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SOME THOUGHTS FOR BOARDS OF DIRECTORS IN 2017

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The evolution of corporate governance over the last three decades has produced meaningful changes in the expectations of shareholders and the business policies adopted to meet those expectations. Decision-making power has shifted away from industrialists, entrepreneurs and builders of businesses, toward greater empowerment of institutional investors, hedge funds and other financial managers. As part of this shift, there has been an overriding emphasis on measures of shareholder value, with the success or failure of businesses judged based on earnings per share, total shareholder return and similar financial metrics. Only secondary importance is given to factors such as customer satisfaction, technological innovations and whether the business has cultivated a skilled and loyal workforce. In this environment, actions that boost short-term shareholder value—such as dividends, stock buybacks and reductions in employee headcount, capital expenditures and R&D—are rewarded. On the other hand, actions that are essential for strengthening the business in the long-term, but that may have a more attenuated impact on short-term shareholder value, are de-prioritized or even penalized.

This pervasive short-termism is eroding the overall economy and putting our nation at a major competitive disadvantage to countries, like China, that are not infected with short-termism. It is critical that corporations continuously adapt to developments in information technology, digitalization, artificial intelligence and other disruptive innovations that are creating new markets and transforming the business landscape. Dealing with these disruptions requires significant investments in research and development, capital assets and employee training, in addition to the normal investments required to maintain the business. All of these investments weigh on short-term earnings and are capable of being second-guessed by hedge fund activists and other investors who have a primarily financial rather

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SEC, UNITED SETTLE INTERNAL CONTROLS CASE

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When the Foreign Corrupt Practices Act (FCPA) was passed, a key portion of the statute centered on the books and records and internal control provisions written by the Securities and Exchange Commission (SEC). While the bribery provisions only apply to foreign officials, the books and records and internal control provisions apply to *all issuers*. In *In the Matter of United Continental Holdings, Inc.*—the Commission's most recent internal control case—the facts regarding a possible *quid pro quo* are reminiscent of many FCPA bribery cases. Yet the action centers on a U.S. issuer, a benefit to a state official and alleges internal controls violations based on not securing a waiver of typical but undocumented procedures.[1]

United Continental is a Chicago-based issuer whose shares are listed on the New York Stock Exchange. The holding company is the parent of United Airlines. The official in this case is David Samson, a member of the Port Authority, a political subdivision of the states of New York and New Jersey that operates Newark Airport, a United Airline hub. The airline has a significant presence at the airport.

Beginning in February 2011, Samson, after becoming Chairman of the Port Authority, began pressing United through a consultant and registered lobbyist to initiate a non-stop flight route from Newark to Columbia, South Carolina. Samson maintained a home in that city. Previously Continental Airlines, later merged into United, had a route between the two points. It was terminated because it was unprofitable.

During the summer and fall of 2011, United was negotiating a lease of three acres of land at the Newark Airport. The airline planned to construct a maintenance hangar for its wide-body aircraft. United estimated that the maintenance hangar would result in efficient routings that would drive $47.5 million in value to the United network on an annual basis. During the summer and fall the negotiations regarding the hangar proceeded.

In September 2011, Samson met with Jeff Smisek, then-CEO of United, and others for dinner in New York City. The focus of the dinner was United's priorities at Newark airport and the hangar. During the course of the dinner Samson noted that Continental Airlines at one time had a route from the Newark Airport to Columbia, South Carolina. Smisek stated that generally the airline did not maintain unprofitable routes but noted he would look into the matter.

Subsequently, United personnel at the Newark Planning Group analyzed potential financial performance of the proposed route that Samson favored. United did not have any written policies or procedures regarding the evaluation of possible routes. Typically, the firm: *i*) prepared and considered financial forecasts and other market data on how the route might perform; *ii*) conducted reviews and sought approvals at several levels within United's Newark Planning Group; *iii*) obtained approval from the Chief Revenue Officer or his staff; and *iv*) presented the route and its details to a group of senior firm executives at a regularly scheduled marketing meeting.

With regard to the proposed Columbia, S.C. route, the preliminary financial analysis concluded that the route would likely lose money. The United government affairs office was informed of the analysis, but was also aware of Samson's interest in the route. On October 13, 2011, United told the consultant who initially contacted the firm about the route that the airline was not interested in operating the route proposed by Samson.

In November 2011, United expected the lease for the hangar project to be considered by the Port Authority. Ultimately the item was omitted from the agenda. The next month the lease was also omitted from the agenda for the Port Authority meeting.

After learning of the Port Authority's action—or inaction, in this case, Smisek approved the route proposed by Samson. The Port Authority approved the lease the same day. Ultimately, after again losing money, the route eventually was terminated.

At the time of its approval, the route had not received initial approval from the Network Planning Group, been approved by the Chief Revenue Officer or his staff, and had not been presented during a regular market meeting. The firm also had a Code of Business Conduct in effect that prohibited bribes and other improper acts, backed by Ethics and Compliance Guidelines. No waiver of the customary procedures had been obtained.

The SEC's Order alleges violations of Exchange Act Section 13(b)(2)(A) and (B).[2] "United initiated a money-losing flight solely to curry favor with a public official, and failed to reflect in its books and records a fair and accurate depiction of the rationale behind the decision and its projected financial impact," stated Andrew M. Calamari, Director of the SEC's New York Regional Office, in a press release announcing the Order.[3]

To resolve the proceeding, United undertook a series of remedial actions. Those included enhancing its Ethics and Compliance Office as well as its global code of conduct and anti-bribery policies. The firm also conducted extensive anti-bribery and corruption training. United consented to the entry of a cease-and-desist order based on the Sections cited in the Order. The firm will pay a civil penalty of $2.4 million. In resolving the action, United did not make any admissions; however, the Order omits the standard "neither admits nor denies" language while stating that United consented to the entry of the Order.

Previously, Samson pleaded guilty to bribery in a criminal case initiated by the U.S. Attorney's Office for the District of New Jersey. United entered into a non-prosecution agreement with the same U.S. Attorney's Office, made certain admissions, agreed to continue enhancing its internal procedures and paid a fine of $2.25 million.

Smisek and two other United employees resigned in September 2015 amid the federal investigation. Samson stepped down from the Port Authority in March 2014, and on July 14, 2016, he pleaded guilty to charges related to the investigation.

ENDNOTES:

[1] *In the Matter of United Continental Holdings, Inc.*, Adm. Proc. File No. 3-17705 (December 2, 2016); available at https://www.sec.gov/litigation/admin/2016/34-79454.pdf.

[2] *In the Matter of United Continental* at 34-37.

[3] *See* SEC Press Release 2016-253, "United Settles Charges in Case of Flight Route to Benefit Public Official" (December 2, 2016); available at https://www.sec.gov/news/pressrelease/2016-253.html.