agreement that the company was not interested in merging with anyone else and no other party was interested in a transaction with the company. Five days after GPC and Essendant signed the Agreement, Sycamore subsequently offered to purchase all of Essendant's outstanding stock at a price of $11.50 per share, which Essendant's board rejected. GPC was not told of this subsequent offer until 10 days later. Finally, on April 29, Sycamore submitted a "renewed" offer—allegedly in response to indications by Essendant that it would be open to receiving a revised proposal—at the same price per share, but this time Essendant's board concluded it was reasonably likely to lead to a Superior Proposal because Sycamore indicated it might increase its bid after receiving non-public information. After GPC was told of the renewed offer, it informed Sycamore that it did not believe the offer constituted a Superior Proposal and warned Essendant that it believed further discussions with Sycamore would violate the Agreement's non-solicitation provision; however, GPC also offered to pay Essendant's shareholders an additional $4 per share in the form of a contingent value right. After several months of further negotiations with Sycamore, Essendant ultimately accepted Sycamore's bid, which had increased to $12.80 per share, after which it paid GPC a termination fee of $12 million and terminated the Agreement.

  GPC filed suit against Essendant asserting that Essendant had breached the no-shop provisions in their merger agreement and seeking monetary damages in addition to the termination fee it had already collected. Essendant moved to dismiss based upon language in the merger agreement that provided for the termination fee to be the sole and exclusive remedy in circumstances where Essendant were to terminate to take a Superior Proposal that "did not arise or result from any material breach" of the non-solicitation provisions in the merger agreement.

  The Delaware Court of Chancery denied the motion to dismiss, finding that the sole and exclusive remedy provisions did not apply because the language providing for Essendant's termination right and the associated payment of the termination fee (and tying them to the sole and exclusive remedy language in the agreement) required compliance with the no-shop provisions of the merger agreement. The Chancery Court also found that GPC's acceptance of the termination fee did not prevent it from pursuing damages caused by termination after an alleged breach and concluded that GPC had adequately pled enough in total to support a pleading stage inference that Essendant breached the non-solicitation clause of the agreement.

  The case serves as a critical reminder of two important contracting points: (1) contracting parties that want to ensure the termination fee remains the sole and exclusive remedy in specific circumstances should ensure the termination, termination fee and remedies provisions are carefully crafted in order to clearly and unambiguously state the parties intentions, especially when read together; and (2) absent specific contractual language to the contrary, mere acceptance of the termination fee will not prevent that party from pursuing damages for breach of contract.

- Of the notable cases in Q3, three were the result of appraisal litigation. The outcome in two of the cases continues to reflect the view of Delaware courts that deal price p rovides strong evidence of fair value when a public company with an efficient trading market is sold in a transaction resulting from an open sales process conducted at arm's-length. However, one such case (although subject to appeal) offered guidance on when the unaffected market price (and not the deal price) is the best indicator of fair value.

  - ***In re Appraisal Stillwater Mining Company***, C.A. 2017-0385-JTL (Del. Ch. Aug. 21, 2019). In this case, the Delaware Chancery Court rejected a suit brought by two large investors in Stillwater Mining Company ("Stillwater") that sought $25.91 per share, instead of the $18 per share that Sibanye Gold Limited ("Sibanye") paid to acquire Stillwater. The plaintiffs argued that the acquisition resulted from an unfair and conflicted sales process, and as a result, a DCF analysis (that supported a per share price that was 43.9% higher than what Sibanye paid) was the best indicator of fair value. In particular, plaintiffs argued a number of alleged conflicts and board oversight failures, as well as alleged inadequate pre- and post-signing market checks and incomplete disclosure to investors. In rejecting plaintiffs' argument, Vice Chancellor Laster noted that the sales process "was not perfect" and even indicated that Stillwater's pre-signing efforts "might not have added much," but found that the process, when viewed as a whole, compared favorably or on par with other recent major appraisal actions, thus making it sufficiently reliable to make the deal price a persuasive indicator of fair value. The court also noted that while, "the evidence demonstrated that Stillwater's trading price could provide a persuasive indicator of value," it ultimately, "was a less persuasive indicator than the deal price." Further, in rejecting the DCF analysis, Vice Chancellor Laster noted that "[n]either side proved that its DCF valuation provided a persuasive indicator of fair value," noting, "[t]he experts disagreed over too many inputs, and the resulting valuation swings were too great for this decision to rely on a model when a market tested indicator is available."

  - ***In re Appraisal of Columbia Pipeline Group, Inc.***, Cons. C.A. No. 12736-VCL (Del. Ch. Aug. 12, 2019). In *Columbia Pipeline*, the court relied on the deal price to affirm the fair value of the $25.50 per share paid by TransCanada Corporation ("TransCanada") to acquire Columbia Pipeline Group, Inc.'s ("Columbia") stock. The plaintiffs targeted the sales process, arguing it was too flawed to justify reliance on the deal price as the best indicator of fair value. In particular, plaintiffs alleged conflicts of interest and that Columbia showed undue favoritism to TransCanada. In rejecting plaintiffs contentions, the court cited recent Delaware Supreme Court precedent that has, "endorsed using the deal price in an arm's-length transaction as evidence of fair value," and applying cases such as *Aruba*, concluded that "the sale process that led to the merger bore objective indicia of fairness that rendered the deal price a reliable indicator of fair value." The court again noted that, "the sale process was not perfect," but referenced the fact that it "compare[d] favorably or on par" with prior Delaware appraisal decisions that have "reversed trial court decisions for failing to give adequate weight to the deal price." The court noted that those prior cases have not indicated when "a sales process would be sufficiently bad that a trial court could give the deal price no weight." But overall, the court found the facts of the case sufficient to justify relying on the deal price, including the fact that the merger was conducted at "arms-length" with no conflicts; Columbia contacted other potential bidders during the pre-signing phase, but none decided to pursue a merger; no bidders emerged post-signing; and the deal protections in the merger agreement were relatively typical, making the absence of a better bid post-signing a significant factor.

