

THOMAS J. DOUGHERTY

The Directors' Handbook

2015 EDITION



Companion CD contains key corporate governance regulations,
case law and other relevant resources

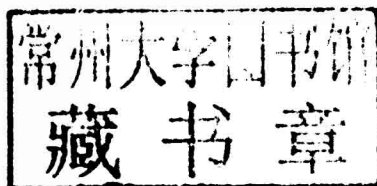


CORPORATION SERVICE COMPANY

THE DIRECTORS' Handbook

SKADDEN
ARPS
SLATE
MEAGHER &
FLOM LLP

2015 Edition



Thomas J. Dougherty

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About the author

Tom Dougherty has been a partner at Skadden, Arps since 1984. He specializes in representation and defense of companies and their officers, directors, underwriters and auditors. He has been involved from the boardroom to the courtroom in many significant jury and judge-tried cases litigated in the past twenty-five years, including litigating in defense of corporate actions and disclosures, proxy contests, hostile takeover cases and numerous class action defenses.

Tom Dougherty was born in Boston and educated at local parochial schools and Holy Cross College. He then attended Oxford University as a Marshall Scholar and received a B. Phil. degree in economics. He was also named a Danforth Foundation Fellow and Woodrow Wilson Fellow at that time. He attended Harvard Law School, graduating in 1976, and subsequently was a law clerk to Stephen Breyer, then a judge on the U.S. Court of Appeals for the First Circuit, now a Supreme Court Justice.

This is the 20th edition of this Handbook.

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What others are saying about *The Directors' Handbook:*

"An invaluable guide to directors and to anyone interested in the critical role that directors play in our corporate governance."

Lucian Bebchuk
Friedman Professor of Law, Economics, and Finance
Director, Program on Corporate Governance
Harvard Law School

"The Directors' Handbook is a jewel! Tom Dougherty has succinctly captured the latest developments facing directors both from a legal and a practical perspective."

Jay W. Lorsch
Professor, Harvard Business School
Author of *Back to the Drawing Board:
Designing Boards for a Complex World*

"The Handbook combines an insightful conceptual framework with practical information for board members and their advisors. It is a gem."

Richard S. Ruback
William Prescott Smith
Professor of Corporate Finance
Harvard Business School

"While external auditors and accountants can provide in-depth material and knowledge, no conscientious board should be without a comprehensive primer. The Directors' Handbook fits that need well. It is a vastly educating, and at times amusing, book that lends practical knowledge to a complex topic."

