

Commonsense Corporate Governance Principles Issued

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A group of twelve CEOs, including JPM, Berkshire Hathaway, GE, GM, Verizon and those from major institutional investors such as Capital Group, BlackRock, Vanguard, StateStreet, T. Rowe Price and ValueAct, have developed a set of "[Commonsense Corporate Governance Principles](#)." Their [open letter](#) states that the purpose of the group was to try to reach consensus on what "good corporate governance" means in the real world. While the group recognizes that there is significant variation among public companies, they want the principles to serve as a catalyst for discussion.

Some of the recommendations regarding governance practices include:

Composition of boards of directors. A subset of directors should have professional experience directly related to the company's business and directors candidates should be drawn from a rigorously diverse pool. Boards should carefully consider a director's service on multiple boards and other commitments to ensure directors can commit substantial time to their roles.

Election and nomination of directors. Directors should be elected by majority voting standards. Long-term shareholders should recommend potential directors if they know the individuals well.

Director compensation and director evaluations. Companies should consider paying a substantial portion, as much as 50% or more, of director compensation in equity and require directors to retain a significant portion for the duration of their tenures. Boards should have robust evaluations and "the fortitude to replace ineffective directors."

Board committees. Boards should consider periodic rotation of leadership roles such as committee chairs and the lead independent director.

Tenure and retirement age. The principles do not endorse mandatory retirement age or term limits. While board refreshment should always be considered, it should be "tempered with the understanding that age and experience often brings wisdom, judgment and knowledge."

Director communication with third parties. Communications of a board's thinking with shareholders is important and certain directors may be designated for those roles. The CEO should actively engage in corporate governance (other than on the CEO's own compensation) when meeting with shareholders.

Agenda items. Agendas should include management performance and focus on the long-term creation of shareholder value like owners of a private company would. Boards should discuss strategic issues and risk assessments, material corporate responsibility matters, shareholder proposals and have "unfettered access to management." A board should also "minimize the amount of time it spends on frivolous or non-essential matters."

Audit committee. The audit committee should focus on whether the company's financial statements would be prepared or disclosed in a materially different matter if the external auditor itself were solely responsible for their preparation.

Shareholder rights. Dual class voting "is not a best practice," and a company should consider having specific sunset provisions based upon time or a triggering event. Written consent and special meeting provisions can be "important mechanisms for shareholder action."

Public reporting. Unlike what has been reported in some media, the principles do not recommend never giving earnings guidance. The principles state that a company should “not feel obligated to provide earnings guidance” and should determine whether it “does more harm than good.” If it does provide guidance, it “should be realistic and avoid inflated projections.” Non-GAAP measures should “be sensible” and not used to “obscure GAAP results,” and all compensation expenses, including equity, should be reflected in any non-GAAP measures of earnings.

Board leadership. A board’s independent directors should decide on the leadership structure and if it decides to combine the chair and CEO roles, there should be a strong independent lead director. The lead independent director’s roles may include guiding the board’s consideration of CEO compensation and the CEO succession planning process.

The principles also contain a discussion of the asset managers’ role in corporate governance which includes engaging with company and giving “due consideration” to a company’s rationale for its positions, including when a company might “take a novel or unconventional approach.” Senior management should oversee proxy voting and corporate governance activities. If speaking with directors, asset managers should evaluate them on their knowledge of the company’s corporate governance practices and interest in shareholders’ concerns as well as the board’s focus on a long-term strategic plan and performance against that plan.

The principles urge asset managers to make voting decisions based on their own guidelines while using proxy advisors to provide information. Finally, asset managers should raise critical issues to companies as early as possible “in a constructive and proactive way” and should consider “sharing their issues and concerns” with the company, especially when they oppose the company’s voting recommendations.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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