  - ***In re: Appraisal of Jarden Corporation***, Cons. C.A. No. 12456-VCS (Del. Ch. July 19, 2019). In this case, which involved the acquisition of Jarden Corporation ("Jarden" or the "Company") by Newell Rubbermaid, Inc. ("Newell"), the Delaware Court of Chancery determined the fair value of Jarden's shares was equal to the Company's unaffected share price ($48.31 per share), which was 18% less than the $59.21 in cash and stock paid as consideration by Newell. In the opinion, Vice Chancellor Slights acknowledged the Delaware Supreme Court's recent decision in *Aruba*, in which the court reversed the decision of the trial court for its reliance on the unaffected market price as the best indicator of fair value, instead directing the court to use the deal-price less synergies approach. Emphasizing the guidance of the appraisal statute to consider "all relevant factors," Vice Chancellor Slights concluded

that the deal-price-less synergies approach was not reliable in this case for two reasons. The first was flaws in what the court referred to as, "the sales process, if you could call it that." In particular, the court took issue with the fact that there was no pre- or post-signing market check, as well as the fact Jarden's executive chairman, who was acting as lead negotiator, "acted with little to no oversight by the Board," and as a result "may well have set an artificial ceiling" on the price. Second, the court found it difficult to determine how much of the value of the expected synergies (if any) was paid to the target stockholders, making the deal-price less synergies "an even less reliable indicator of fair value." Instead, due to a number of factors—including evidence that the market for Jarden's stock was efficient—the court found that Jarden's unaffected market price was the best indicator of fair value. The court also considered the parties' competing DCF analyses, which were incredibly divergent, and utilized components from each to construct its own DCF analysis, which came to a share price of $48.13 per share, which the court found corroborative of the unaffected market price as the most reliable indicator of fair value. Thus, while the case is subject to appeal, it provides an important reminder to practitioners that despite the ruling in *Aruba*, the unaffected market price can still be used as the best indicator of fair value depending on the specific facts of an individual appraisal action.

In Memoriam

While happening in October, we would be remiss if we didn't note the passing of retired Chancellor William T. Allen on October 13, 2019. His distinguished career as a jurist, counselor and academic included serving as chancellor of the Delaware Court of Chancery for 12 years from 1985-1997, where he made landmark contributions to corporate law. During his time on the bench Chancellor Allen wrote hundreds of opinions related to corporate law, including such seminal cases as *Caremark*, where he defined the board's fiduciary obligations to monitor corporate compliance; *Blasius*, where he articulated an enhanced standard of judicial review when board action seeks to interfere with the stockholder franchise; and *Time-Warner*, where he articulated how the board can balance the many competing considerations in the context of a potential sale of the corporation not subject to *Revlon*.

As described by the Delaware Judiciary, Chancellor Allen was, "a giant of the corporate bar, academia, and the Delaware Bench,"[2] and in the words of outgoing Delaware Supreme Court Justice Leo E. Strine, Jr., "Chancellor Allen set a standard of excellence that made Delaware stand out in the eyes of all sophisticated observers."[3]

Regulatory

On September 17, 2019, the U.S. Treasury Department issued two proposed rules to further implement the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"), which was enacted in August 2018 and amended the statute authorizing foreign investment reviews by the Committee on Foreign Investment in the United States ("CFIUS").

The proposed rules build upon interim rules that Treasury issued in October 2018, which partially implemented FIRRMA and established a critical technology pilot program.

Notably, the proposed rules would (among other things):

- Expand mandatory filings to certain transactions involving "TID U.S. Businesses" and foreign government interests. Mandatory filings would be required when: (1) a foreign government holds (directly or indirectly) a 49% or greater voting stake in a foreign person and (2) the foreign person acquires (directly or indirectly) a 25% or greater voting stake in a U.S. business that (a) works with critical technologies, (b) performs certain specified functions with respect to critical infrastructure or (c) maintains or collects (directly or indirectly) sensitive personal data of U.S. citizens (collectively, "TID U.S. Businesses"). Mandatory filings would be required at least 30 days before closing, and any person who fails to file may be liable for a civil penalty up to $250,000 per violation or the value of the transaction, whichever is greater.

- Extend CFIUS's jurisdiction to non-controlling investments in unaffiliated TID U.S. Businesses that afford the foreign investor certain rights. These rights include: (1) access to material non-public technical information; (2) board membership or observer rights; and (3) any involvement (outside of voting shares) in substantive decision-making regarding critical technologies, critical infrastructure or sensitive personal data.