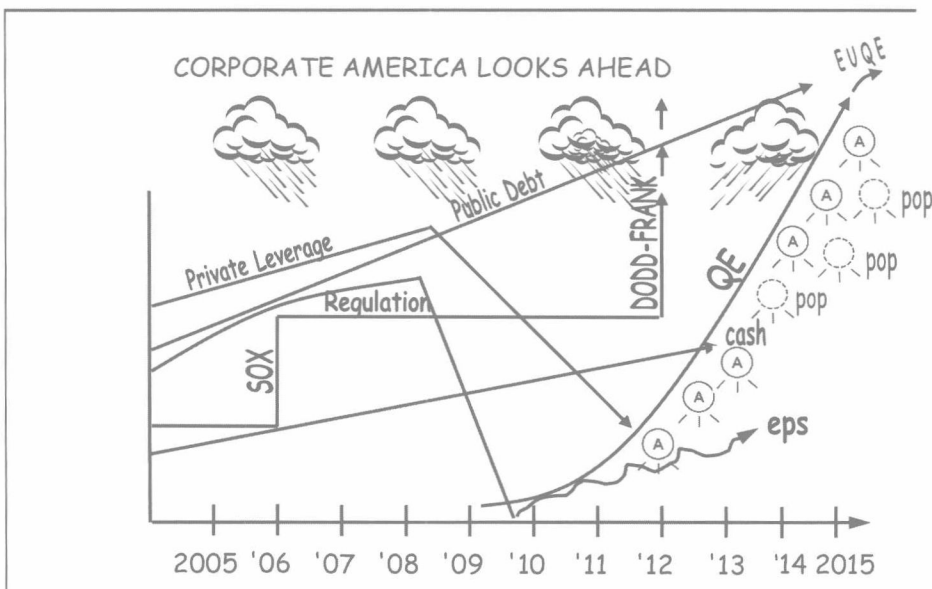
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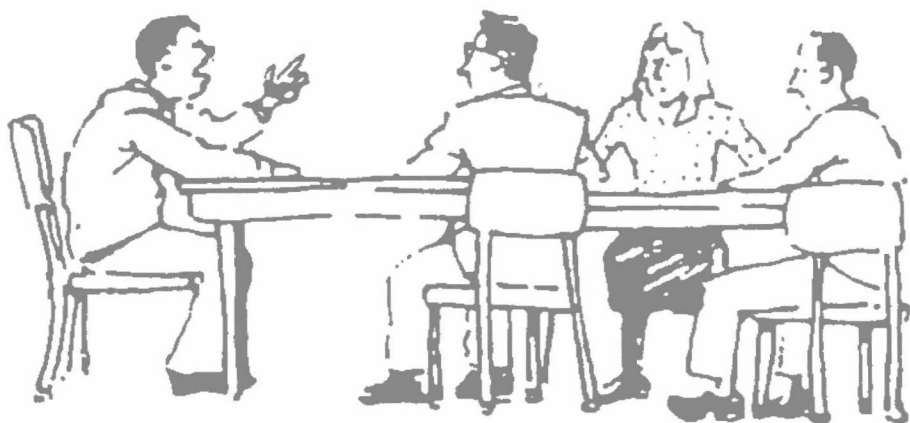
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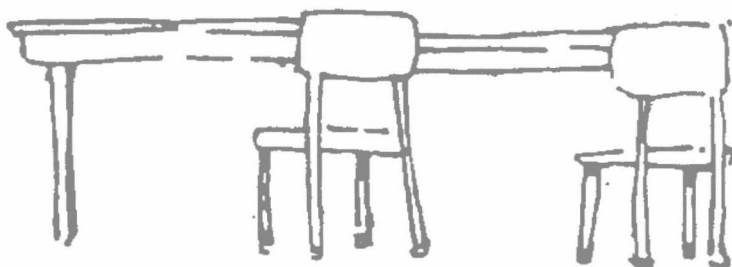
"So what if a few asset bubbles pop."

Tell me about your directors'
vision and vigilance,
and I will tell you the
future of your company.

2015
CULTURE INFORMS STRATEGY



"We don't have time to re-set firm culture.
We'll re-set strategy first, and the culture
will just have to catch up."



Foreword

No Director Left Behind

F.1 The Culture-Structure Interplay

We tend to think of board structure in relation to its stock exchange-mandated board committees, or other standing committees, including Audit, Compensation, Nominating, Governance, Finance and M&A. Much of this Handbook is taken up with discussion of those committees and related director duties. Deservedly so.

But there is a predicate question and, I submit, a related concern that should be addressed, at least annually, regarding board structure. That is the interplay between board structure and board culture, which manifests itself, for good or bad, in many ways. The board's division of labor across its standing committees facilitates decision-making in our world of audit, compensation and governance complexity. But in the process, there are manifold opportunities for some directors, who are not on one committee or the other, to get "left behind" other directors in their exposure to, and grasp of, key risks, opportunities and even basic operational desiderata. Much of the responsibility to avoid that eventuality rests mutually with the respective committee chairs (whose regular reports to the full board and committee minutes must be robust) and with those directors not on a given committee. The latter should from time to time attend committee meetings or otherwise become sufficiently informed of each committee's work that they are both comfortable that its work is being well-handled and also educated enough about its process that they can intelligently assess the reporting-out by the committee chair.

So far, so good. Where does culture come into it? Insofar as standing committees are concerned, there is a beneficial dynamic of self-interested mutuality: Most directors will likely be on some committees and not others, so all share the need to inform those not on their committees and be informed by other directors about committee work and output for standing committees they are not on. However, the risk — the rub if you will — comes when the ongoing work of the board over the year requires on an interim basis that one or more small groups of directors take on projects or follow-up work between board meetings to address matters that arise outside the scope of the standing committees. Examples range from a subset of directors being asked to meet with a new board candidate as part of board

refreshment due diligence to a working group of directors being asked to review with HR the strength of mid-level management talent in order to assess internal candidates' top-tier potential to a project team asked between board meetings to help assess whether the company should bid for a firm that has become the subject of takeover bid by a competitor.

A significant difference between the cultural reinforcement of standing committee participation, on the one hand, and, on the other hand, the one-off working-group inter-meeting follow-up team, or interview task-force, is that there is not the structural incentive for mutuality of coordination in the latter which self-interest (if not collegiality) prompts in the former. This can be a problem in two respects. First, directors not included on the inter-meeting working group can feel, or be, left behind — rendered out of touch with the subject matter of that project.

