

## COMMONSENSE PRINCIPLES 2.0

The following is a series of corporate governance principles for public companies, their boards of directors and their institutional shareholders (both asset managers and asset owners). These principles are intended to provide a basic framework for sound, long-term-oriented governance. Given the differences among U.S. public companies – including their size, products and services, geographic footprint, history, leadership and ownership – we recognize that not every principle will be applied in the same fashion (or at all) by every company, board or shareholder. Nonetheless, we intend to use these principles to guide our thinking.

### I. Board of Directors – Duties, Composition and Internal Governance

#### a. Duties of Loyalty and Care

- Directors are accountable to shareholders and owe duties of loyalty and care to the company. Directors' performance should be evaluated through the company's long-term performance, financial and otherwise.

#### b. Composition

- A board must not be beholden to the CEO or management. A significant majority of the board (and all of the members of the audit, compensation and nominating and governance committees of the board) should be independent, consistent with the New York Stock Exchange rules or similar standards.
- All directors must have high integrity and the appropriate competence to represent the interests of all shareholders in achieving the long-term success of their company. Ideally, in order to facilitate engaged and informed oversight of a company and the performance of management, a subset of directors will have professional experiences directly related to the company's business. At the same time, however, it is important to recognize that some of the best ideas, insights and contributions can come from directors whose professional experiences are not directly related to the company's business.
- Independent directors should be just that: strong and steadfast, independent of mind and willing to challenge the CEO and other directors constructively – concepts that may not be fully reflected in black-and-white rules. At the same time, directors should not be divisive or self-serving. Collaboration and collegiality also are critical for a healthy, functioning board.
- Directors should be business savvy and shareholder-oriented, and have a genuine passion for their company.
- Directors should have complementary and diverse skill sets, backgrounds and experiences. Diversity along multiple dimensions, including diversity of thought, is critical to a high-functioning board. Director candidates should be drawn from a rigorously diverse pool.

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- While no one size fits all – boards need to be large enough to allow for a variety of perspectives, as well as to manage required board processes – a board generally should be as small as practicable so as to promote an open dialogue among directors.
- Directors need to commit substantial time and energy to the role. Therefore, a board should assess the ability of its members to maintain appropriate focus and not be distracted by competing responsibilities. In so doing, the board should carefully consider a director’s service on multiple boards and other commitments. While senior managers of other companies may be time constrained, they may be able to offer unique insights and otherwise add significant value to a board.

### c. Elections of directors

- It is a fundamental right of shareholders to elect directors whom they believe are best suited to represent shareholder interests.
- In uncontested elections, directors should be elected by a majority of the votes cast “for” and “against/withhold” (i.e., abstentions and non-votes should not be counted for this purpose). An individual director who fails to receive such a majority should tender an offer of resignation. The board ordinarily should accept the resignation; if it does not, it should clearly explain its rationale to the company’s shareholders.
- No matter how frequently a company chooses to elect directors, a director ordinarily should refrain from joining a board on which he or she is not committed to serving for at least three years.
- Requiring all directors to stand for election on an annual basis may help promote board accountability to shareholders. If a company chooses to hold elections on a staggered basis or otherwise elect directors less frequently than annually, the board should explain clearly (ordinarily in the company’s proxy statement) its rationale for doing so.

### d. Nominating directors

- A company’s board is responsible for nominating qualified directors consistent with the criteria for board composition set forth in I.b (“Composition”) above.
- Long-term shareholders should recommend potential directors for the board’s consideration if they know the individuals well and believe they would be additive to the board.
- A company is more likely to attract and retain strong directors if the board focuses on big-picture issues and can delegate other matters to management (see below at II.b., “Critical activities of the board; setting the agenda”).

