office functions, transition services, and supply agreements to support the divested business.

- Close monitoring of the adequacy of due diligence made available to the proposed divestiture buyer.
- Ensuring divestiture buyer access to customer and third party relationships.
- Greater scrutiny of divestiture buyer financing and viability.
- Increased use of up-front buyers.
- Monitoring the overall divestiture process, including with an appointed "monitor trustee."
- Encouragement that divestiture buyers reach out to FTC staff if they encounter difficulties.
- Greater demands by the Compliance Division for information with which to evaluate the likely success of proposed remedies.
- More delay in obtaining FTC approval of a divestiture package and proposed purchaser.

DOJ has no dedicated "Compliance" division or equivalent group whose focus is to help draft and negotiation remedies with merging parties. The DOJ staff that investigated the merger, along with their immediate supervisor (section chief), are responsible for negotiation of a potential remedy agreement. The proposed settlement is then vetted by DOJ management before being sent for final approval by the Assistant Attorney General for Antitrust. Although the DOJ did not participate in the FTC study, DOJ staff and the incoming leadership team are likely to consider similar best practices.

Although the report confirmed that the vast majority of remedies in FTC cases have been "successful," businesses and their counsel should focus on the remainder—the remedies that were deemed only a "qualified success" or a "failure," and the FTC staff's assessment of the reasons why. These cases, cautionary tales, are likely to drive the agencies' evaluations of all remedies; no staff lawyer or manager wants to be responsible for having signed off on a remedy that later proves flawed. Going forward, merging parties can expect enhanced scrutiny of proposed remedies at both agencies.

## CORPORATE GOVERNANCE FEATURE: DIRECTORS MUST NAVIGATE CHALLENGES OF SHAREHOLDER-CENTRIC PARADIGM

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The corporate governance landscape has become more complicated, making it more difficult for directors to manage the often inconsistent demands of multiple constituencies while pursuing the fundamental fiduciary obligation to act in the best interests of the corporation and its stockholders. Evolution in the prevailing corporate governance model to a more shareholder-centric paradigm, widening fault lines between the perspectives of different types of shareholders, and the expanding reach of governmental regulation and enforcement efforts, among other forces, have contributed to the issues contemporary boards face. Directors' ability to assess these factors and successfully navigate these challenges will be critical in the year ahead.

### Shareholder Activism and Engagement

Activist agitation, proxy contests and precatory proposals were all evident last year, including at large-cap issuers, with activists continuing to see significant success. While name-brand activists continued to obtain board seats through settlements without pursuing proxy contests, newer entrants into the asset class pursued aggressive campaigns. Activist success is due to a number of factors, including the growth of assets under management (AUM) by investors pursuing activist strategies, increased sophistication in dealing with both companies and other investors, and leveraging media focus. The most important factor, however, has been the support of activist campaigns by traditional long equity investors. While activists funds are estimated to have over $150 billion in AUM, this figure is minimal compared to the trillions of dollars under management by pension funds, mutual funds, and other traditional investment intermediaries. Activists rely on these institutions for support.

There are signs, however, that the tide of hedge fund activism may have reached its high-water mark and that influential market participants believe elements of activism have gone too far. Discussion of activism has been increasingly enveloped in a broader debate over corporate "short-termism" and its effects on the companies, the economy, and society. Passive investment managers such as index funds represent an increasingly significant portion of holdings at many companies (estimated at 30% of Standard & Poor's 500 index companies) and together with other traditional institutional investors have become more vocal in articulating a preference for corporate strategies supporting long-term value creation. In the last couple of years, the CEOs of BlackRock and Vanguard wrote open letters cautioning against pursuit of short-term agendas that negatively impact long-term growth. In October 2016, State Street Global Advisors published a statement voicing concerns over companies' quick settlements with activists without receiving input from long-term shareholders, and suggesting that settlements with activists contain terms that align with the interests of long-term shareholders. These institutions do not propose to return to a more board-centric governance paradigm or to provide greater board insulation from shareholder sentiment—their published governance policies promote shareholder power and corporate responsiveness—but greater investor support for well-functioning boards pursuing long-term strategies would be a welcome development. Unfortunately, many investors continue to judge corporate performance on the basis of quarters, not years.

Companies must continue to embrace meaningful engagement with shareholders, with directors overseeing—and at times directly participating in—that engagement. This provides an opportunity to communicate corporate vision and strategy as well as an opportunity to hear shareholder views and concerns outside the context of an activism campaign. In the specific context of such a campaign, the nature and degree of engagement with institutional shareholders on the activist requests will vary based on multiple factors, including the nature of the request or proposal, prior engagement, the state of public disclosure, and the company's proposed response.

## Corporate Governance

The multi-decade campaign by shareholder advocates and proxy advisers for implementation of a fairly standard set of corporate governance "best practices" at U.S. public companies fundamentally shifted the role and relative influence of shareholders in corporate governance. Much of this agenda, such as annual director elections by majority vote and implementation of shareholder ability to call meetings or act by written consent, has been implemented at larger public companies. However, additional items continue to be added to the list of best practices. In considering these items, boards must continue to balance the policy preferences articulated by many of their largest shareholders with directors' views on appropriate governance based on individual company circumstances.

