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**President Ramo:** Gentlemen and ladies, the President of the ALI almost never gets to decide much of anything by herself. But one thing you do get to do, it turns out, is that you do get to look at the incredible people in a

class and decide each year who would be a representative of the class that people would be interested in hearing and that might have a perspective that would particularly illuminate our discussions for the next 25 years. And in this class, it was really hard because all you have to do is look around the room to see so many people that have been so important on the bench, as scholars, and in the private practice of law, and some of you also in public life.

But as I thought about it, there was one name in particular that resonated with me, and he wouldn't have any idea probably why. In the early 1970s, when we returned to Albuquerque and I was in practice, one of our clients were two crazy kids, Bill Gates and Paul Allen. And we ended up—our firm did; we were 14 strong—being the counsel for Microsoft in the arbitration between them and what was then Tandy, Radio Shack later, who had bought the first personal computers and thought they bought the operating system. (*Laughter*)

Happily—but I was thinking back about what that meant and who they really were. Well, how is it that we got chosen for this august representation? And it was really something that shows what's happened in 25 years—or longer than that now.

What happened was that Bill's father, many of you know, was a lawyer in Seattle, and he did what people did then when they realized they needed a lawyer. He went to the Martindale-Hubbell book. Right? He looked in Albuquerque and he found that one of my partners had two sterling qualifications. He had gone to the Harvard Law School, which he thought was okay, but more importantly, he had gone to the University of Washington as an undergraduate. And so he called Paul and, lo and behold, for several years we had Bill and Paul in our offices on their bicycles, dressed as 18- and 19-year-old computer nerds at the time dressed.

They were brilliant and totally understood, at the time, how important lawyers were to their enterprise. It was really amazing when you think of their ages. They literally understood, in a very serious way, that the world had changed, that they were the change-makers, and that they needed unusual lawyers to help them make this new world a reality in which they could participate.

Larry Sonsini, who graduated both as an undergraduate and from the law school at the University of California at Berkeley, and is on the faculty—he's an adjunct professor both at Berkeley at Boalt Hall and at Stanford—that must make hard times for athletic events for you; I just have to think about this—somehow understood, and I hope he'll tell us a little bit about it—in the middle 1960s and in the early 1970s that the world had changed, that there were going to be companies doing what we couldn't have even imagined then, and that they needed special lawyers to understand what they were doing, their businesses, the impact, and how to make this new technologic world a legal

reality. And over the last 25 years, how the world has changed, as we heard the Director of the FBI speak, now every second, not just every 18 months.

So I called the person in your class who, I thought, had been at the epicenter of this change, and who himself was a legal change-maker, and that was Larry Sonsini, who agreed to come and speak on behalf of your class today. Larry? (*Applause*)

**Mr. Larry W. Sonsini:** Roberta, thank you so much. It's absolutely wonderful to be here. Twenty-five years just goes by. I remember when I was doing transactions; I think, Andy, you and I were doing deals when you were at Unisys. And then Ron Olson and I are always running into each other. I think we last collaborated last year on dual class structures at Google, of all things.

But it's an honor to be here, especially to sit next to my old professor, Geoff Hazard. I think it was in 1964 when I took Civil Procedure, and it's so great to see him today, one of the great scholars, and so many of you, so many friends out there.

I want to focus my remarks today on one aspect, and that's what's happening in corporate governance.

I am so proud of what we do in this country. We are pulling away from the world when you look at innovation and commercialization of technology. It's really astounding what is happening. We're changing communities. We're changing the way we think. Everything is becoming so disruptive. And it has put a lot of pressure on us. You heard from the Director of the FBI on one aspect of it. But it's affecting our business worlds in so many ways.

One area that it's affecting is what's happening in the boardrooms of our corporations. We're entering a period of time where we seem to be moving away from what I call a director-centric governance to more of a shareholder-centric governance model. And I think that there are some good things to that, but there are some bad things and there are some dangers out there lurking. And we have to understand them.

Today we call it shareholder activism. And what is that? What are the causes of shareholder activism? And how should boards and companies address the issues? I thought I would try to make my remarks center on that a bit and to give some insight of what we're dealing with.

I think we have to recognize, first of all, the landscape, the background. There are several factors that really have contributed and are contributing to this activism today that is changing so much—the business models of so many companies.

First of all, we have to recognize the size and diversity of the institutional investor. We've become an institutional shareholder today. And they have different agendas, different holding periods, different voting patterns. They

have different levels of activism. They are fiduciaries themselves. The retail investor has really drifted away into mutual funds and exchange-traded funds. And there is a rush to get shareholder returns in an environment of the institutional shareholder.

Secondly, we've seen the proliferation of derivatives, synthetic securities, hedging transactions where there is a decoupling of the economics from voting. Sometimes we're borrowing votes. Sometimes we're sharing votes. Sometimes we don't have any votes at all, but control economic interests.