### e. Director compensation and stock ownership

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- A company's independent directors should be fairly and equally compensated for board service, although (i) lead independent directors and committee chairs may receive additional compensation, and (ii) committee service fees may vary. If a director receives any additional compensation from the company that is not related to the director's service as a board member, such activity should be disclosed and explained.
  - Companies should consider paying a substantial portion (e.g., for some companies, as much as 50% or more) of director compensation in stock or similar equity-like instruments. Companies also should consider requiring directors to retain a significant portion of their equity compensation for the duration of their tenure to further directors' economic alignment with the long-term performance of the company.
- f. Board committee structure and service
- Companies should conduct a thorough and robust orientation program for their new directors, including background on the industry and the competitive landscape in which the company operates, the company's business and operations, important legal and regulatory issues, etc.
  - A board should have a well-developed committee structure with clearly understood responsibilities. Disclosures to shareholders should describe the structure and function of each board committee.
  - Boards should consider periodic rotation of board leadership roles (i.e., committee chairs and the lead independent director), balancing the benefits of rotation against the benefits of continuity, experience and expertise.
- g. Director tenure and retirement age
- It is essential that a company attract and retain strong, experienced and knowledgeable board members.
  - Some boards have rules around maximum length of service and mandatory retirement age for directors; others have such rules but permit exceptions; and still others have no such rules at all. Whatever the case, companies should clearly articulate their approach on term limits and retirement age. And insofar as a board permits exceptions, the board should explain (ordinarily in the company's proxy statement) why a particular exception was warranted in the context of the board's assessment of its performance and composition.
  - Board refreshment should always be considered in order to ensure that the board's skill set and perspectives remain sufficiently current and broad in dealing with fast-changing business dynamics. But the importance of fresh thinking and new perspectives should be tempered with the understanding that age and experience often bring wisdom, judgment and knowledge.

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### h. Director effectiveness

- A board should have a robust process to evaluate itself on a regular basis, led by the non-executive chair, lead independent director or appropriate committee chair. The board should have the fortitude to replace ineffective directors.

## II. Board of Directors' Responsibilities

### a. Director communication with third parties

- Robust communication of a board's thinking to the company's shareholders is important. On some issues, such as board governance and CEO compensation, direct communication from the board may be warranted. Companies may wish to designate certain directors to do so – as appropriate and in coordination with management. Directors who communicate directly with shareholders ideally will be experienced in such matters.
- Directors should speak about the company with the media only if authorized by the board and in accordance with company policy.
- In addition, the CEO should actively engage on corporate governance and key shareholder issues (other than the CEO's own compensation) when meeting with shareholders.

### b. Critical activities of the board; setting the agenda

- The full board (including, where appropriate, through the non-executive chair or lead independent director) should have input into the setting of the board agenda.
- Over the course of the year, the agenda should include and focus on the following items, among others:
  - ❖ A robust, forward-looking discussion of the business.
  - ❖ The performance of the current CEO and other key members of management and succession planning for each of them. One of the board's most important jobs is making sure the company has the right CEO. If the company does not have that CEO, the board should act promptly to address the issue.
  - ❖ Creation of shareholder value, with a focus on the long term. This means encouraging the sort of long-term thinking owners of a private company might bring to their strategic discussions, including investments that may not pay off in the short run.
  - ❖ Major strategic issues (including material mergers and acquisitions and major capital commitments) and long-term strategy, including thorough

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consideration of operational and financial plans, quantitative and qualitative key performance indicators, and assessment of organic and inorganic growth, among others.

- ❖ The board should receive a balanced assessment on strategic fit, risks and valuation in connection with material mergers and acquisitions. The board should consider establishing an ad hoc transaction committee if significant board time is otherwise required to consider a material merger or acquisition. If the company's stock is to be used in such a transaction, the board should carefully assess the company's valuation relative to the valuation implied in the acquisition. The objective is to properly evaluate the value of what you are giving vs. the value of what you are getting.
- ❖ Significant risks, including reputational risks. The board should not be reflexively risk averse; it should seek the proper calibration of risk and reward as it focuses on the long-term interests of the company's shareholders.
- ❖ Standards of performance, including the maintaining and strengthening of the company's culture and values.
- ❖ Material corporate responsibility matters.
- ❖ Key shareholder concerns.
  - a. It is important that companies engage with shareholders and receive feedback about matters relevant to long-term shareholder value.
  - b. *Shareholder proposals.* In the event that a company receives a shareholder proposal, it should consider engagement with the proposing shareholder (as well as other shareholders, to the extent appropriate) early in the process, preferably before the proposal appears in the proxy. Should the proposal receive majority shareholder support, the company should consider further engagement with shareholders and either implement the proposal (or a comparable alternative) or promptly explain why doing so would not be in the best long-term interests of the company. As a best practice, the company also should consider further engagement with shareholders to discuss shareholder proposals that receive significant but less than majority support and formulate an appropriate response. And while such response may include the adoption of the proposal (or a comparable alternative), the board should be mindful of the fact that a majority of the company's shareholders did *not* support the proposal.
  - c. *Management proposals.* Similarly, in connection with a management proposal, the company should consider engagement