Of course, there are some occasions when a director should be excluded, for example if the director is recused due to a potential or actual conflict of interest. But where that is not the case, a board can risk becoming balkanized if some but not all directors are involved or at least not kept very much up to speed with the developments arising from the working group's efforts.

This leads to the second issue: How and when does the subgroup update the board? “When” may be straightforward — as needed to keep all directors current. But the “how” has led to some confusion. Must the subgroup have a formal charter, as contrasted with a mandate to simply fact find and report back? Likely, the simple mandate method works. (Internal board-led investigations are different. See Chapter 6). The project may not last beyond weeks or at most months, and there may or may not be a desire that it be a formal committee with charter, minutes and meeting fees, depending on a number of factors. However, those directors not involved will want some record that they also kept some oversight on the matter.

Need the updates from the working group to the full board occur only at minuted board meetings? Directors want to be sure their due diligence is recorded, but, most times, a telephonic board update between the regularly scheduled meetings will suffice if developments progress at such a rapid speed between meetings that keeping all directors current makes that desirable. Such telephonic updates need not be minuted. The Secretary will have a record, and the telephonic update(s) can be referenced in a sentence or two as having occurred in the minutes of the next board meeting.

As simple as this may sound, instituting and following protocols like the one described above affirms a culture of mutual respect and support. Absent it, directors risk being left behind and board cohesion and decision-making suboptimized.

F.2 Committee Staff

It has been more than twelve-and-a-half years since the Sarbanes Oxley (SOX) Act prompted a cascade of additional board and committee requirements, associated disclosure obligations and stock exchange rule enhancements. These days, audit committees commonly meet a dozen times a year on a scheduled basis, in contrast to the pre-SOX norm of four or five times yearly. Other committees, such as M&A and Compensation (especially since the 2007 stock options snafus — see Chapter 3) now wade through reams of data. And the Nominating and Governance Committees must now deal more vigorously with annual committee charter reviews, activist pressures for board change, CEO succession, ISS and Glass Lewis dynamics, diversity and sustainability reviews, etc. Chairing some of these committees has become virtually a full-time job for substantial parts of the year.

The intensity of committee work raises the subject of committee staffing. Support for respective standing committee chairs is provided by the relevant senior management units and advisors (such as compensation consultants and independent auditors). Yet, with the increasing workloads and coordination needs of both committee chairs and the independent lead director, there comes a point at which reliance on the respective business units or CEO staff is, or may be, insufficient or inappropriate. We may be at a point where publicly traded company boards need a small dedicated administrative staff focused on coordinating and supporting directors' work as committee chairs, as independent lead director and as board and committee members. Among other things, that would facilitate independent lead directors' liaison with the other board members and provide human complement to the gigabytes of electronically disseminated board and committee materials. It would make active, not passive, the culture of interchange through secure company resources — instead of default-mode communication with directors at their day-job email addresses (which raises issues relating to security and attorney-client privilege protection). With so many resources appropriately concentrated in the CEO's hands, such a directors' staff need not be at all large in order to provide the degree of

separation and, when desired, independence of execution helpful to board work.

F.3 Now, Something Completely Different

There was an extraordinary demonstration of corporate culture at work (forgive the pun) through the use of social media by employees of a large retailer in the Northeast U.S. in 2014. Their organic initiation and months-long use of social media — soon echoed in intensive traditional media coverage — accompanied a board battle that was ultimately resolved to the mutual satisfaction of all concerned.

It was not a publicly traded company. And yet, that use of social media triggers the thought that there is a presently authorized but little utilized electronic forum protocol for publicly traded companies that could be of great value to boards and employee shareholders. The SEC's proxy rules now contain a provision that allows managements and shareholders (including employee shareholders) to host and/or participate in electronic forums, using, for example, a dedicated webpage or microsite accessed through an existing web home page. Through that, the host can provide a symposium-type electronic forum through which management and shareholder views can be developed and shared real time. Use of such an e-forum will not be considered in direct solicitation of proxies to vote in favor or against upcoming shareholder meeting agenda items (director candidates or shareholder proposals) provided some ground rules (explained below) are adhered to.