And then, of course, there's the way shares are held. We've had a system for so long where beneficial holders can hold their shares in street name and oftentimes we don't know who the shareholder is. We've been under a model where the street-name holder, the broker, could vote the shares, and they traditionally always voted with management when in doubt. And that has changed.

And then, of course, we've had the growth of the proxy advisory firms. With the growth of the institutions comes a fiduciary obligation to vote shares. They are regulated that way. Well, when you invest in hundreds and thousands of companies, your ability to analyze proxy statements gets a little facile.

So we have a proxy advisory industry that grew up, an industry dominated by Institutional Shareholder Services, ISS, and Glass Lewis. Together they control about 97 percent of the proxy advisory business. They have no economic interest in the shares, and yet they are making the voting recommendations on behalf of these institutions. ISS controls about 61 percent of that market. And quite frankly, they have a great influence on boards of directors. In fact, a study was done by NASDAQ and the Stanford Rock Center for Corporate Governance where 70 percent of corporate America said that the decisions they make in compensation committees are influenced about what ISS thinks.

ISS and Glass Lewis are not regulated industries, and at the same time, they use tactics such as withholding votes on directors if directors make decisions that are contrary to what they perceive to be the proper governance guidelines.

On top of that, you have what I call the politicizing of the boardroom. Take majority voting. As you know, under state law, directors are elected by a plurality. However, the result of activism by some institutions came up with a philosophy that boards should be determined by majority vote. Those that get more votes for, as opposed to withheld votes, should be elected. And that's contrary to the concepts of plurality voting under the theory we must always have a board of directors.

Well, I estimate that a majority of the Fortune 1000 have adopted majority-voting standards, so that if you do not get a majority of votes, you must

tender your resignation, and then it's up to usually nominating and governance committees to decide whether to accept it.

Now when you take majority voting, that trend, which is not the result of any case or court decision or law but pure activism, and you couple it with an old rule that's been around for 70 or 80 years, Rule 452 of the New York Stock Exchange, which basically says when a broker who holds shares in street name can vote those shares, that rule has evolved to chip away that discretion to vote, particularly when it comes to the election of directors. So if a beneficial holder does not instruct the broker, those shares are not voted. They are like a "no" vote. That, coupled with majority voting, shows how ownership of a small number of shares can influence outcomes in the boardroom.

And on top of that, we have to deal with what's happened to director independence. We have rules requiring that majorities of our public companies be independent. But quite frankly, independence has become more contextual. You may be independent for one decision, but not independent for another decision. Take what happened to Oracle when it formed a special committee of independent directors to determine whether or not there had been an insider trade by the CEO, Larry Ellison. It was a wonderful committee. They spent thousands of hours with good advisers, came up with a great report, and the Delaware court says this is a great job, but it's not acceptable because you're not independent. [In re Oracle Corp. Derivative Litig., 824 A.2d 917 (Del. Ch. 2003).] And the reason you're not independent is Larry Ellison makes gifts to Stanford and two of the three committee members are involved with Stanford. One is a professor and one is with the Hoover Institution. Contextual independence.

The activists today have a lot of capital. By some estimates, it ranges from anywhere to $120 billion to over $200 billion under management. On the low end, that's a 250 percent increase since 2009. For example, Icahn manages maybe $29 billion. Third Point, maybe $14 billion. Elliott Management, maybe $32 billion. Rational, maybe $7 billion. And the list goes on. So these activists are managing money with fiduciary obligations. They are very well funded. And their economic returns have been good compared to hedge funds and the S&P 500. So the economics are working.

Then you take the long-only investors, T. Rowe Price, Fidelity, the BlackRocks. Frankly, they are somewhat becoming activists, too. They pay attention to some activist agendas.

All of these result in an asset-management group that is very well funded, very sophisticated, and driving multiple agendas. And their tactics are far-reaching today. Shareholder activists make public campaigns. They are willing to write public letters and press releases, delving into business plans, and criticizing boards of directors. They are willing to wage proxy contests. They

are willing to make shareholder proposals. They retain investment advisers. They retain well-trained lawyers. They are willing to wage multiyear campaigns.

So what we have today is an activity in the market that is driving more and more stress into the boardroom. And the activists are successful. One report says that almost 75 percent of the activists' demands were at least partially satisfied in 2014. Ernst and Young says that half of the S&P 500 engaged with activists last year. And *The Wall Street Journal* reported that there were 92 proxy fights last year, and 56 percent were won by activists.

All of this has led to a very interesting debate: is this good for corporate America? Is this just a trend? Is this just the fact that interest rates are low and there's a lot of capital that has to go to work? Or is it a real shift in how we should think of modeling and running our corporations?

I think, quite frankly, the jury is out on that. I think it's a little of both. But I think that the debate is very interesting.

