JONES DAY

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GOVERNANCE PERSPECTIVES

Director Tenure: The New Frontier in Board Independence

- Some corporate boards are receiving scrutiny of the independence of long-tenured directors.
- Cultivating and maintaining a board that is balanced in terms of skills, expertise, and experience is paramount for long-term value creation.
- Term limits are an inelegant solution to address directors perceived to be "over-tenured."

Director independence has been a key corporate governance issue for many years, and independence standards have become significantly more stringent in the wake of Sarbanes-Oxley and evolving exchange listing requirements. Currently, independence standards generally focus on material relationships between the director and the company, including employment and familial and other relationships. It increasingly appears that an additional focus by some institutional shareholders on director independence may be on board tenure—the length of service of particular directors on the board.

Investors and governance experts have conflicting perspectives on the issue of director tenure. Some feel that long-tenured directors provide invaluable expertise, experience, continuity, and stability to a board, as well as a historical perspective that can be indispensable in determining a company's strategy. Others believe that directors with many years of service may be entrenched, lack a fresh perspective, and inhibit healthy board turnover. There are some signs that this latter viewpoint is gaining traction (among both governance experts and activist investors) and that long-tenured directors may soon be viewed to be so enmeshed with the company, its management, and the board as to lack independence.

While ISS does not currently have a voting policy relating to director tenure, its views on the subject are evident through its QuickScore 2.0 governance rating system, which states that "[l]imiting [non-executive] director tenure allows new directors to the board to bring fresh perspectives. A tenure of more than nine years is considered to potentially compromise a director's independence and as such QuickScore will consider tenure > 9 years excessive." ISS further states that it believes that "a balanced board that is diverse in relevant viewpoints and experience is ideal."

Perhaps more importantly, the results of ISS's 2013–2014 annual policy survey on this topic may drive changes to its proxy voting guidelines. Institutional investors that responded to ISS's 2013–2014 policy survey evidenced concern with "over-tenured" directors—74 percent of institutional investors indicated that they viewed long director tenure as "problematic." (Conversely, 84 percent of the companies that responded to the same policy survey indicated that the length of a director's tenure should not be presumed to be problematic.) Moreover, ISS announced in late 2013 that it was soliciting input on whether to reclassify long-tenured directors as non-independent or to examine the mix of director tenures on a board as a key factor when making voting recommendations as to nominating committee members. In light of those developments, and because the continual evolution of ISS's voting policies is a key component of its business strategy, we anticipate that director tenure may be yet another subject of an ISS voting policy.

If ISS adopts a policy that—parallel to its QuickScore policy—states that it will consider directors with more than nine years of tenure to lack independence, a great number of companies will be affected, as the average tenure of S&P 1500 company boards is currently 10.8 years. Companies with directors who have served for longer than nine years would be well-advised to take a hard look at their proxy disclosures relating to those directors with the expectation of greater scrutiny and a possible need to defend those directors' qualifications and continued service. Moreover, those companies should also be prepared to proactively address the topic of board tenure with investors during their shareholder engagement processes in 2014 and beyond.

Companies could, of course, seek to avoid the long-tenured director issue altogether by establishing director term limits. However, many companies and investors see term limits as arbitrary and objectionable—97 percent of S&P 500 companies did not employ director term limits in 2013. Moreover, in our view, having directors whose tenures are longer than the tenure of the sitting CEO helps ensure independent oversight. In these circumstances, the board–CEO dynamic can be healthy, and this guards against the board comprising CEO cronies. In our view, the best method to ensure healthy board evolution is through rigorous and thoughtful consideration of the renomination of current directors prior to each election based on a variety of factors, including director performance, skills and expertise, the company's needs, and board diversity, as well as length of board tenure, both on a board average and stand-alone basis. We are strongly opposed to one-size-fits-all thinking in corporate governance and believe that each board should consider its own circumstances and that a reasonable approach is likely to ensure an appropriate balance between long-tenured and more recently added board members.

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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