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with shareholders early in the process. Should the proposal be defeated or receive significant shareholder opposition, the company should consider further engagement with shareholders and formulate an appropriate response, again mindful of how a majority of the company's shareholders voted.

- ❖ The board (or appropriate board committee) should:
  - a. determine the best approach to compensate management, taking into account all the factors it deems appropriate, including corporate and individual performance and other qualitative and quantitative factors; and
  - b. discuss and approve the CEO's compensation.

See below at VII ("Compensation of Management").

- A board should be continually educated on the company and its industry, seeking information from a variety of sources, including research reports, audit reports and, where relevant, regulatory pronouncements. If a board feels it would be productive, outside experts and advisors should be brought in to inform directors on issues and events affecting the company.
- The board should minimize the amount of time it spends on frivolous or non-essential matters – the goal is to provide perspective and make decisions to build real value for the company and its shareholders.
- As authorized and coordinated by the board, directors should have unfettered access to management, including those below the CEO's direct reports.
- At each meeting, to ensure open and free discussion, the board should meet in executive session without the CEO or other members of management. The independent directors should ensure that they have enough time to do this properly.
- In addition to its other responsibilities, the audit committee should focus on whether the company's financial statements would be prepared or disclosed in a materially different manner if the external auditor itself were solely responsible for their preparation.

### III. Shareholder Rights

- a. Public companies should allow for some form of proxy access, subject to reasonable requirements that do not make proxy access unduly burdensome for significant, long-term shareholders. Among the larger market capitalization companies that have adopted proxy access provisions, generally a shareholder (or group of up to 20 shareholders) that has continuously held a minimum of 3% of the company's outstanding shares for three years is

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eligible to include on the company's proxy statement nominees for a minimum of 20% (and, in some cases, 25%) of the company's board seats. A higher threshold of ownership (e.g., 5%) often has been adopted for smaller market capitalization companies (e.g., less than \$2 billion). In either case, as a general matter, only shares in which the shareholder has a full, unhedged economic interest should count toward satisfaction of the ownership/holding period requirements.

- b. Dual class voting is not a best practice. If a company has dual class voting, which sometimes is intended to protect the company from short-term behavior, the company ordinarily should have specific sunset provisions, based upon time or a triggering event, which would eliminate dual class voting. In addition, all shareholders should be treated equally in any corporate transaction.
- c. Written consent and special meeting provisions can be important mechanisms for shareholder action. Where they are adopted, there should be a reasonable minimum amount of outstanding shares required in order to prevent a small minority of shareholders from being able to abuse the rights of other shareholders or waste corporate time and resources.
- d. Poison pills and other anti-takeover measures can diminish board and management accountability to shareholders. Insofar as a company adopts a poison pill or other anti-takeover measure, the board ordinarily should put the item to a vote of the shareholders and clearly explain why its adoption is in the best interests of the company's shareholders. On a periodic basis, the board should review such measures to determine whether they remain appropriate.

### IV. Public Reporting

- a. Transparency around quarterly financial results is important.
- b. A company should frame its required quarterly reporting in the broader context of its articulated strategy and provide an outlook, as appropriate, for trends and metrics that reflect progress (or not) on long-term goals. A company should not feel obligated to provide quarterly earnings guidance – and should determine whether providing quarterly earnings guidance for the company's shareholders does more harm than good. If a company does provide quarterly earnings guidance, the company should be realistic and avoid inflated projections. Making short-term decisions to beat guidance (or any performance benchmark) is likely to be value destructive in the long run.
- c. As appropriate, long-term goals should be disclosed and explained in a specific and measurable way.
- d. A company should take a long-term strategic view, as though the company were private, and explain clearly to shareholders how material decisions and actions are consistent with that view.

