WHITE & CASE

Client**Alert**

Securities | Mergers and Acquisitions

March 2010

Relationships between Directors and Senior Management under Stock Exchange Independence Standards

A recent disclosure by Black & Decker Corp. and a subsequent clarification as a result of a complaint by the New York Stock Exchange provide helpful insight regarding how business, and possibly other, relationships between directors and senior management may impair a director's independence both for exchange listing standards and other contexts, and may give rise to unwanted publicity.[1]

Background

On March 9, 2010, Black & Decker Corp. issued a press release ahead of a special stockholder meeting being held to approve its merger with The Stanley Works. In the press release, Black & Decker disclosed what it termed "a private business relationship" between its CEO, Nolan D. Archibald, and one of its directors, M. Anthony Burns. The business relationship disclosed by Black & Decker in the press release consisted of a real estate co-investment by Mr. Burns and Mr. Archibald involving an undisclosed, yet "significant," amount. The investment was in a private golf and four-season recreational community in Utah. In the press release, Black & Decker stated "[p]ersonal business relationships between individuals (as opposed to relationships with the company) generally are not relevant to the independence tests under the New York Stock Exchange rules because they do not create a material relationship between a director and the company."[2]

On March 10, 2010, Black & Decker issued the following clarification: "In discussions between representatives of the New York Stock Exchange ("NYSE") and Black & Decker after the issuance of the press release, representatives of the NYSE advised Black & Decker that, in interpreting its rules, the NYSE believes relationships between a director and a member of senior management that are material to either party should be considered by a board of directors in its evaluation of a director's independence."[3]

1 The rules of The New York Stock Exchange and The Nasdaq Stock Market permit foreign private issuers to opt out of the exchanges' corporate governance requirements and to follow their home country practices instead. Accordingly, the director independence requirements will only apply to foreign private issuers that have not opted out of the exchanges' majority independence standards.

2 *See* Press Release, dated March 9, 2010, titled "Black & Decker Provides Additional Information in Connection With the Special Meetings of Stockholders to Consider the Stanley Transaction," available at http://www.ir.bdk.com/phoenix.zhtml?c=100780&p=irol-newsArticle&id=1400263.

3 *See* Press Release, dated March 10, 2010, titled "Black & Decker Issues Further Statement in Connection with the Special Meetings of Stockholders to Consider the Stanley Transaction," available at http://www.ir.bdk.com/phoenix.zhtml?c=100780&p=irol-newsArticle&ID=1400908.

White & Case is a leading global law firm with lawyers in 36 offices across 25 countries.

If you have questions or comments about this Client Alert, please contact the White & Case lawyer who regularly advises you or one of the lawyers listed below:

Oliver Brahmst
Partner, New York
Tel: + 1 212 819 8219
E-mail: obrahmst@whitecase.com

Colin J. Diamond
Partner, New York
Tel: + 1 212 819 8754
E-mail: cdiamond@whitecase.com

Gary Kashar
Partner, New York
Tel: + 1 212 819 8223
E-mail: gkashar@whitecase.com

John Reiss
Partner, New York
Tel: + 1 212 819 8247
E-mail: jreiss@whitecase.com

White & Case LLP
1155 Avenue of the Americas
New York, NY 10036
United States
+ 1 212 819 8200

Mr. Burns was one of three directors serving on a special transaction committee formed in July 2009 to consider The Stanley Works' proposal to acquire Black & Decker. The committee ultimately recommended the acquisition of Black & Decker by Stanley, including the terms of Mr. Archibald's engagement as Executive Chairman of the combined enterprise and his compensation package. In addition to base salary, an annual cash bonus, annual equity awards and various perquisites, Mr. Archibald is entitled to a bonus of up to US$45 million three years after the merger depending on the level of cost savings achieved by the combined enterprise.

Stock Exchange Independence Requirements

Director independence under Nasdaq and NYSE rules is determined based on a list of specific prohibited relationships coupled with a general requirement that the board determine (in the case of the NYSE) that the director does not otherwise have any "material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company)"[4] and (in the case of Nasdaq) that the director does not otherwise have "a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."[5]

The NYSE's commentary accompanying its rules states that boards should consider "all relevant facts and circumstances" when determining independence, but also states "when assessing the materiality of a director's relationship *with the listed company*, the board should consider the issue not merely from the standpoint of the director, but also from that of persons or organizations with which the director has an affiliation" (emphasis added). It is therefore understandable that Black & Decker might have read the NYSE rules as not requiring any consideration of business relationships between directors and senior management.

It should be noted that the NYSE's clarification regarding relationships between directors and senior management is not limited to business relationships, but also indicates that other relationships between a director and a member of senior management that are material to either party should be considered.

SEC Disclosure Requirements

Item 407 of Regulation S-K requires a listed company to disclose "for each director or nominees for director…by specific category or type, any transactions, relationships or arrangements…that were considered by the board of directors under the applicable independence definitions in determining that the director is independent." The instructions to the rule clarify that "The description of the specific categories or types of transactions, relationships or arrangements…must be provided in such detail as is necessary to fully describe the nature of the transactions, relationships or arrangements."

The SEC's rules do not expressly require that the board of directors of a listed company adopt an independence policy containing categories or types of transactions, relationships or arrangements that will impair independence; however, a company that does not adopt such policy must disclose any individual transaction, relationship or arrangement considered by the board when making its independence determination for each director. Conversely, a company with such a policy will only need to disclose which directors had relationships that fell into one of the categories or types listed in the policy without having to disclose further details. The outcome is disclosure that is slightly more specific than the requirements of the NYSE's former rules regarding "categorical independence standards" that were repealed effective January 1, 2010.

