Delaware General Corporations Law

§ 141 – Board of directors; powers; number, qualifications, terms and quorum; committees; classes of directors; nonstock corporations; reliance upon books; action without meeting; removal.

(a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.

(b) The board of directors of a corporation shall consist of 1 or more members, each of whom shall be a natural person. The number of directors shall be fixed by, or in the manner provided in, the bylaws, unless the certificate of incorporation fixes the number of directors, in which case a change in the number of directors shall be made only by amendment of the certificate. Directors need not be stockholders unless so required by the certificate of incorporation or the bylaws. The certificate of incorporation or bylaws may prescribe other qualifications for directors. Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal. Any director may resign at any time upon notice given in writing or by electronic transmission to the corporation. A resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events. A resignation which is conditioned upon the director failing to receive a specified vote for reelection as a director may provide that it is irrevocable. A majority of the total number of directors shall constitute a quorum for the transaction of business unless the certificate of incorporation or the bylaws require a greater number. Unless the certificate of incorporation provides otherwise, the bylaws may provide that a number less than a majority shall constitute a quorum which in no case shall be less than 1/3 of the total number of directors except that when a board of 1 director is authorized under this section, then 1 director shall constitute a quorum. The vote of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors unless the certificate of incorporation or the bylaws shall require a vote of a greater number.

(c)(1) All corporations incorporated prior to July 1, 1996, shall be governed by this paragraph (c)(1) of this section, provided that any such corporation may by a resolution adopted by a majority of the whole board elect to be governed by paragraph (c)(2) of this section, in which case this paragraph (c)(1) of this section shall not apply to such corporation. All corporations incorporated on or after July 1, 1996, shall be governed by paragraph (c)(2) of this section. The board of directors may, by resolution passed by a majority of the whole board, designate 1 or more committees, each committee to consist of 1 or more of the directors of the corporation. The board may designate 1 or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. The bylaws may provide that in the absence or disqualification of a member of a committee, the member or members present at any meeting and not disqualified from voting, whether or not the member or members present constitute a quorum, may unanimously appoint another member of the board of directors to act at the meeting in the place of any such absent or disqualified member. Any such committee, to the extent provided in the resolution of the board of directors, or in the bylaws of the corporation, shall have and may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the certificate of incorporation (except that a committee may, to the extent authorized in the resolution or resolutions providing for the issuance of shares of stock adopted by the board of directors as provided in § 151(a) of this title, fix the designations and any of the preferences or rights of such shares relating to dividends, redemption, dissolution, any distribution of assets of the corporation or the conversion into, or the exchange of such shares for, shares of any other class or classes or any other series of the same or any other class or classes of stock of the corporation or fix the number of shares of any series of stock or authorize the increase or decrease of the shares of any series), adopting an agreement of merger or consolidation under § 251, § 252, § 254, § 255, § 256, § 257, § 258, § 263 or § 264 of this title, recommending to the stockholders the sale, lease or exchange of all or substantially all of the corporation's property and assets, recommending to the stockholders a dissolution of the corporation or a revocation of a dissolution, or amending the bylaws of the corporation; and, unless the resolution, bylaws or certificate of incorporation expressly so provides, no such

committee shall have the power or authority to declare a dividend, to authorize the issuance of stock or to adopt a certificate of ownership and merger pursuant to § 253 of this title.

(2) The board of directors may designate 1 or more committees, each committee to consist of 1 or more of the directors of the corporation. The board may designate 1 or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. The bylaws may provide that in the absence or disqualification of a member of a committee, the member or members present at any meeting and not disqualified from voting, whether or not such member or members constitute a quorum, may unanimously appoint another member of the board of directors to act at the meeting in the place of any such absent or disqualified member. Any such committee, to the extent provided in the resolution of the board of directors, or in the bylaws of the corporation, shall have and may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to the following matter: (i) approving or adopting, or recommending to the stockholders, any action or matter (other than the election or removal of directors) expressly required by this chapter to be submitted to stockholders for approval or (ii) adopting, amending or repealing any bylaw of the corporation.