[2] Press Release, Delaware Judiciary, Delaware Judiciary Expresses Condolences on Passing of Retired Chancellor William T. Allen (October 14, 2019) *available at* https://www.courts.delaware.gov/Forms/Download.aspx?id=116558.

[3] *Id.* at 1 (quoting Delaware Supreme Court Justice Leo E. Strine Jr.).

- Extend CFIUS's jurisdiction to certain real estate transactions. CFIUS would be able to review certain transactions (sales, leases and concessions that afford certain property rights) by foreign persons involving real estate in close proximity to sensitive U.S. government facilities or that involve airports or maritime ports. The proposed rules include a list of sensitive facilities, as well as a number of important exceptions.

- Exempt investors from certain countries from CFIUS's expanded jurisdiction. Investors from a to-be-determined list of countries that meet certain criteria would be exempt from CFIUS's new jurisdiction over non-controlling investments and real estate. The list of eligible countries will be published in connection with the final rules, and is expected to be limited. The exemption does not apply to transactions that could result in control of a U.S. business.

- Expand the availability of short-form "declarations." Short-form declarations—generally no more than five pages—could be used for all transactions submitted to CFIUS. Filing a declaration rather than a long-form notice could have timing implications for CFIUS clearance.

Comments to the proposed rules were due October 17, 2019. Treasury is expected to issue final rules by early next year, and FIRRMA requires that the final regulations take effect by February 13, 2020. The new rules would not apply to transactions that are signed, or public offers that are launched, prior to the effective date of the final rules.

Activism[4]

In October 2019, Lazard released its Q3 2019 Review of Shareholder Activism, which offers key observations regarding activist activity levels and shareholder engagement through the first three quarters of 2019.

Key findings / insights from the report include:

- Q3 proved to be a busy quarter, both in terms of number of campaigns and capital deployed;

- Activists achieve board change, winning 98 board seats YTD, and while the majority of board seats were secured outside the proxy process, activists were successful in 5 out of 21 proxy fights that have gone to a vote in 2019 YTD;

- Record pace of activism in Europe in the third quarter, and significant levels of non-U.S. activism overall (~40% of campaign activity); and

- M&A theses (break-up / divestiture, "bumpitrage" / opposition to deals, and sell the company) continue to be a major theme, arising in 45% of all campaigns, with over half of all capital deployed in M&A-oriented campaigns.

TRENDS

Increase in Campaign Activity in Q3 2019 Relative to Q3 2018; YTD Activism Remains Slightly Down, But Overall Activism Remains On Par With Prior Years; Board Seat Wins Through Q3 Nearly Match Total for 2017

Q3 2019 featured 51 new campaigns initiated against 46 companies globally, a ~19% increase in terms of number of campaigns relative to somewhat depressed levels in Q3 2018, which featured 43 new campaigns against 39 companies globally. On the whole, the first three quarters of 2019, which featured 159 campaigns against 145 companies globally, is down relative to the first three quarters of 2018, which featured 185 campaigns against 171 companies globally. Nevertheless, levels of activism have remained generally on par with recent years, with the 145 companies targeted through Q3 2019 just below the Q1 through Q3 average of 149 companies targeted from 2015-2018.

[4] Activism data from Lazard, *Review of Shareholder Activism – Q3 2019*, which includes all data for campaigns conducted globally by activists at companies with market capitalizations greater than $500 million at the time of campaign announcement; companies that are spun off as part of the campaign process are counted separately.

For the quarter, global capital deployment towards new campaigns was 26% higher than capital deployed in Q3 2018, featuring $11 billion in capital deployed in Q3 2019, relative to Q3 2018's $8.7 billion. Nonetheless, the first three quarters of 2019 have seen an overall dip in capital deployed towards new campaigns, with $35.7 billion deployed through Q3 2019 relative to average Q1 through Q3 capital deployment from 2015-2018 equal to $44.95 billion. As a general matter, 2017 and 2018 saw heightened levels of activism, with the first half of 2018 seeing a remarkable $44.3 billion in capital deployed.

Through Q3 2019, 53 companies have been targeted by activists seeking board seats, with activists securing 98 board seat wins. This total nearly matches the total number of board seat wins for the full year 2017 (103), and is on par with the average number of board seats won from Q1 through Q3 for 2015-2018 (~105). Of the 98 board seat wins through Q3 2019, 83 were secured via settlement, of which 50 board seats were secured outside a contested proxy process, a continuation of the trend away from proxy fights and toward more settlements.

Propelled by a Record Q3, European Activism Nears the High End of Historical Levels; APAC Activism Remains Strong YTD; Japan Proves the Second Busiest Non-U.S. Jurisdiction, Even After a Slow Q3

Through the first three quarters of 2019 non-U.S. activism accounted for ~40% of global campaign activity, in line with historical figures. Europe, which saw a slow first half as activists used this period to refocus on existing positions, saw a record Q3 2019 in terms of newly initiated campaigns—20 new European campaigns were initiated, ~74% greater than the Q3 average of 11.5 new campaigns initiated from 2015-2018. Capital deployed against European companies remains consistent with historical figures—through the first three quarters of 2019 capital deployed was $8.3 billion, already exceeding the full-year figure of $7.9 billion for 2016, and putting it on pace to exceed the full-year figure for 2015 ($10.4 billion) as well, with the potential to near the heightened 2018 yearly total of $16.3 billion.