Director Independence in Other Contexts

Determinations regarding director independence are required outside of exchange listing requirements, notably for special transaction committees in the context of certain change of control transactions and special litigation committees in the context of derivate shareholder claims. While special transaction committees may be formed for a variety of reasons, they most commonly arise in connection with change of control transactions involving management or a significant stockholder in order to shift to a plaintiff the burden of proving a transaction's "entire fairness."[6]

The Delaware Supreme Court has defined a disinterested director as one who "neither appear[s] on both sides of a transaction nor expect[s] to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally."[7]

The Delaware Chancery Court has stated that "A director can be controlled by another if in fact he is *dominated* by that other party, whether through close personal or familial relationship or through force of will. A director can also be controlled by another if the challenged director is *beholden* to the allegedly controlling entity. A director may be considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral

4 For purposes of NYSE listing standards, a "material relationship" may include commercial, industrial, banking, consulting, legal, accounting, charitable or familial relationship.

5 *See* Nasdaq Listing Rules §5605(a)(2).

6 *See*, e.g., *Kahn v. Lynch Communication Systems*, 638 A.2d 1110 (Del. 1994), *In re Emerging Communications, Inc. Shareholder Litigation*, 2004 WL 1305745 (Del. Ch. 2004).

7 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

power (whether direct or indirect through control over other decision makers), to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is dependent or is of such subjective material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively."[8]

In the special litigation committee context, a 2003 decision by the Delaware Court of Chancery, *In re Oracle Corp. Derivative Litigation*[9], made clear that a director's independence could be compromised by social factors. The court denied the Oracle special litigation committee's motion to dismiss a derivative shareholder action, holding that a number of connections between the special litigation committee members and directors of Stanford University called into question the special litigation committee members' independence. These connections included, among other things, that two special litigation committee members and one defendant were professors at the university and one special litigation committee member and this defendant served on a research steering committee at the university; that one of the defendants was an alumnus who donated millions to Stanford; and that another defendant also made millions of dollars in donations to the university and was contemplating the establishment of a US$170 million scholarship fund at Stanford. The court stated: "the independence of the special committee involves a fact-intensive inquiry that varies from case to case." In this case, the court concluded: "by any measure this was a social atmosphere painted in too much vivid Stanford Cardinal red for the special litigation committee members to have reasonably ignored it." Instead of forming a special litigation committee "whose membership was free from bias-creating relationships, Oracle formed a committee fraught with them."

In a subsequent decision by the Delaware Supreme Court in 2004, the plaintiffs argued in another shareholder derivative action that three board members were not independent because of their close ties with Martha Stewart. The plaintiffs alleged that two directors were Ms. Stewart's friends and the third allegedly contacted the chief executive officer of a publishing company about a planned critical biography of Ms. Stewart. Despite these alleged personal ties, the court found that the plaintiffs did not meet their burden of pleading specific facts to create a reasonable doubt as to the independence of the three directors. The court quoted the Chancery Court's opinion: "some professional or personal friendships…may raise a reasonable doubt whether a director can appropriately consider demand…. Not all friendships, or even most of them, rise to this level."[10]

Conclusion and Points for Consideration

Black & Decker's clarification regarding the NYSE's independence requirements provides helpful guidance regarding the NYSE's rules and puts boards of listed companies on notice that a wider range of business and, possibly, social relationships between board members and senior management, should be considered when making independence determinations. Indeed, boards should view exchange independence standards as similar to those articulated in Delaware special committee cases. With this in mind, we recommend that boards of listed companies consider the following:

- Boards should adopt specific guidelines regarding business relations between directors and members of senior management. These guidelines should form part of the company's policies regarding independence and should also be included in its corporate governance guidelines or code of conduct. Although larger transactions would be more likely to impair independence, smaller transactions should nonetheless be subject to scrutiny by the general counsel and, if necessary, the nominating and governance committee.
- Companies should review their D&O questionnaires to ensure that they solicit the appropriate information from directors. Directors should be sensitized to a higher level of scrutiny and more obtrusive questions.
- Companies should ensure that board members provide timely updates regarding any business or other relationship with senior management in real time rather than waiting until annual proxy season (or, as in the case of Black & Decker, a special meeting) arises.
- Boards should consider articulating the level of personal or social relations that will impair independence. Such statements should be drafted broadly enough to allow flexible application to the facts of each case, but narrowly enough to avoid specific disclosure of particular relationships. For example, we believe that any such statement should clarify that friendships and periodic social interaction should not impair independence, whether predating board membership or resulting from connections made during board membership. Conversely, however, under limited circumstances, particularly close ties of friendship with senior management might call into question a director's independence.

8 *Orman v. Cullman*, 794 A.2d 5, 26 (Del. Ch. 2002).

9 *In re Oracle Corp. Derivative Litig.*, 2003 WL 21396449 (Del. Ch. June 17, 2003).

10 *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1050 (Del. Supr. 2004).

Supporting Clients Across the Globe

White & Case is a leading global law firm with lawyers in 36 offices across 25 countries.

We advise on virtually every area of law that affects cross-border business and our knowledge, like our clients' interests, transcends geographic boundaries.

Whether in established or emerging markets our commitment is substantial, with dedicated on-the-ground knowledge and presence.

Our lawyers are an integral, often long-established part of the business community, giving clients access to local, English and US law capabilities plus a unique appreciation of the political, economic and geographic environments in which they operate.

At the same time, working between offices and cross-jurisdiction is second nature and we have the experience, infrastructure and processes in place to make it happen effortlessly.

We work with some of the world's most well-established and most respected companies—including two-thirds of the *Global Fortune 100* and half of the *Fortune 500*—as well as start-up visionaries, governments and state-owned entities.

NYC/0310_CM_A_05360_v5