(3) Unless otherwise provided in the certificate of incorporation, the bylaws or the resolution of the board of directors designating the committee, a committee may create 1 or more subcommittees, each subcommittee to consist of 1 or more members of the committee, and delegate to a subcommittee any or all of the powers and authority of the committee.

(d) The directors of any corporation organized under this chapter may, by the certificate of incorporation or by an initial bylaw, or by a bylaw adopted by a vote of the stockholders, be divided into 1, 2 or 3 classes; the term of office of those of the first class to expire at the first annual meeting held after such classification becomes effective; of the second class 1 year thereafter; of the third class 2 years thereafter; and at each annual election held after such classification becomes effective, directors shall be chosen for a full term, as the case may be, to succeed those whose terms expire. The certificate of incorporation or bylaw provision

dividing the directors into classes may authorize the board of directors to assign members of the board already in office to such classes at the time such classification becomes effective. The certificate of incorporation may confer upon holders of any class or series of stock the right to elect 1 or more directors who shall serve for such term, and have such voting powers as shall be stated in the certificate of incorporation. The terms of office and voting powers of the directors elected separately by the holders of any class or series of stock may be greater than or less than those of any other director or class of directors. In addition, the certificate of incorporation may confer upon 1 or more directors, whether or not elected separately by the holders of any class or series of stock, voting powers greater than or less than those of other directors. Any such provision conferring greater or lesser voting power shall apply to voting in any committee or subcommittee, unless otherwise provided in the certificate of incorporation or bylaws. If the certificate of incorporation provides that 1 or more directors shall have more or less than 1 vote per director on any matter, every reference in this chapter to a majority or other proportion of the directors shall refer to a majority or other proportion of the votes of the directors.

(e) A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.

(f) Unless otherwise restricted by the certificate of incorporation or bylaws, any action required or permitted to be taken at any meeting of the board of directors or of any committee thereof may be taken without a meeting if all members of the board or committee, as the case may be, consent thereto in writing, or by electronic transmission and the writing or writings or electronic transmission or transmissions are filed with the minutes of proceedings of the board, or committee. Such filing shall be in paper form if the minutes are maintained in paper form and shall be in electronic form if the minutes are maintained in electronic form. Any person (whether or not then a director) may provide, whether through instruction to an agent or otherwise, that a consent to action will be effective at a future time

(including a time determined upon the happening of an event), no later than 60 days after such instruction is given or such provision is made and such consent shall be deemed to have been given for purposes of this subsection at such effective time so long as such person is then a director and did not revoke the consent prior to such time. Any such consent shall be revocable prior to its becoming effective.

(g) Unless otherwise restricted by the certificate of incorporation or bylaws, the board of directors of any corporation organized under this chapter may hold its meetings, and have an office or offices, outside of this State.

(h) Unless otherwise restricted by the certificate of incorporation or bylaws, the board of directors shall have the authority to fix the compensation of directors.

(i) Unless otherwise restricted by the certificate of incorporation or bylaws, members of the board of directors of any corporation, or any committee designated by the board, may participate in a meeting of such board, or committee by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting pursuant to this subsection shall constitute presence in person at the meeting.

(j) The certificate of incorporation of any nonstock corporation may provide that less than 1/3 of the members of the governing body may constitute a quorum thereof and may otherwise provide that the business and affairs of the corporation shall be managed in a manner different from that provided in this section. Except as may be otherwise provided by the certificate of incorporation, this section shall apply to such a corporation, and when so applied, all references to the board of directors, to members thereof, and to stockholders shall be deemed to refer to the governing body of the corporation, the members thereof and the members of the corporation, respectively; and all references to stock, capital stock, or shares thereof shall be deemed to refer to memberships of a nonprofit nonstock corporation and to membership interests of any other nonstock corporation.