So far, only a few companies have used this capability. Royal Dutch Shell (its "Tell Shell Forum"), Verizon, and Dell Inc. (before it went private: "Dell Shares") are examples. Based on the impact of the 2014 retailer employee forum site, I expect that the SEC's e-forum option will get more use — especially in the following particular and important way. The better e-forum sites to date have utilized well-controlled (by Investor Relations) access, terms, conditions and topics, allowing the host (IR) to qualify potential posting contributors and also reject or delete participants' posts.

Given that many employees of publicly traded companies are shareholders in their company and/or otherwise vitally interested in topics affecting it (and them), an e-forum utilizing confidential employee I.D. identification and password can restrict forum access and at the same time powerfully validate the credibility of the site content as provided by

knowledgeable employee shareholders who have a two-fold interest in company success. An e-forum such as “Connecting” (on how to better work together to coordinate various divisions’ sales to the same customer, thereby avoiding the embarrassment of multiple divisions each responding in overlapping fashion to the customer’s same RFP) or “Our Views” (in response to an activist shareholder initiative) could be powerful expressions of the company culture as well as a means of reinforcing it.

A director’s job is exceptionally hard and exceptionally important. Directors’ watchwords for 2015 should continue to be vigilance, transparency, strategic vision and conflict of interest avoidance. This edition of the *Handbook* fine-tunes and updates each chapter based on events, developments and input from readers.

Please e-mail your comments and suggestions for future editions and revisions to this handbook to me at the address below. Such feedback has been an invaluable aid to the development of this commentary.

You are busy with your day job and your directorship. If you have a chance to read this handbook, and you do so, I feel as if something good has taken place. Thanks to CSC® Publishing for once again publishing *The Directors’ Handbook* and to Meg Campbell for making it happen.

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Preface to the First Edition

A Rising Tide

Being a corporate director has become increasingly difficult. Just as directors began to adapt to their share of the \$1 trillion shrinkage in public equity during the 1980s (in favor of ever increasing debt and fragile balance sheets), an IPO and secondary equity boom of unprecedented proportions (\$400 billion since 1989) has changed the prevailing assumptions once again. No sooner were outside directors learning the lingo of EBITDA, bear hugs and PIK preferreds as necessary parts of corporate Darwinism, than the market started reminding them of terms as simple as P/E and dividend. From “highly confident” and ever inflating asset values, to recession, restructuring and draconian cost cutting more quickly than you can say “staggered board.” Never mind, as sea-sickening as such cross-currents might have been in other circumstances, their effects suddenly have been ameliorated by the rising tide of recovering earnings. What better time than now to open the hatch, sniff the breeze and reset the rigging (or what’s left of it)?

With every IPO, a new set of public company directors is born and welcomed to the world of insider information, securities suit exposure, and director and officer liability premiums and deductibles so large that they look more like policy limits than annual insurance payments. With every secondary offering, yet another registration statement is added to the SEC’s (and class action plaintiff lawyers’) pile, with the attendant caution about director liabilities for material misstatements or omissions under the Securities Act. With every proxy statement, “peer group” comparisons must now be made and, not surprisingly, stockholders can be skeptical if each large company in the industry (according to *its chosen version* of the peer group) somehow beats all the others.

Meanwhile, the available literature on matters affecting inside and outside directors is diffuse, ponderous, technical, or all of the foregoing. Into that breach we vault with this handbook: an independent source of topical information about matters of current concern to directors of public (and soon to be public) corporations, written in a non-technical way, with graphics and appropriate tables. This handbook aims to acquaint (or reacquaint) you with the essential guidelines needed for a director to function in the several types of settings he or she confronts: regular board

meetings; special board meetings; annual and special stockholder meetings; committee work including Executive, Audit and Compensation Committees, as well as the increasingly important use of special committees (when they are needed, who comprise and lead them and what they do). Basic financial and operating data review as well as auditor interaction (both internal and outside auditor) are addressed. It also reviews dealing with litigation, D&O insurers and indemnification claims. And it contains important checklists for you to use in dealing with everything from routine regular meetings, to understanding disclosure obligations, to reviewing your company's takeover defenses.

Given the increasing importance of foreign sales to U.S. corporations and of foreign competition in the U.S. for customers and assets, there is also a chapter specifically dedicated to the comparative political economy of corporations containing information directors need to know — and use.

It is for management, usually, to propose and for the outside directors to advise and, where appropriate, consent. Outside directors act as a check and balance on inside discretion. Accordingly, this edition also spotlights important recent developments from the perspective of inside and outside directors.

November 1994

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