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- e. Companies should explain when and why they are undertaking material mergers or acquisitions, major capital commitments or significant restructuring or cost-savings initiatives.
  - f. Companies are required to report their results in accordance with Generally Accepted Accounting Principles (“GAAP”). While it is acceptable in certain instances to use non-GAAP measures to explain and clarify results for shareholders, such measures should be sensible, and companies should provide a bridge from non-GAAP items to the most comparable GAAP items, so as not to obscure GAAP results. In this regard, it is important to note that *all* compensation, including equity compensation, is plainly a cost of doing business and should be reflected in any non-GAAP measurement of earnings in precisely the same manner it is reflected in GAAP earnings.
- V. Board Leadership (Including the Lead Independent Director’s Role)
- a. Independent leadership of the board is essential to a well-functioning board and, in particular, effective oversight of the company and its management. There are two common structures for independent board leadership in the U.S.: (1) an independent chair; or (2) a lead independent director.
  - b. The board’s independent directors should decide, based upon the circumstances at the time, whether it is appropriate for the company to have separate or combined chair and CEO roles. The board should periodically review its leadership structure and explain clearly (ordinarily in the company’s proxy statement) to shareholders why it has separated or combined the roles, consistent with the board’s oversight responsibilities.
  - c. If a board decides to combine the chair and CEO roles, it is critical that the board has in place a strong designated lead independent director and governance structure. The role of the lead independent director should be clearly defined and sufficiently robust to ensure effective and constructive leadership. The responsibilities of the lead independent director and the executive chair should be clearly delineated, agreed upon by the board, and disclosed to shareholders.
  - d. Depending on the circumstances, a lead independent director’s responsibilities may include:
    - Serving as liaison between the chair and the independent directors.
    - Presiding over meetings of the board at which the chair is not present, including executive sessions of the independent directors.
    - Ensuring that the board has proper input into meeting agendas for, and information sent to, the board.
    - Having the authority to call meetings of the independent directors.

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- Insofar as the company's board wishes to communicate directly with shareholders, engaging (or overseeing the board's process for engaging) with those shareholders.
- Guiding the annual board self-assessment.
- Guiding the board's consideration of CEO compensation.
- Guiding the CEO succession planning process.

### VI. Management Succession Planning

- a. Senior management bench strength can be evaluated by the board and shareholders through an assessment of key company employees; direct exposure to those employees is helpful in making that assessment.
- b. Companies should inform shareholders of the process the board has for succession planning and also should have an appropriate plan if an unexpected, emergency succession is necessary.

### VII. Compensation of Management

- a. To be successful, companies must attract and retain the best people – and competitive compensation of management is critical in this regard. To this end, compensation plans should be appropriately tailored to the nature of the company's business and the industry in which it competes. Varied forms of compensation may be necessary for different types of businesses and different types of employees. While a company's compensation plans will evolve over time, they should have continuity over multiple years and ensure alignment with long-term performance.
- b. Compensation should have both a current component and a long-term component.
- c. Benchmarks and performance measurements (financial and otherwise) ordinarily should be disclosed to enable shareholders to evaluate the rigor of the company's goals and the goal-setting process. That said, compensation should not be entirely formula based, and companies should retain discretion (appropriately disclosed) to consider factors that may not be easily measured, such as integrity, work ethic, effectiveness, openness, etc. Those matters are essential to a company's long-term health and ordinarily should be part of how compensation is determined.
- d. Companies should consider paying a substantial portion (e.g., for some companies, as much as 50% or more) of compensation for senior management in the form of stock, performance stock units or similar equity-like instruments. The vesting or holding period for such equity compensation should be appropriate for the business to further senior management's economic alignment with the long-term performance of the company. With properly designed performance hurdles, stock options may be one element of effective compensation plans, particularly for the CEO. All equity grants (whether stock or options)

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should be made at fair market value, or higher, at the time of the grant, with particular attention given to any dilutive effect of such grants on existing shareholders.

