Governance Round-Up

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Nasdaq Proposes Disclosure of Third-Party Payments to Directors and Nominees

So-called "golden leash" payments, *i.e.*, compensation arrangements between a third party and a board nominee or director in connection with that person's nomination or board service have generated significant debate between those who believe they create conflicts of interests and those who believe they further align interests of directors and stockholders. On January 28, 2016, Nasdaq proposed a rule that would require a listed company to disclose, on its website or in its proxy statement for its next annual meeting (or if it does not file proxy statements, in its Form 10-K or 20-F), all agreements and arrangements between any director or nominee and any person or entity, other than the company, that provides for compensation or other payment (such as the payment of health care premiums) in connection with that individual's candidacy or service as a director, subject to limited exceptions. At a minimum, companies would be required to disclose the parties to the compensation arrangements and their material terms. The rules would not require disclosure of agreements or arrangements that existed before a nominee's candidacy and that have otherwise been publicly disclosed, or that relate only to expenses incurred in connection with the nominee's candidacy for director.

In proposing the rule, Nasdaq expressed concern that investors may lack complete information about such third-party payments since existing disclosure rules relating to related-party transactions and director independence may not require disclosure about them. Nasdaq noted that these arrangements potentially raise several concerns, including that they may lead to conflicts of interests among directors, may call into question a director's ability to satisfy his or her fiduciary duties and may promote a focus on short-term results at the expense of long-term value.

Nasdaq is conducting a survey as to the appropriateness of the proposed rule. The survey is available on Nasdaq's Governance Clearinghouse webpage and the deadline to respond is Monday, March 18, 2016. The proposed rule was reportedly rejected on technical grounds, but it is anticipated that Nasdaq will resubmit soon. The rule change requires SEC approval.

Investors Continue to Push for Proxy Access; SEC No-Action Letters Support Company Arguments for "Substantial Implementation"

As expected, proxy access continues to be an important agenda item for U.S. public companies. ISS is currently tracking approximately 115 proxy access proposals for 2016. The New York City Comptroller, on behalf of the New York City Pension Funds, is continuing its Boardroom Accountability Project and submitted proxy access proposals to 72 companies, including 36 companies that received the proposal in 2015 which have not yet enacted, or agreed to enact, proxy access bylaws.

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Market terms for key proxy access thresholds have coalesced, with a substantial majority of adopted proxy access bylaws including:

- a 3% ownership threshold;
- a 3-year holding period;
- group aggregation of up to 20 shareholders; and
- the right to nominate up to 20% of the board.

Notwithstanding a détente on these core terms, debate has continued as to the appropriateness of commonly adopted terms that certain investors view as material restrictions on their proxy access rights, including restrictions on third-party compensation of nominees, prohibitions on resubmission of failed nominees, required post-meeting shareholding periods and counting individual funds within a mutual fund family as separate shareholders for aggregation purposes. For companies that have adopted or are considering adopting proxy access, one key question has been to what extent shareholders will be able to challenge the terms of a company-adopted proxy access bylaw through subsequent shareholder proposals.

On February 12, 2016, the SEC staff issued 18 no-action letters involving requests to exclude shareholder proxy access proposals on the basis that the proposals had already been "substantially implemented" under Rule 14a-8(i)(10). Sixteen of the proposals were submitted by corporate gadfly, John Chevedden, and two were submitted by the New York City Comptroller. The SEC staff granted relief to the thirteen companies which had adopted the substantive 3% for three-year ownership thresholds proposed by shareholders, even though the company-adopted bylaws differed on such terms as aggregation and nomination thresholds (*e.g.*, group aggregation of no more than 20 compared to a shareholder proposal for unlimited aggregation and limits on board nomination of 20% compared to a proposed 25% cap) and contained additional restrictions that were not applicable to all board nominees. The SEC staff denied no-action relief only to the three companies which had adopted a 5% ownership threshold where shareholders were proposing a 3% ownership threshold. While the staff's position on any individual no-action request will depend on the facts and circumstances, companies should take comfort in the fact that these no-action letters overwhelmingly support company-adopted bylaws so long as the terms implement the shareholder's proposed stock ownership threshold, regardless of whether other terms differed from the proposal.

Heading into the 2016 proxy season, approximately 25% of S&P 500 companies have adopted proxy access (up from 1% in 2014). Whether or not a company has received a proxy access shareholder proposal, management and the board should consider whether to implement proxy access and should have a game plan for shareholder engagement on the issue.

Facebook Settles Director Compensation Litigation

On January 22, 2016, Facebook settled shareholder litigation alleging that its non-employee directors breached their fiduciary duty of loyalty by awarding themselves excessive compensation. In the settlement, Facebook agreed to submit its director compensation program, as well as 2013 equity grants to its nonemployee directors (which were at issue in the lawsuit), to a shareholder vote at its 2016 annual shareholder meeting. Facebook also agreed to amend its compensation committee charter to provide that,

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for five years, Facebook's compensation committee and board of directors must annually review its director compensation program and that the compensation committee use an independent consultant in that review. The settlement is pending court approval.