***Proxy Access***. Shareholder proponents continue their focus on proxy access, having submitted over

 

200 proxy access proposals for 2016 annual meetings. A market standard has developed based on 3% ownership for a three-year period. In the 2016 season, a majority of companies receiving a proxy access shareholder proposal adopted a 3% proxy access bylaw or announced an intention to do so, resulting in a majority of the 2016 shareholder proposals being withdrawn by the proponents or excluded pursuant to the Securities and Exchange Commission no-action process on the basis of substantial implementation. In votes where companies had not adopted or proposed a 3% proxy access bylaw, more than 75% of the shareholder proposals received the support of a majority of votes cast. Almost 350 public companies—including approximately half of S&P 500 companies—now have a proxy access bylaw, up from approximately a dozen companies at the end of 2014. Companies that have not yet adopted proxy access are increasingly likely to come under pressure to do so.

***Board Composition and Director Tenure***. Investors, academics and others continue to scrutinize board composition, including director skill sets, diversity and tenure. An increasing number of institutions have been adopting tenure policies that can differ in important ways—for instance, noting that long board tenure is not necessarily an impediment to director independence and that a variety of tenures in the boardroom can be beneficial (BlackRock); voting against nominating committee chairs if average board tenure is 15 years or longer or if there has not been a new board appointment for five or more years; and voting against the lead independent director and any member of a key board committee when the person's tenure is 15 years or longer (Legal & General Investment Management). Investor focus on board composition and tenure will be ongoing, and boards should continue to pursue board refreshment.

***Board Leadership***. Separation of the roles of CEO and board chair continues to engender discussion and a significant number of shareholder proposals. However, most institutional investors are satisfied with a board leadership structure pairing a robust lead independent director with a combined chair/CEO, and shareholder support for proposals to require an independent board chair continues to fall below 30% of votes cast in favor (no proposals received majority support in 2016). Still, boards should continue to periodically consider the leadership structure that best suits the company and its particular circumstances.

***Compensation Design and Clawbacks***. Based on concerns that some management compensation structures have incentivized excessive risk-taking, and consistent with re-emerging investor focus on long-term value creation, boards are re-evaluating compensation programs to ensure management's financial incentives are aligned with long-term strategy. Trends include reassessing the balance of base and incentive compensation, implementing holding periods for equity awards and adopting incentive compensation clawback policies. Compensation committees and boards likely will continue to spend significant time reviewing and adjusting management compensation programs to ensure that they support corporate strategy, are appropriately tied to both annual and long-term performance goals and are sufficiently competitive to retain employees.

***Mergers and Acquisitions***. While M&A opportunities generally are identified by management, oversight of material transactions is a core board function. In the context of the sale of a company, this means active director decision-making as to whether and how to pursue a sale, consideration of implications of political and regulatory environments relevant to a proposed transaction, and active oversight of executives during any sale process. In the case of significant acquisitions, the nature and amount of board focus and attention on any particular transaction will vary based on factors related to significance.

## Risk Oversight

Shareholders, government enforcement agencies and courts have continued to scrutinize the performance of boards of directors in overseeing compliance and management of enterprise risk. While many directors are frustrated with the amount of time they must spend on regulatory and financial compliance matters, this need is not likely to abate. Dramatic shifts in the political, economic and regulatory environments are occurring, changing the business environment and regulatory framework within which many companies operate.

The obligation to appropriately oversee risk is an element of directors' overarching duties of care and loyalty. Directors must pay sufficient attention to business risks in order to be able to act on them in an informed manner. Overall, case law reflects that it is difficult to show a breach of fiduciary duty for failure to exercise oversight, provided a monitoring system is in place. In *Reiter v. Fairbank*, the Delaware Court of Chancery recently provided an explanation of Delaware law on the standard for imposing oversight liability, noting that there must be evidence of directors' bad faith—that "the directors knew that they were not discharging their fiduciary obligations."

Cyber risks also were on public display in 2016, including data breaches at consumer-facing companies, email hacking of corporations and political parties, and unauthorized transfers from financial institutions. Cyber-security has become one of the most significant enterprise risk issues that companies encounter, and the importance of board attention to this issue has become clear. Board engagement on cyber risk can help set an agenda benefiting the company and reduce the risk certain types of post-breach investigations and litigation pose.

# BANK MERGERS: MANAGING REGULATORY ISSUES AND TERMINATION RISKS

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Mergers and acquisitions of bank holding companies ("BHCs") and banks are subject to lengthy and sometimes unpredictable regulatory scrutiny and application processing between signing and closing. Bank M&A applications are subject to numerous regulatory risks, including preexisting conditions that are unknown or whose importance to the process is underestimated when the deal is signed, changes in the merging parties' businesses, changes in regulatory views or policies, and new regulatory examinations or findings. Market, economic, and credit conditions, as well as the parties' balance sheets, performance, and people can change materially while regulatory applications are being processed. All risks, including potential losses of the target's customers and employees to competitors, increase the longer the regulatory process continues.

Various bank M&A transactions have been significantly delayed, terminated or become subject to possible termination in recent years, a trend that appears to be growing. This article discusses:

- Bank M&A regulatory approval processes;

 