In contrast, the APAC region (including all of Asia, Australia and New Zealand) saw a slower Q3 2019, with only $100 million deployed in one new campaign. However, despite the slow quarter, the 14 APAC companies that have been targeted this year is still greater than the number of APAC companies targeted in full-year 2015, and nearly equal to the number targeted in all of 2016. In terms of capital deployed, the $4 billion in capital deployed against APAC companies is near the average yearly capital deployment against APAC companies of $4.75 billion from 2015-2018, which in many ways highlights the strength of 1H 2019 for APAC activism.

The trends across the broader APAC region were also true for Japan, which featured the sole campaign for the region in Q3 2019. However, despite the slow quarter, through Q3 2019 Japan is the second busiest non-U.S. jurisdiction in terms of the number of non-U.S. campaigns, and is tied with Germany and the United Kingdom as leaders in terms of capital deployed against non-U.S. targets.

M&A-Related Campaigns Continue to be a Major Theme

M&A-related objectives comprised 45% of all activist campaigns through the first three quarters of 2019 (a record proportion), with the 71 M&A oriented campaigns through Q3 2019 on pace to surpass 2018's full-year record number of M&A campaigns (82). The most common M&A objectives were relatively evenly split across three categories through Q3 2019—"bumpitrage" and opposition to deals (38%), break-up / divestiture (31%) and sale of the company (31%).

Notable examples of M&A-related campaigns include:

- Elliot encouraging AT&T to conduct a strategic review, "including an analysis of which businesses AT&T must prioritize today and which businesses are distractions that should not be part of the portfolio", resulting in reports that AT&T is considering divesting or spinning off the company's DirecTV business;

- Paulson & Co.'s opposition to Callon's acquisition of Carrizo Oil & Gas, suggesting that Callon should instead sell itself; and

- Vintage Capital calling on Red Robin to initiate a strategic review, which resulted in Red Robin adding new independent directors after rejecting a takeover bid from Vintage; in response, Vintage said it would explore nominating directors.

SELECT CAMPAIGNS / DEVELOPMENTS

Company	Market Capitalization ($ in billions)[5]	Activist	Outcome
AT&T	$268	Elliott	• Elliot discloses $3.2 billion stake in AT&T • Elliot argues that AT&T could unlock value by divesting assets, taking a more disciplined approach to M&A, de-levering its balance sheet, and overhauling the company's leadership / oversight
EssilorLuxottica	$63.7	Investor group (7 investors) / Third Point	• Q2—in the midst of a CEO succession dispute, Fidelity International, Baillie Gifford and five other investors nominate two directors to the company's board; two dissident nominees fail to get elected • Q3—Third Point reportedly builds stake of at least 1.2%, but is yet to disclose its intentions; reports suggest Third Point is pushing the company to resolve internal issues and accelerate value creation
Sony	$54.8	Third Point	• Q2—Third Point calls on the company to focus on its entertainment business by spinning off its semiconductor business and selling its stakes in Sony Financial, M3, Olympus and Spotify • Q3—In August, Sony announces it will sell its 5% stake in Olympus (though the company indicates it was unrelated to Third Point's demands) • In September, Sony announces it will not divest its image sensors business (a demand from Third Point)
Emerson	$39.5	D.E. Shaw	• Reports indicate D.E. Shaw acquires stake in Emerson and will push for split of Automation and Commercial & Residential Solutions businesses
Marathon Petroleum	$36.5	Elliott	• Elliott calls for the company to be broken up into three separate companies (similar to demands made by Elliott in 2016) • Marathon announces it will evaluate Elliott's proposal and looks forward to continued engagement on these issues; reports indicate the company is considering selling two refineries
Aramark	$8.6	Mantle Ridge	• Q2—according to reports, Mantle Ridge considers forming consortium to mount a takeover of Aramark or otherwise push for a sale • Q3—Mantle Ridge discloses investment in Aramark (no disclosed objectives); shortly after Aramark's CEO announces retirement; Mantle Ridge and Aramark ultimately settle with six new directors appointed
Scout24	$6.0	Elliott / Pelham Capital	• Elliott calls for Scout24 to divest its AutoScout24 business • Pelham Capital separately nominates director to the board, who was elected at the company's annual meeting
Box	$2.2	Starboard Value	• Starboard discloses a 7.5% stake in Box, noting the company was "undervalued" and "represented an attractive investment opportunity" • CEO of Box announces the company will seek to engage with Starboard productively
Cloudera	$1.8	Icahn Enterprises L.P.	• Icahn acquires 12.6% stake in Cloudera and disapproves of the company's recent merger with Hortonworks • Shortly after Icahn settled for two board seats
Unizo	$1.1	Elliott	• Elliott discloses initial stake in Unizo during hostile takeover bid from Japanese company H.I.S. • H.I.S. drops hostile offer after Unizo receives competing bid from Fortress Investment Group, with Blackstone also bidding • Unizo withdraws support for Fortress bid and rejects Blackstone proposals; Blackstone submits additional bid, which Unizo says it is considering

[5] Market capitalization as of campaign announcement.