(k) Any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors, except as follows:

(1) Unless the certificate of incorporation otherwise provides, in the case of a corporation whose board is classified as provided in subsection (d) of this section, stockholders may effect such removal only for cause; or

(2) In the case of a corporation having cumulative voting, if less than the entire board is to be removed, no director may be removed without cause if the votes cast against such director's removal would be sufficient to elect such director if then cumulatively voted at an election of the entire board of directors, or, if there be classes of directors, at an election of the class of directors of which such director is a part.

Whenever the holders of any class or series are entitled to elect 1 or more directors by the certificate of incorporation, this subsection shall apply, in respect to the removal without cause of a director or directors so elected, to the vote of the holders of the outstanding shares of that class or series and not to the vote of the outstanding shares as a whole.

Summary: Lucian Bebchuk, THE CASE FOR INCREASING SHAREHOLDER POWER, 118 Harvard L. Rev. 833 (2005)

This Article reconsiders the basic allocation of power between boards and shareholders in publicly traded companies with dispersed ownership. U.S. corporate law has long precluded shareholders from initiating any changes in the company's basic governance arrangements. Professor Bebchuk's analysis and his empirical evidence indicate that shareholders' existing power to replace directors is insufficient to secure the adoption of value-increasing governance arrangements that management disfavors. He puts forward an alternative regime that would allow shareholders to initiate and adopt rules-of-the-game decisions to change the company's charter or state of incorporation. Providing shareholders with such power would operate over time to improve all corporate governance arrangements.

Furthermore, Professor Bebchuk argues that, as part of their power to amend governance arrangements, shareholders should be able to adopt provisions that would give them subsequently a specified power to intervene in additional corporate decisions. Power to intervene in game-ending decisions (to merge, sell all assets, or dissolve) could address management's bias in favor of the company's continued existence. Power to intervene in scaling-down decisions (to make cash or in-kind distributions) could address management's tendency to retain excessive funds and engage in empire-building. Shareholders' ability to adopt, when necessary, provisions that give themselves a specified additional power to intervene could thus produce benefits in many companies.

A regime with shareholder power to intervene, Professor Bebchuk shows, would address governance problems that have long troubled legal scholars and financial economists. These benefits would result largely from inducing management to act in shareholder interests without shareholders having to exercise their power to intervene. Professor Bebchuk also discusses how such a regime could best be designed to address concerns that supporters of management insulation could raise; for example, shareholder-initiated changes in governance arrangements could be adopted only if they enjoy shareholder support in two consecutive annual meetings. Finally, examining a wide range of possible objections, Professor Bebchuk concludes that they do not provide a good basis for opposing the proposed increase in shareholder power.

Excerpt from Stephen M. Bainbridge, THE CASE FOR LIMITED SHAREHOLDER VOTING RIGHTS, 53 UCLA L. Rev. 601 (2006)

. . . [I]n large corporations, authority-based decisionmaking structures are desirable because of the potential for division and specialization of labor. Bounded rationality and complexity, as well as the practical costs of losing time when one shifts jobs, make it efficient for corporate constituents to specialize. Directors and managers specialize in the efficient coordination of other specialists. In order to reap the benefits of specialization, all other corporate constituents should prefer to specialize in functions unrelated to decisionmaking, such as risk-bearing (shareholders) or labor (employees), delegating decisionmaking to the board and senior management. This natural division of labor, however, requires that the chosen directors and officers be vested with discretion to make binding decisions. Separating ownership and control by vesting decisionmaking authority in a centralized nexus distinct from the shareholders and all other constituents is what makes the large public corporation feasible.

Even if one could overcome the seemingly intractable collective action problems plaguing shareholder decisionmaking, active shareholder participation in corporate decisionmaking would still be precluded by the shareholders' widely divergent interests and distinctly different levels of information. Although neoclassical economics assumes that shareholders come to the corporation with wealth maximization as their goal, and most presumably do, once uncertainty is introduced it would be surprising if shareholder opinions did not differ on which course would maximize share value. . . . Shareholder investment time horizons are likely to vary from short-term speculation to long-term buy-and-hold strategies, for example, which in turn is likely to result in disagreements about corporate strategy. Even more prosaically, shareholders in different tax brackets are likely to disagree about such matters as dividend policy, as are shareholders who disagree about the merits of allowing management to invest the firm's free cash flow in new projects. . . .