The hedge funds, the activists, the institutions will tell you that activism is a good thing because it's requiring management and boards to focus on business models, that you can't afford to be a potted plant in corporate America anymore, even if you ever were.

However, the evidence on the other side is somewhat compelling. Larry Summers, our former Treasury Secretary, has been quoted to say that the epidemic right now of activism is directed at getting management to choke off investment. Is there a choking off of investment? Is there a short-termism that is growing into our boardrooms that's going to affect innovation and affect jobs and affect our communities? Or is this just a trend that will dissipate when the market perhaps returns to other norms?

I think that we have to recognize that activism is having a major effect. I advise a large number of public companies. I'm in the boardroom almost every other day, just as Ron Olson is. And I will tell you that companies are returning capital to shareholders in response to this kind of pressure, more stock buybacks, more dividends. Is that a good thing? There has been a reduction in investment in Research and Development. There has been a lot of Merger and Acquisition activity because one of the agendas is that if your business plan isn't robust, you ought to sell the company or bust it up.

A classic example of this debate is what happened just recently with DuPont. A $68 billion valued company. So no company is immune from this activism. And Nelson Peltz waged a contest to get representatives on that board of directors. Now, he lost. And many people have paused and said maybe the pendulum is swinging back. I don't think so, because I think he lost for two reasons. One is the CEO did a very good job. She did a very good job of two things. She anticipated the activists' agenda and agreed to cut expenses and agreed to do massive buybacks. That was part of the agenda. And she got

on the road and met with investors, meetings upon meetings, communicating the DuPont strategy. And so although the activists lost, the activists also won. And that is the debate that's going on that is affecting how we run our companies.

So what does this mean to a board of directors today? How do you deal with this? How do you advise them? And I think there are several directives that come to mind.

First of all, boards have to recognize that activism is well funded, it's sophisticated, and it's committed. I think boards have to understand the activists' agenda. And, quite frankly, the agenda is a good way to gain perspective on how to look at a business plan. Do we have too much cash on the balance sheet?

Take a client. Apple Computer, the most highly valued company in the world today by more than half. It is facing activism all the time. What are you going to do with the cash? The board says we are going to invest. We are going to build more devices, better software, more mobility, more communication. The activist is saying the cash is too idle. You don't have any return on it. Give it back to us.

What's happening in technology, as I've said, is we are disrupting businesses. It is shocking what's coming, and it's going to be phenomenal. What's happening in bioscience, what's happening in life science, what's happening in communication, what's happening in the change of semiconductors and the speed at which we're going to do things, it's all coming and it's disrupting industries. Look what Uber is doing to the taxi industry. Look at what Amazon has done to the retail industry. Look what Apple has done to mobility. Look what Google has done to information.

All of that change is coming and it's exhilarating. And, at the same time, you have all of this capital that wants to go to work, and that capital is saying to companies, get better returns, shorter term, or capitulate to this change and bust up or sell or consolidate. And that is the tension that's going on.

The second thing boards have to recognize is the expectation of greater tension in the boardroom.

We have to manage to long-term value. That is our job in the boardroom. We should not manage to short-term. But that is really becoming a very difficult challenge today. Information has made the market able to force more transparency and short-termism on business models, and boards today are constantly fighting for that.

I think there has to be, as a result, greater emphasis on shareholder communication. We are going to have more transparency about business plans and about business strategies. I remember practicing in the 1970s and 1980s, there was very little transparency. If you look at the proxy-statement size of

companies 40 years ago, they were 10 percent of the length today. It's amazing the quantity of disclosure that is being put out there because of this force on transparency. So there has to be more communication.

I think DuPont won that battle because they got on the road and talked to those shareholders. But remember, even though Peltz lost, he did get support from some very fine investors. J.P. Morgan voted for him. Fidelity Capital voted for him. So it goes to show you that this debate is really real.

Another directive, I think, that would be important is to really have an understanding of defensive measures. As you know, such things as poison pills, staggered boards, dual-class structures, all of those things now are out of phase. I remember when 60 percent of the Fortune 500 had poison pills. Today it's down, less than 20 percent, maybe 15 percent.

But there's a place for defensive strategies. And the reason why there's a place is because the board's duty is to protect long-term value, and if long-term value is there, then short-term gain has to be resisted. And that is the rhetoric in the debate, and a defensive measure is appropriate as long as the board is focused on a real threat and a real assumption of long-term value.

Of course, I think we also have to realize that boards have to think about their obligations differently. This is the next change. We are often asked, how should you think as a director today, given this background? And I've come up with what I call my top 10 themes that I think are important. Some are obvious.

One is process matters. The courts are ill-equipped to determine whether the actions of a board are good substantively. Judges do not like to substitute their judgment for the judgment of members of the board of directors. But what they love to do, and that they are very adroit at, is they really focus on process. How did you come to the decision? How well informed were you about the decision? How independent was that decision? How much debate did you have on that decision? And that's where the key is. That's where these cases are won and lost. They are won and lost on process.