Corporate Governance

TRENDS

2019 Proxy Season Highlights Include Increased Support for ESG, Concern for "Overboarding" and Investor Focus on the Link Between Executive Pay and Strategy / Performance[6]

Environmental and Social (E&S) proposals also saw continued support as investors continue to link E&S issues to long-term performance—48% of Russell 3000 E&S proposals received 30% or more support, relative to 39% and 28% in 2018 and 2017, respectively. Additionally, board diversity continues to be a major focus for investors—currently 27% of S&P 500 board seats are occupied by women (up significantly from the 18% figure in 2013); all S&P 500 boards have at least one female director; and 95% of S&P 1500 boards have one female director.

In part due to stricter investor policies regarding director "overboarding", directors during the 2019 proxy season saw increased scrutiny. Through Q3 2019, the number of Russell 3000 directors that failed to receive majority support increased ~114%, going from 29 directors through Q3 2018 to 62 directors in 2019.

Finally, investors have continued to focus on strong links between strategy and performance and executive pay programs. The failure rate for "Say on Pay" proposals has remained constant year-over-year (2.6% and 2.4% in 2018 and 2019 YTD, respectively, at Russell 3000 companies). However, there have been a number of notable cases that illustrate the types of concerns shareholders can have with executive compensation programs, including:

- Ameriprise Financial, where 66% of the company's shareholders voted against Ameriprise's "Say on Pay" proposal, even as the company lowered maximum payout targets, over concerns regarding large equity grants awarded despite share price underperformance; and

- CenturyLink, where 59% of CenturyLink shareholders voted against CenturyLink's "Say on Pay" proposal due to continuing concerns regarding a number of large pay opportunities over a relatively short time period.

Growth in Exchange Traded Funds (ETFs) Supports Passive Investor Influence, with Such Influence from the "Big 3" Index Funds Continuing to Focus on ESG

As has been highlighted by many in the legal, policy and business communities, the rise in popularity of passive investment strategies, and particularly the growing importance of ETF ownership (which has demonstrated a CAGR of 5.8% from 2015-2019 YTD in terms of the number of listed ETFs), has resulted in the "Big 3" index funds—BlackRock, State Street and Vanguard—owning an enormous percentage of U.S. public company stock. Additionally, as the "Big 3" have grown in size, they have also become more vocal on governance-related issues. As a result, understanding particular focus areas for these leading governance-focused investors is critically important for corporations to be able to meet the needs and expectations of their shareholders. Notably, the "Big 3" have maintained a particular focus on ESG, as such considerations become more synonymous with sustainability and good governance. As such, as corporations reflect on the results of the 2019 proxy season and prepare for 2020, it is imperative that this preparation involve continuing engagement on ESG issues—from both a governance and disclosure perspective.

Chief Justice Strine's Proposal Toward Fair and Sustainable Capitalism

In September 2019, Chief Justice Leo E. Strine, Jr., the outgoing Chief Justice of the Delaware Supreme Court, released a comprehensive proposal "Toward Fair and Sustainable Capitalism". Chief Justice Strine's proposal opens by stating his view that, "[t]he incentive system for the governance of American corporations has failed in recent decades to adequately encourage long-term investment, sustainable business practices, and most importantly, fair gainsharing between shareholders and workers." The proposal states that, in order to address this perceived problem, among other things, employees be given a voice within corporate boardrooms, and corporate management should give greater thought to the treatment of employees. The proposal also acknowledges the significant role of institutional investors, which own approximately 75% of U.S. public companies' stock, in shaping corporate policy. Chief Justice Strine cites the pressure on companies for immediate share price returns and the associated pressure that can place on companies and their management to focus on short-term stock price performance at the

[6] Data regarding 2019 proxy season highlights and growth in ETFs supporting passive investor influence from Lazard, *Review of Shareholder Activism – Q3 2019.*

expense of long-term, responsible stewardship for all stakeholders. The proposal also suggests that institutional investors should tailor their voting policies in U.S. public company elections with their ultimate investors—the "worker-investors" saving for retirement—and their interests in mind, which may not be entirely monetary (such as the need for a clean environment, safe products and gainful employment at appropriate wages).

Chief Justice Strine's proposal contains a number of policy suggestions to advance his proposed framework for corporate governance, including:

- Enhancing disclosure about companies and their businesses' impact on workers, consumers, communities, the environment and the nation;
- Requiring boards of large, socially important companies to create workforce committees at the board level to address workforce issues;
- Requiring companies that issue quarterly earnings guidance to do so in the context of a disclosed long-term plan for earnings growth;
- Steps to better align institutional investors' voting policies with the investment objectives and other social interests of the worker-investors whose money they invest;
- Reform the corporate electoral system at U.S. public companies to promote sustainable, long-term growth, including revisions to "say-on-pay" voting frequency and making changes to ensure that proponents of shareholder proposals have a genuine stake in the company;
- Requiring that public companies obtain shareholder approval before spending company funds on political activity; and
- Making a number of tax, accounting and disclosure changes to align incentives, promote growth, innovation and job creation, and provide transparency, including closing Schedule 13D reporting loopholes currently utilized by activist investors.

The proposal contains a number of additional policy suggestions not summarized here, and the proposal is required reading for those interested in the current focus in corporate governance around the role of American companies in society at large, and the debate about stockholder versus stakeholder corporate governance.