This settlement would conclude litigation brought in June 2014 alleging, among other things, that Facebook's payments to its non employee directors were 43% higher than the average payment made by companies in Facebook's peer group and that Facebook's equity plan had no meaningful limit on director compensation. While Mark Zuckerberg, Facebook's CEO, co-founder and controlling shareholder, had indicated (by affidavit and deposition) his approval of the director compensation program, the Delaware court chastised Facebook for not following proper governance procedures for obtaining shareholder ratification under Delaware law. Applying an "entire fairness" standard, the court denied Facebook's and its directors' motion for summary judgment of the lawsuit.

This litigation and settlement follows other recent instances of challenges to non-employee director compensation in the Delaware courts (*e.g.*, *Calma on Behalf of Citrix Sys., Inc. v. Templeton*). Companies and boards of directors should keep a close eye on establishing appropriate levels of director compensation and adhering to appropriate governance procedures and formalities regarding the same.

BlackRock Continues Dialogue on Long-Versus Short-Termism

In February 2016, Fortune 500 CEOs received a letter from Larry Fink, CEO of BlackRock, urging them to focus on the company's "strategic framework for long-term value creation" and to avoid the pitfalls of market pressures toward short-termism, including managing to quarterly guidance. In the letter, Mr. Fink emphasized that long-term investors need to better understand companies' future plans and that companies should clearly articulate those plans. Specifically, he suggested that:

- CEOs should lay out for shareholders annually a strategic framework for long-term value creation;
- CEOs should explicitly affirm that their boards have reviewed the company's long-term strategic plans; and
- Environmental, social and governance (ESG) considerations, which are important to long-term investors, should be incorporated into a company's strategic plans and communications.

While BlackRock does not support activists that focus on near-term profits over long-term development, Mr. Fink noted in the letter that BlackRock will support activists that articulate better long-term strategies than management. During the 2015 proxy season, in the 18 largest U.S. proxy contests, BlackRock voted with activists 39% of the time.

Chair White Focuses on Board Diversity

In March 2015, CII, on behalf of public pension fund fiduciaries, submitted a rulemaking petition asking the SEC to require new disclosures regarding director nominees' gender and racial and ethnic diversity, in addition to their mix of skills and other characteristics. Current SEC disclosure rules require companies to disclose whether diversity is considered in the director nomination process. Some investors and corporate governance advocates have argued that the information provided under these rules is often boilerplate that fails to provide meaningful information given that the rules leave it up to the companies to define "diversity," with many doing so in the broadest sense.

These concerns appear to have resonated with the SEC. In remarks delivered at a January 2016 securities conference, Chair White indicated that she is focused on board diversity and has instructed the SEC staff to review existing company disclosures and provide recommendations on whether the SEC should amend its rules to require companies to provide more specific information about the racial or gender composition of their boards. While it is unclear whether the SEC will propose rule changes, companies may wish to consider improvements to their disclosures relating to board diversity in light of this recent investor and SEC focus.

NACD Report: Top Governance Issues for Institutional Investors in 2016

In December 2015, the NACD released its annual report: "Critical Issues for Board Focus in 2016." The issues identified in the report were gleaned from group and individual conversations held late in 2015 with institutional investors representing approximately $15.7 trillion in assets under management. The NACD identified three developing trends that may be particularly important for the 2016 proxy season:

- Major investors expect dialogue with companies to include topics such as compensation and risk management, with a focus on strategy;
- Dialogue is evolving on a number of corporate governance issues that will remain in focus in 2016, including proxy access, board refreshment, and executive compensation; and
- Governance practices at IPO companies will be scrutinized to ensure that they benefit all shareholders.

The report is available at *www.nacdonline.org*.

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Please do not hesitate to contact us with any questions.

Governance Round-Up

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919 Third Avenue
New York, New York 10022
+1 212 909 6000
www.debevoise.com

Washington, D.C.
+1 202 383 8000

London
+44 20 7786 9000

Paris
+33 1 40 73 12 12

Frankfurt
+49 69 2097 5000

Moscow
+7 495 956 3858

Hong Kong
+852 2160 9800

Shanghai
+86 21 5047 1800

Jeffrey J. Rosen
Partner
+1 212 909 6281
jrosen@debevoise.com

Steven J. Slutzky
Partner
+1 212 909 6036
sjslutzky@debevoise.com

William D. Regner
Partner
+1 212 909 6698
wdregner@debevoise.com

Matthew E. Kaplan
Partner
+1 212 909 7334
mekaplan@debevoise.com

Anne C. Meyer
Counsel
+1 212 909 7441
acmeyer@debevoise.com

Gary W. Kubek
Partner
+1 212 909 6267
gwkubek@debevoise.com

Meir D. Katz
Partner
+1 212 909 6615
mdkatz@debevoise.com

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