Overcoming the collective action problems that prevent meaningful shareholder involvement would be difficult and costly, of course. Even if one could do so, moreover, shareholders lack both the information and the incentives necessary to make sound decisions on either operational or policy questions. . . . Accordingly, shareholders will prefer to irrevocably delegate decisionmaking authority to some smaller group, as, in the long run, this will maximize shareholder wealth.

What is that group? The Delaware Code, like the corporate law of virtually every other state, gives us a clear answer: The corporation's "business and affairs . . . shall be managed by or under the direction of a board of directors." . . .

Proxy Statements and Shareholder Proposals

SECURITIES EXCHANGE ACT of 1934

Section 14

(a) Solicitation of proxies in violation of rules and regulations

(1) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78l of this title.

(2) The rules and regulations prescribed by the Commission under paragraph (1) may include—

(A) a requirement that a solicitation of proxy, consent, or authorization by (or on behalf of) an issuer include a nominee submitted by a shareholder to serve on the board of directors of the issuer; and

(B) a requirement that an issuer follow a certain procedure in relation to a solicitation described in subparagraph (A).

SECURITY AND EXCHANGE COMMISSION RULE 14a-8
17 CFR 240.14a-8

This section addresses when a company must include a shareholder's proposal in its proxy statement and identify the proposal in its form of proxy when the company holds an annual or special meeting of shareholders. In summary, in order to have your shareholder proposal included on a company's proxy card, and included along with any supporting statement in its proxy statement, you must be eligible and follow certain procedures. Under a few specific circumstances, the company is permitted to exclude your proposal, but only after submitting its reasons to the Commission. We structured this section in a question-and-answer format so that it is easier to understand. The references to "you" are to a shareholder seeking to submit the proposal.

WHAT IS A PROPOSAL?

A shareholder proposal is your recommendation or requirement that the company and/or its board of directors take action, which you intend to present at a meeting of the company's shareholders. Your proposal should state as clearly as possible the course of action that you believe the company should follow. If your proposal is placed on the company's proxy card, the company must also provide in the form of proxy means for shareholders to specify by boxes a choice between approval or disapproval, or abstention. Unless otherwise indicated, the word "proposal" as used in this section refers both to your proposal, and to your corresponding statement in support of your proposal (if any).

WHO IS ELIGIBLE TO SUBMIT A PROPOSAL, AND HOW DO I DEMONSTRATE TO THE COMPANY THAT I AM ELIGIBLE?

In order to be eligible to submit a proposal, you must have continuously held at least $ 2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date you submit the proposal. You must continue to hold those securities through the date of the meeting. . . .

WHO HAS THE BURDEN OF PERSUADING THE COMMISSION OR ITS STAFF THAT MY PROPOSAL CAN BE EXCLUDED?

Except as otherwise noted, the burden is on the company to demonstrate that it is entitled to exclude a proposal.

If I have complied with the procedural requirements, on what other bases may a company rely to exclude my proposal?

(1) Improper under state law: If the proposal is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization;
(2) Violation of law: If the proposal would, if implemented, cause the company to violate any state, federal, or foreign law to which it is subject; . . .
(3) Violation of proxy rules: If the proposal or supporting statement is contrary to any of the Commission's proxy rules . . . ;
(4) Personal grievance; special interest: If the proposal relates to the redress of a personal claim or grievance against the company or any other person, or if it is designed to result in a benefit to you, or to further a personal interest, which is not shared by the other shareholders at large;
(5) Relevance: If the proposal relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings

and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business;

(6) Absence of power/authority: If the company would lack the power or authority to implement the proposal;

(7) Management functions: If the proposal deals with a matter relating to the company's ordinary business operations;

(8) Director elections: If the proposal:

- (i) Would disqualify a nominee who is standing for election;
- (ii) Would remove a director from office before his or her term expired;
- (iii) Questions the competence, business judgment, or character of one or more nominees or directors;
- (iv) Seeks to include a specific individual in the company's proxy materials for election to the board of directors; or
- (v) Otherwise could affect the outcome of the upcoming election of directors.