Institutional Shareholder Services (ISS) Announces the Results of its Annual Policy Survey[7]

Following the 2019 proxy season, ISS launched its Annual Policy Survey, a key component of ISS' annual benchmark policy development process.[8] The survey looks at potential policy changes for 2020 and beyond and solicits feedback from investors, companies and corporate governance organizations.[9]

In September 2019, ISS released the results of its Annual Policy Survey, which was based on 396 responses, including from 128 investor representatives and 268 non-investors that include corporate executives, corporate directors, corporate consultants, academics, trade associations and other non-investor entities.[10] Key findings from the survey for global and U.S. focused respondents include:

- Global—board gender diversity continues to be viewed as essential to effective board governance. 61% of investors and 55% of non-investors concurred that board gender diversity is an essential attribute of effective board governance, regardless of the company or its market. For those who disagreed, investors tended to favor a market-by-market approach, and non-investors tended to favor a company specific analysis.
- Global—director overboarding continues to be important, but how many boards is "too many" remains elusive. Investors and non-investors expressed differing views on the question of how many boards is too many for an individual director. For investor respondents—42% indicated that four public-company boards is the appropriate maximum limit for non-executive directors, while 45% indicated that two board seats is an appropriate maximum limit for CEOs (the CEOs current employer board plus one additional board seat). For non-investor respondents—39% and 36%

[7] Data from Institutional Shareholder Services (ISS) Analytics, *2019 Global Policy Survey* (September 11, 2019) (hereinafter *2019 Global Policy Survey*).

[8] Institutional Shareholder Services Inc., ISS Opens Global Policy Survey for 2020, Investors, Companies and Corporate Governance Organizations Encouraged to Participate in ISS' Annual Policy Development Process (July 22, 2019), *available at* https://www.issgovernance.com/iss-opens-global-policy-survey-for-2020/.

[9] *Id.*

[10] Institutional Shareholder Services Inc., ISS Announces Results of Global Benchmark Policy Survey, Majority of Investors Say Companies Should Assess, Disclose, Mitigate Climate-related Risks (September 11, 2019), *available at* https://www.issgovernance.com/iss-announces-results-of-global-benchmark-policy-survey/.

indicated that a general board seat limit should not be applied to either non-executives or CEOs, respectively, and indicated that each board should consider what is appropriate and act accordingly.

- Global—significant support for climate change risk oversight, but the issue is of greater importance for investor respondents. 60% of investor respondents indicated that all companies should be assessing and disclosing climate-related risks and taking appropriate actions to mitigate these risks. 35% of investor respondents favored a more company-specific approach, answering, "Maybe – each company's appropriate level of disclosure and action will depend on a variety of factors including its own business model, its industry sector, where and how it operates, and other company specific factors and board members". Only a significant minority of investors (5%), indicated that "the possible risks associated with climate change are often too uncertain to incorporate into a company-specific risk assessment model." For non-investor respondents, the level of support for climate change risk oversight was less enthusiastic—answers to these three questions were 21%, 68% and 11%, respectively—but still remained significant overall. For companies deemed to be not effectively reporting or addressing climate related risks, investors and non-investors indicated that engagement with the company and considering support for related shareholder proposals were the most appropriate shareholder responses.

- U.S.—for companies that do not have at least one woman on the board, the scope of mitigating factors investors and non-investors consider important when determining how to vote for certain board members remains unclear. Starting in 2020, ISS' U.S. policy guidelines will generally recommend voting against the nominating committee chair (and other members of the board as appropriate) at Russell 3000 and/or S&P 1500 companies that do not have at least one woman on the board. The guidelines include three mitigating factors that will be considered before a negative recommendation is made: (1) whether the company has stated in it's a proxy statement a firm commitment to appoint at least one woman to the board in the near term (such as within the next year); (2) the presence of at least one woman on the board at the time of the preceding annual meeting; and (3) other relevant mitigating factors on a case-by-case basis (if applicable).[11] Respondents were asked if ISS should consider other mitigating factors. Investor respondents were less likely than non-investor respondents to say that other mitigating factors—such as adopting "Rooney-rule" procedures to include one or more women in its pool of candidates whenever it looks to add a new director or maintaining an active recruitment process despite the absence of a vacancy on the board—should be considered and may be sufficient to avoid a negative recommendation. However, overall the range of other mitigating factors (and the emphasis that investors and non-investors believe should be placed on each), remains unclear, making it difficult to assess how shareholders will likely vote in these situations.

- U.S.—many market participants agree in principle on the importance of independent board leadership, but disagree on whether this can properly be achieved with a combined CEO / Chair. In this context, the debate centers on whether a lead independent director is an acceptable alternative to an independent board chair. As a general matter, ISS U.S. policy recommends supporting shareholder proposals requesting that the position of board chair be filled by an independent director after taking into consideration a wide variety of factors. For investors, poor company responsiveness to shareholder concerns and governance practices that weaken or reduce board accountability to shareholders (e.g., a classified board, plurality vote standard, lack of ability to call special meetings and lack of a proxy access right) were the most commonly cited factors that strongly suggest the need for an independent chair. Non-investors cited a poorly-defined lead director role and poor company responsiveness to shareholder concerns as the most common factors.

