JONES DAY

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GOVERNANCE PERSPECTIVES

ISS FORMALLY OPPOSES DIRECTOR COMPENSATION BYLAWS

Institutional Shareholder Services Inc. ("ISS") has now formalized its position on director compensation bylaws. In short, ISS has adopted the position that a board that adopts a bylaw provision prohibiting directors from accepting third-party compensation for board service has infringed on the right of shareholders to elect directors of their choosing, which ISS considers to be a "material failure of governance" that may result in an "against" or "withhold" vote recommendation in respect of the reelection of the company's director nominees.

While we recognize that ISS has recently taken steps in the right direction on other topics, particularly by revamping the quantitative component of its approach to executive compensation, we think that this voting policy is misguided and misses the serious governance issues raised by compensation schemes offered by some dissident shareholders to their nominees—depending, of course, on the structure, these compensation schemes can be divisive at best and contrary to basic tenets of fiduciary duties at worst.

Of course, it is well established that boards may adopt bylaws that set forth qualifications for directors. Moreover, it is difficult to understand how bylaws designed to prevent conflicts of interest in the boardroom and to ensure that directors are not beholden to third parties with special interests are a governance failure. One-time payments to dissident nominees for agreeing to run on a slate have long been accepted and are not prohibited by carefully crafted bylaws. However, special compensation arrangements, especially those tied to short-term stock price gains, paid by a dissident shareholder for ongoing board service simply cannot be reconciled with a director's fiduciary duties of loyalty to the corporation and its shareholders generally.

As the 2014 proxy season unfolds, we expect that some companies that have adopted these bylaws will repeal them, while others will submit them to a vote of shareholders or take no action and withstand a possible withhold vote campaign. (Notably, the directors of Provident Financial were reelected despite ISS's negative voting recommendation.) We continue to believe that director compensation bylaws serve legitimate corporate interests, and hold out hope that shareholders will support reasonably crafted director compensation bylaws that permit the payment of a one-time "candidacy fee" designed to fairly compensate an insurgent's nominees for the time and effort involved in participating in a contested election.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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