(9) Conflicts with company's proposal: If the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting; . . .

(10) Substantially implemented: If the company has already substantially implemented the proposal; . . .

(11) Duplication: If the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting;

(12) Resubmissions: If the proposal deals with substantially the same subject matter as another proposal or proposals that has or have been previously included in the company's proxy materials within the preceding 5 calendar years, a company may exclude it from its proxy materials for any meeting held within 3 calendar years of the last time it was included if the proposal received [a specified low percentage of the vote]:

(13) Specific amount of dividends: If the proposal relates to specific amounts of cash or stock dividends. . . .

1601 Willow Road
Menlo Park, California 94025

April 24, 2015

To Our Stockholders:

You are cordially invited to attend the 2015 Annual Meeting of Stockholders (Annual Meeting) of Facebook, Inc. to be held at the Santa Clara Marriott, located at 2700 Mission College Boulevard, Santa Clara, California 95054, on June 11, 2015, at 11:00 a.m. Pacific Time.

The matters expected to be acted upon at the meeting are described in detail in the accompanying Notice of Annual Meeting of Stockholders and proxy statement.

You may cast your vote over the Internet, by telephone, or by completing and returning the enclosed proxy card in the postage-prepaid envelope to ensure that your shares will be represented. Your vote by proxy will ensure your representation at the Annual Meeting regardless of whether or not you attend in person. Returning the proxy does not deprive you of your right to attend the meeting and to vote your shares in person.

We look forward to seeing you at the meeting.

Mark Zuckerberg
Chairman and Chief Executive Officer
Menlo Park, California

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE STOCKHOLDER MEETING TO BE HELD ON JUNE 11, 2015: THIS PROXY STATEMENT AND THE ANNUAL REPORT ARE AVAILABLE AT www.proxyvote.com

20170319

Facebook, Inc.
1601 Willow Road
Menlo Park, California 94025

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON JUNE 11, 2015

To Our Stockholders:

NOTICE IS HEREBY GIVEN that the 2015 Annual Meeting of Stockholders of Facebook, Inc. will be held at the Santa Clara Marriott, located at 2700 Mission College Boulevard, Santa Clara, California 95054, on June 11, 2015, at 11:00 a.m. Pacific Time, for the following purposes:

1. To elect eight directors, all of whom are currently serving on our board of directors, each to serve until the next annual meeting of stockholders and until his or her successor has been elected and qualified, or until his or her earlier death, resignation, or removal.

Marc L. Andreessen
Erskine B. Bowles
Susan D. Desmond-Hellmann
Reed Hastings
Jan Koum Sheryl
K. Sandberg Peter
A. Thiel
Mark Zuckerberg

2. To ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for the year ending December 31, 2015.

3. To re-approve the Internal Revenue Code of 1986, as amended (Code), Section 162(m) limits of our 2012 Equity Incentive Plan to preserve our ability to receive corporate income tax deductions that may become available pursuant to Section 162(m) of the Code.

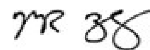
4. To consider and vote upon three stockholder proposals, if properly presented.

5. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

The foregoing items of business are more fully described in the proxy statement accompanying this Notice.

Only stockholders of record at the close of business on April 13, 2015 are entitled to notice of, and to vote at, the Annual Meeting or any adjournment or postponement thereof.

By Order of the Board of Directors,



Mark Zuckerberg
Chairman and Chief Executive Officer
Menlo Park, California

Whether or not you expect to attend the Annual Meeting, please vote via the Internet, by telephone, or complete, date, sign, and promptly return the accompanying proxy in the enclosed postage-paid envelope so that your shares may be represented at the meeting.