The Annual Policy Survey results cover a number of other topics and geographies, and provides a useful survey on market participants' views heading into the 2020 proxy season. As a result of the Annual Policy Survey and other components of ISS' policy development process, ISS will release draft policy updates in the second half of October for public comment prior to their finalization, which will culminate in final policies being released mid-November. The final policies will be applicable to shareholder meetings occurring on or after February 1, 2020.

[11] *2019 Global Policy Survey* at 10.

The Business Roundtable Issues a New Statement on the Purpose of a Corporation That Shifts Away from Shareholder Primacy and Includes a Commitment to all Stakeholders

In August 2019 the Business Roundtable, an association of chief executive officers of leading U.S. companies, issued a new "Statement on the Purpose of the Corporation." The new statement signals a shift away from the "shareholder primacy" model, which is based on the longstanding view in the U.S. that corporations exist to principally serve the shareholders, towards a stakeholder centric model based on the idea that corporations should be led for the benefit of all stakeholders, including customers, employees, suppliers, communities and shareholders. In the words of the statement, the signatories hold a "commitment to all of our stakeholders."

In many ways, the new purpose statement is consistent with the existing fiduciary obligations of the board of directors in providing oversight and setting the policy of U.S. companies. As long as directors are not conflicted and exercise due care, they can expect to receive the protection of the business judgment rule when reconciling the competing interests of the company's stakeholders to promote the long-term value of the corporation. The tension between stockholder and stakeholder primacy models is most apparent in enhanced scrutiny situations (such as a sale of control of the company), where judicial review of board decisions in some jurisdictions will focus on the benefits to shareholders above those of other constituents, as opposed to decisions involving the day-to-day management of the company.

The statement reflects two key trends that have been developing over time within the U.S. business and legal community—(1) concern among executives and directors that short-termism undercuts their ability to act in the long-term interest of the corporation and (2) a focus by certain shareholders and the general public on corporate responsibility for social issues. With respect to the latter, the statement can be seen as a proactive self-regulatory effort to dissuade politicians or regulators from imposing more stringent protocols, such as Elizabeth Warren's Accountable Capitalism Act that would give employees voting power in the boardroom of certain corporations.

Nonetheless, the new Statement on the Purpose of the Corporation has resulted in widespread debate and has prompted opposition from a number of different sources, chief among them the Council of Institutional Investors, who argue that, "[t]he statement undercuts notions of managerial accountability to shareholders."[12] Decisions made on the basis of one constituency (shareholder welfare) can be debated, but the many and often conflicting stakeholder interests would equip directors with a rationale for almost any decision.

CASES

In re Clovis Oncology, Inc. Derivative Litigation, No. 2017-0222-JRS (Del. Ch. Oct. 1, 2019).

In this case, the Delaware Court of Chancery denied a motion to dismiss by the board of directors of Clovis Oncology, Inc. ("Clovis"), finding that the plaintiffs adequately pled facts sufficient to support a pleading stage inference that the board breached its duty of loyalty by failing to monitor or oversee a critical aspect of Clovis' operations. In the *Clovis* case, the board faced claims stemming from its alleged failure to respond to red flags that Clovis was not adhering to clinical trial protocols in connection with the clinical trials it was conducting for FDA approval of its lead product candidate, as well as Clovis's alleged material misstatements and omissions regarding that product candidate's efficacy to the FDA and the market. Under Delaware law there are two ways to establish the board breached its duty of loyalty by failing to monitor the operations of the corporation: (1) "the directors completely fail[ed] to implement any reporting or information system or controls"; or (2) "having implemented such a system or controls, consciously fail[ed] to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[13] *Clovis* is the second recent Delaware decision to find plaintiffs adequately pled a violation of the duty of loyalty under the "duty to monitor" doctrine. The first case, *Marchand v. Barnhill*, addressed the "complete failure" prong. *Clovis* addresses the "conscious failure to monitor" prong.

Facts

In 2016, Clovis—a biopharmaceutical company focused on acquiring, developing and commercializing cancer treatments—withdrew Rociletinib ("Roci"), a promising lung cancer treatment, from FDA consideration after disappointing clinical trials. The announcement of the adverse results, which were worse than

[12] Press Release, Council of Institutional Investors, Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose (August 19, 2019) *available at* https://www.cii.org/aug19_brt_response.

[13] *In Re Clovis* at *33. Such claims are referred to as a "*Caremark* claims" after the seminal case on the duty to monitor, *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).

what was previously publicly reported, as well as the withdrawal of the FDA application, caused the price of Clovis' stock to fall precipitously. At the time, Clovis had no products on the market and generated no sales revenue, but had three drugs in the development stage, of which Roci was the most promising. In order to make it to market Roci had to obtain FDA approval, which required Clovis to adhere to certain "clinical trial protocols" throughout Roci's clinical trial. The court acknowledged that the board had established a board-level compliance system to monitor Roci's clinical trial, but found the plaintiffs adequately pled that the board consciously failed in its duty to monitor that compliance system. Specifically, the plaintiffs cited presentations to the board—which was comprised of pharmaceutical industry experts familiar with clinical trial protocols and FDA regulations—that allegedly described the clinical trial results in a way that did not comply with the required protocols. By allegedly ignoring such "red flags", the Board "plac[ed] FDA approval of the drug in jeopardy. [And] [w]ith the trial's skewed results in hand, the Board then allowed the Company to deceive regulators and the market regarding the drug's efficacy." As a result, the court concluded that the plaintiffs adequately pled, "that the Board consciously ignored red flags that revealed a mission critical failure to comply with the [clinical trial] protocol and associated FDA regulations," thus establishing a viable *Caremark* claim.