- e. Companies should clearly articulate their compensation plans to shareholders. While companies should not, in the design of their compensation plans, feel constrained by the preferences of their competitors or the models of proxy advisors, they should be prepared to articulate how their approach links compensation to performance and aligns the interests of management and shareholders over the long term. If a company has well-designed compensation plans and clearly explains its rationale for those plans, shareholders should consider giving the company latitude in connection with individual annual compensation decisions.
- f. Grants to management of large special compensation awards (not normally recurring annual or biannual awards, but those considered special awards or special retention awards) should be carefully evaluated and reserved for special circumstances. The rationale for special awards to the CEO and other “Named Executive Officers” whose compensation is set forth in the company’s proxy statement should be clearly explained.
- g. Companies should maintain clawback policies for both cash and equity compensation.

### VIII. Investors’ Role in Corporate Governance

- a. Asset managers
  - On behalf of their clients, asset managers are significant owners of public companies and, therefore, often are in a position to influence the corporate governance practices of those companies and otherwise encourage companies and their boards to focus on long-term value creation.
  - Asset managers should exercise their voting rights thoughtfully, devoting sufficient time and resources to evaluate matters presented for shareholder vote in the context of long-term value creation. Asset managers should actively engage, as appropriate, based on the issues, with the management and board of the company, both to convey the asset manager’s point of view and to understand the company’s perspective. Ideally, such engagement will occur early in the process to facilitate alignment on resolution of issues where possible and avoid unnecessary disruption. Asset managers should give due consideration to the company’s rationale for its positions, including its perspective on certain governance issues where the company might take a novel or unconventional approach.
  - Given their importance to long-term investment success, proxy voting and corporate governance activities should receive appropriate senior-level oversight by the asset manager.
  - Asset managers, on behalf of their clients, should evaluate the performance of boards of directors, including thorough consideration of the following:

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- ❖ To the extent directors are speaking directly with shareholders, the directors' (i) knowledge of their company's corporate governance and policies, and (ii) interest in understanding the key concerns of the company's shareholders.
  - ❖ The board's focus on a thoughtful, long-term strategic plan and on performance against that plan.
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- An asset manager's ultimate decision makers on proxy issues important to long-term value creation should have access to necessary information about the company. Asset managers with significant share ownership should have access to the company's management and, in some circumstances, the company's board. Similarly, a company, its management and board should have access to an asset manager's ultimate decision makers on those issues.
  - Asset managers should raise critical issues to companies (and vice versa) as early as possible, in a constructive and proactive way. Building trust between shareholders and the company is a healthy objective.
  - Asset managers may rely on a variety of information sources to support their evaluation and decision-making processes. While data and recommendations from proxy advisors may form pieces of the information mosaic on which asset managers rely in their analysis, ultimately, their votes should be based on independent application of their own voting guidelines and policies. To the extent they use recommendations from proxy advisors in their decision-making processes, asset managers should disclose that they do so, and should be satisfied that the information upon which they are relying is accurate and relevant. Proxy advisors whom they use should have in place processes to avoid or mitigate conflicts of interest.
  - Asset managers should make public their proxy voting process and voting guidelines and have clear engagement protocols and procedures. They should disclose their policies for dealing with potential conflicts in their proxy voting and engagement activities.
  - Asset managers should consider sharing their issues and concerns (including, as appropriate, voting intentions and rationales therefor) with the company (especially where they oppose the board's recommendations) in order to facilitate a robust dialogue if they believe that doing so is in the best interests of their clients.
  - Compensation of portfolio managers investing in public companies should be structured to consider performance over an appropriate term, given the strategy and investment time horizon applicable to the portfolio. Ordinarily, that will mean using performance benchmarks over three- and five-year periods (and other periods, as appropriate) – as well as a one-year period – for some portion of a portfolio manager's compensation.

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### b. Institutional asset owners

- Institutional asset owners such as pension plans and endowments are in a position to influence public companies either directly (insofar as they direct their own investments) or through their interactions with asset managers (insofar as those managers invest on their behalf). In either case, such asset owners can use their position to advance sound and long-term oriented corporate governance. When investing through asset managers, owners may wish to encourage such practices through, for example:
  - ❖ the use of benchmarks and performance reports consistent with the asset owner’s strategy and investment time horizon
  - ❖ interactions and dialogue with asset managers concerning corporate governance issues; and
  - ❖ the evaluation of asset managers on how they discharge their own role in corporate governance matters, as set forth above in VIII.a (“Asset managers”).