20170319

Facebook, Inc.
1601 Willow Road
Menlo Park, California 94025

PROXY STATEMENT

April 24, 2015

QUESTIONS AND ANSWERS ABOUT THE PROXY MATERIALS AND THE ANNUAL MEETING

1. What are proxy materials?

The accompanying proxy is delivered and solicited on behalf of the board of directors of Facebook, Inc., a Delaware corporation, in connection with the 2015 Annual Meeting of Stockholders (Annual Meeting) to be held at the Santa Clara Marriott, located at 2700 Mission College Boulevard, Santa Clara, California 95054, on June 11, 2015, at 11:00 a.m. Pacific Time. The Notice of Internet Availability of Proxy Materials (Notice) and proxy statement and form of proxy are being distributed and made available on the Internet on or about May 1, 2015. As a stockholder, you are invited to attend the Annual Meeting and are requested to vote on the items of business described in this proxy statement. This proxy statement includes information that we are required to provide to you under Securities and Exchange Commission (SEC) rules, and is designed to assist you in voting your shares. The proxy materials include our proxy statement for the Annual Meeting, an annual report to stockholders, including our Annual Report on Form 10-K for the year ended December 31, 2014 (Annual Report), and the proxy card or a voting instruction card for the Annual Meeting.

2. Why did I receive a notice in the mail regarding the Internet availability of proxy materials instead of a full set of proxy materials?

In accordance with the SEC rules, we may furnish proxy materials, including this proxy statement and our Annual Report, to our stockholders by providing access to such documents on the Internet instead of mailing printed copies. Accordingly, we are sending the Notice to our stockholders of record and beneficial owners as of April 13, 2015, which is the record date.

3. How can I access the proxy materials over the Internet?

The Notice and proxy card or voting instruction card will contain instructions on how to view the proxy materials on the Internet, vote your shares on the Internet, and request electronic delivery of future proxy materials. An electronic copy of this proxy statement and Annual Report are available at **www.proxyvote.com**.

Choosing to receive your future proxy materials by email will save us the cost of printing and mailing documents to you, and will reduce the environmental impact of printing and mailing these materials. If you choose to receive future proxy materials by email, you will receive an email next year with instructions containing a link to those materials and a link to the proxy voting site. Your election to receive proxy materials by email will remain in effect until you terminate it.

4. I share an address with another stockholder. Why did we receive only one copy of the proxy materials and how may I obtain an additional copy of the proxy materials?

The SEC has adopted rules that permit companies and intermediaries (e.g., brokers) to satisfy the delivery requirements for a Notice of Internet Availability of Proxy Materials or other annual meeting materials with respect to two or more stockholders sharing the same address by delivering a single Notice of Internet Availability of Proxy Materials or other annual meeting materials addressed to those stockholders. This process, which is commonly referred to as "householding," is intended to provide extra convenience for stockholders and cost savings for companies.

A number of brokers with account holders who are our stockholders will be "householding" our proxy materials. A single Notice will be delivered to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. If you have received notice from your broker that they will be "householding" communications to your address, "householding" will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in "householding" and would prefer to receive a separate Notice, please notify your broker. Stockholders who have multiple accounts in their names or who share an address with other stockholders can request "householding" and authorize your broker to discontinue mailings of multiple annual reports and proxy statements by contacting your broker.

20170319

5. What items of business will be voted on at the Annual Meeting?

The items of business scheduled to be voted on at the Annual Meeting are:

- Proposal One: the election of eight directors;
- Proposal Two: the ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm for the year ending December 31, 2015;
- Proposal Three: the re-approval of the Internal Revenue Code of 1986, as amended (Code), Section 162(m) limits of our 2012 Equity Incentive Plan (2012 Plan) to preserve our ability to receive corporate income tax deductions that may become available pursuant to Section 162(m) of the Code;
- Proposal Four: a stockholder proposal regarding change in stockholder voting;
- Proposal Five: a stockholder proposal regarding an annual sustainability report; and
- Proposal Six: a stockholder proposal regarding a human rights risk assessment.