Takeaways

Similar to *Marchand*, the court accepted plaintiffs allegations that Roci was "intrinsically critical to the [C]ompany's business operations," and also emphasized the idea that, "as relates to *Caremark* liability, it is appropriate to distinguish the board's oversight of the company's *management of business risk* that is inherent in its business plan from the board's oversight of the company's *compliance with positive law*—including regulatory mandates." As a result, despite being only on a motion to dismiss, the case serves as another reminder of the importance of ensuring appropriate and well documented procedures exist to monitor and supervise reporting systems and risks that are "mission critical." And it further serves as a reminder that Delaware courts will expect directors to be engaged and scrutinize the results of information systems that report on risks that are "intrinsically critical" to the corporation.

Perhaps troubling, however, is the ability for the plaintiffs to sustain a duty of loyalty claim out of what is, at least in part, a securities disclosure claim. In *Clovis*, the court focused not only on Clovis' alleged misstatements and omissions to the FDA, but also to the investor community in its investor presentations and earnings releases. It will be interesting to see if plaintiffs in other stock drop cases try to use *Clovis* as a way to turn a securities disclosure claim into a *Caremark* failure of oversight claim, with the "oversight" being that over a company's public disclosures.

POLICY

From a policy perspective, Q3 2019 saw continued focus on proxy advisers and the proxy process more generally.

Securities and Exchange Commission (SEC) Issues New Guidance on Proxy Advisory Firms

In August 2019 the SEC issued two separate releases covering two aspects of the proxy voting process—(1) proxy voting responsibilities for investment advisers and (2) the applicability of the federal proxy rules to proxy voting advice.

<u>Proxy Voting Responsibilities of Investment Advisers</u>

In this set of guidance, the SEC clarified the proxy voting responsibilities of investment advisers, particularly when they retain a proxy advisory firm (such as ISS or Glass Lewis) for research and voting recommendations and included, among other things:

- Guidance on how an investment adviser and its client, in establishing their relationship, may agree on the scope of the investment adviser's authority and responsibilities to vote proxies on behalf of that client;

- Guidance on what steps an investment adviser, who has assumed voting authority on behalf of clients, could take to demonstrate it is making voting determinations in a client's best interest and in accordance with the investment adviser's proxy voting policies and procedures;

- Considerations that an investment adviser should take into account if it retains a proxy advisory firm to assist it in discharging its proxy voting duties;

- Steps for an investment adviser to consider if it becomes aware of potential factual errors, potential incompleteness, or potential methodological weaknesses in the proxy advisory firm's analysis that may materially affect one or more of the investment adviser's voting determinations;

- Guidance on how an investment adviser could evaluate the services of a proxy advisory firm that it retains, including evaluating any material changes in services or operations by the proxy advisory firm; and

- Whether an investment adviser who has assumed voting authority on behalf of a client is required to exercise every opportunity to vote a proxy for that client.[14]

On the whole, much of the guidance focuses on steps investment advisers can take to hold proxy advisory firms accountable in the context of delivering proxy-related services to investment advisers, and encourages investment advisers to seek greater transparency in the context of these services so as to be able to comply with their fiduciary obligations.

Applicability of the Federal Proxy Rules to Proxy Voting Advice

In a related release, the SEC also issued guidance that articulated its view that proxy voting advice generally constitutes a solicitation subject to the federal proxy rules. The SEC's interpretation does not affect the ability of proxy advisory firms to continue to rely on exemptions to the information and filing requirements of the federal proxy rules, which (among other things) provide relief to file a proxy statement as long as the advisory firm complies with the conditions for exemption under Rule 14a-2(b).[15]

However, the SEC also underscored that such solicitations—even if exempt from the federal proxy rules' filing requirements—remain subject to Exchange Act Rule 14a-9, which prohibits any solicitation from containing any statement that is materially false or misleading at the time and in light of the circumstances under which it is made.

In this context, the SEC's guidance explains the type of information a person providing proxy voting advice should consider disclosing in order to avoid a potential violation of Rule 14a-9. For example, the guidance notes that providers of proxy voting advice should consider whether (depending on the particular statement) it may need to disclose:

- An explanation of the methodology used to formulate its advice;

- Information sources and the extent to which such information differs from the registrant's public disclosures (to the extent the proxy advice is based on information other than the registrant's public disclosures); and/or

- Information regarding material conflicts of interest.

The guidance notes that such information may need to be disclosed where failure to do so would render the advice materially false or misleading. And together with the guidance for investment advisers issued by the SEC it is generally viewed as a step to promote greater accountability and transparency amongst proxy advisors, although the SEC emphasized that its interpretive guidance was not changing any rules or regulations.

This review relates to general information only and does not constitute legal advice.
Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.

[14] Press Release, Securities and Exchange Commission, SEC Clarifies Investment Advisers' Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice (August 21, 2019) *available at* https://www.sec.gov/news/press-release/2019-158.

[15] *Id.*