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Special Compensation Arrangements with Dissident Director Nominees

By Ted Powers and Jeffery Bell

Certain activist shareholders involved in proxy contests have offered special compensation (e.g., a fee for agreeing to be nominated on the activist's slate or performance-related bonuses after election) to their director nominees.[1] Activists state a desire to compensate nominees who commit time and risk a public proxy fight, but such arrangements call into question who the dissident director nominee is really representing — all the target company's shareholders or just the activist. Indeed, it is this very concern that results in unaffiliated nominees of activists being more likely to be elected than employees of activist firms.

Leading commentators have criticized special compensation arrangements with dissident director nominees as:

- creating incentives to trigger the special compensation arrangements, even if not in the best interests of all shareholders;
- potentially sacrificing long-term value for short-term gain;
- creating a dysfunctional board, as dissident and non-dissident directors are compensated and motivated differently from each other;
- introducing conflicts and complexity to strategic reviews and impacting dissident directors' abilities to satisfy their fiduciary duties; and
- undermining the board's ability to set compensation and determine the timeframe for achieving corporate goals.

In response, some companies have adopted, or considered adopting, bylaws prohibiting nominees who are given these special compensation arrangements.[2] Adopting a bylaw disqualifying director nominees who are parties to special compensation arrangements would not prevent an activist from nominating a director, reimbursing such nominee's expenses, or indemnifying such nominee in connection with the solicitation, or from providing compensation to a nominee for his or her efforts if he or she is not elected. Such a bylaw would also not disqualify a principal or employee of the activist fund from serving as a director merely because his or her compensation may depend on the trading price of the target company shares.

[1] For example, Elliott Management Corp. and JANA Partners have run minority slates of directors for the boards of Hess Corp. and Agrium Inc., respectively, and each has offered to pay special bonuses to its nominees (and no other directors).

[2] According to Dealbook, Halliburton, Marathon Oil, Eastman Chemical, and Wynn Resorts are among the companies that have adopted a version of the bylaw.

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Boards of target companies can generally adopt a bylaw disqualifying director nominees who are parties to special compensation arrangements without a shareholder vote. Note, however, that ISS and Glass Lewis believe that the best governance practice for boards wishing to implement a restriction on dissident director nominee compensation is to allow shareholders to vote upon the ratification of such a bylaw, and both have stated that they will recommend that shareholders vote against corporate governance committee members at annual meetings if the board has adopted such a bylaw without seeking shareholder approval.

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