Secondly, I think boards have to focus more on being well informed, being deliberate, being inquisitive, and being independent. I think that those are the themes that are constantly under challenge. Boards should frequently ask the question, what is the company's stand-alone plan? What are the risks and assumptions of that plan? And do we have the quality of management to execute and to manage those risks?

We have to continue to take the long-term view. I think that we've got to resist this theme of returning capital by share buybacks and dividends. Share buybacks may look like they change earnings per share, but that's just math. They don't do a darned thing operationally or fundamentally to the business plan. All you are doing is redeploying an asset. And I think that that asset should be managed responsibly, and turning it back to shareholders is

just too short-term an answer. That isn't to say it isn't appropriate in many cases. The activist agenda is not facile. But I think sometimes we react too quickly to it.

I think also that we have to very carefully understand the distinction between a board's role and that of management. Oftentimes with this kind of pressure, boards react by getting involved too much in the management of the enterprise. That's not their job. Our job is to reach agreement on the company's strategic plan, assess the risk of that plan, select the CEO and management team to execute that plan, and ensure compliance with a high quality of ethics at the top and regulatory compliance. And those themes, if they are driven hard, usually result in the best results.

The fact of the matter is board agendas have become out of whack. They have become check-the-box items because of all of this external pressure. Take compensation committees today. They are inundated with say-on-pay resolutions, tying executive compensation to performance, trying to satisfy ISS and Glass Lewis, and dealing with the demands and competition of the marketplace. Look at the disclosure and proxy statements on compensation. It takes up a third of the disclosure.

I think that we have to continue to have constructive tension in the boardroom. There should be tension between management and the board, but it's got to be constructive.

And at the same time, we have to have a collegial and diversified board. I think that collegiality is critical. The press for independence that came out of the Enrons and Sarbanes-Oxley [the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002)], all of which were necessary regulatory reactions, has a danger to it. We are creating strangers in the boardroom, and we've got to get rid of that. Independence does not mean strangeness, and independence does not mean no collaboration with management. And so we've got to have boards be more willing to evaluate themselves candidly. And board evaluation should go to peer-to-peer analysis where people should critique each other.

I will tell you that the next activist agenda that is gaining momentum is to go after boards of directors (e.g., Board Tenure). If you've been on a board for more than three terms, you may face pressure to be out. It's not even age anymore. It's called staleness and sustainability, and I think we have to recognize that this pressure is going to be coming. So we have to continue to build collegial boards that assess themselves regularly.

I think, lastly, it's so critically important that we be willing to take risks. One of the fears I have is that we are diminishing risk-taking. Now I come from Silicon Valley where a lot of it is about risk, of course. And again, it's a fascinating time of what's coming. But what I worry about is when I go into the boardrooms of public companies that have been public for a while, the

entrepreneurialism is coming out of the system. Sometimes it's because of these external pressures. Sometimes it's because of lack of understanding of really what's happening in the competitive environment. Sometimes it's just short-termism. And I think we have to fight that.

We are going through change in corporate governance at the same time that we are going through change in communication and access to information. I think we are going to see more disruption of our industries coming at a time when we are trying to rationalize these capital markets.

My last point is the good news. We have the greatest capital markets in the world. I spend time in China, Hong Kong IPOs [initial public offerings], you have it. Everybody wants to emulate what we've done in our markets, and no one is close. We've had a great balance of transparency and liquidity and ethics, and we've had a great balance between private-sector dynamism and not too much regulation. And so we've got to keep that balance going, because we have great momentum in this country. I think we commercialize technology in a way that is good for our communities, good for the health of our communities, good for the education and our institutions, but we have to recognize that we are going to have more disruptive change in our industries and in our markets. But as long as we keep in mind building long-term value, I think that we will continue to lead the world.

I thank you very much for listening to me. It's just an honor to be here, and you've been very patient and kind. Thank you. (*Applause*)

**President Ramo:** Well, as always, this was an extraordinary address, substantive, serious, important, and I think one that your class is very proud of. It's impactful to all of us. You'd be amazed at the number of people here who deal with these issues every day, sometimes in big contexts and sometimes in small ones.

So on behalf of The American Law Institute, let me present you—everybody in the class will get one of these—your 25-year certificate. And thank you for doing this.

**Mr. Sonsini:** Thank you, Roberta.

**President Ramo:** Thank you. (*Applause*)

Well, again, I thank everybody in the class for their diligence, their gifts of all kinds, intellectual and monetary.

And now we are going to start, a few minutes late—so hustle right in—something enormously important, I think, in American life, and that is our first look at a Tentative Draft of part of the Restatement of the Law of American Indians. Thank you all. (*Applause*)