The three stockholder proposals (Proposals Four through Six) are hereinafter referred to as the Stockholder Proposals. Other than the six proposals described in this proxy statement, we are not aware of any other business to be acted upon at the Annual Meeting.

6. How does the board of directors recommend I vote on these proposals?

- "FOR" the election of each director nominee;
- "FOR" the ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm for the year ending December 31, 2015;
- "FOR" the re-approval of the Section 162(m) limits of our 2012 Plan to preserve our ability to receive corporate income tax deductions that may become available pursuant to Section 162(m) of the Code; and
- "AGAINST" each of the three Stockholder Proposals (Proposals Four through Six).

7. Who is entitled to vote at the Annual Meeting?

Only holders of record of our Class A common stock and Class B common stock at the close of business on April 13, 2015, which is the record date, will be entitled to vote at the Annual Meeting. At the close of business on April 13, 2015, we had 2,246,834,198 shares of Class A common stock outstanding and 559,339,723 shares of Class B common stock outstanding and entitled to vote. Holders of our Class A common stock are entitled to one vote for each share held as of the above record date. Holders of our Class B common stock are entitled to ten votes for each share held as of the above record date. Holders of our Class A common stock and Class B common stock will vote as a single class on all matters described in this proxy statement. A quorum is required for our stockholders to conduct business at the Annual Meeting. A quorum will be present if stockholders holding at least a majority of the voting power of the shares of our Class A common stock and Class B common stock (voting together as a single class) entitled to vote are present at the Annual Meeting in person or represented by proxy. Dissenters' rights are not applicable to any of the matters being voted upon at the Annual Meeting.

Registered Stockholders. If your shares are registered directly in your name with our transfer agent, Computershare Trust Company, N.A. (Computershare), you are considered the stockholder of record with respect to those shares, and the Notice was provided to you directly by us. As the stockholder of record, you have the right to grant your voting proxy directly to the individuals listed on the proxy card or to vote in person at the Annual Meeting.

Beneficial Stockholders. If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in "street name" and the Notice was forwarded to you by your broker or nominee, who is considered, with respect to those shares, the stockholder of record. As the beneficial owner, you have the right to direct your broker or nominee how to vote your shares. Beneficial owners are also invited to attend the Annual Meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the Annual Meeting unless you follow your broker's procedures for obtaining a legal proxy. If you request a printed copy of the proxy materials by mail, your broker or nominee will provide a voting instruction card for you to use.

8. What votes are required to approve each of the proposals?

For Proposal One, directors will be elected by a plurality of the votes of the shares of our Class A common stock and Class B common stock (voting together as a single class) present in person or represented by proxy at the Annual Meeting and entitled to vote on the election of directors, which means that the eight nominees receiving the highest number of affirmative votes will be elected.

Approval of Proposals Two through Six requires the affirmative "FOR" vote of a majority of the voting power of the shares of our Class A common stock and Class B common stock (voting together as a single class) properly cast "FOR" or "AGAINST" such proposal.

9. How are broker non-votes and abstentions counted?

A broker non-vote occurs when shares held by a broker are not voted with respect to a particular proposal because the broker does not have discretionary authority to vote on the matter and has not received voting instructions from its clients. If your broker holds your shares in its name and you do not instruct your broker how to vote, your broker will only have discretion to vote your shares on "routine" matters. Where a proposal is not "routine," a broker who has not received instructions from its clients does not have discretion to vote its clients' uninstructed shares on that proposal. At our Annual Meeting, only Proposal Two (ratifying the appointment of our independent registered public accounting firm) is considered a routine matter. Your broker will therefore not have discretion to vote on the following "non-routine" matters absent direction from you: the election of directors, the re-approval of the Section 162(m) limits of our 2012 Plan, and each of the three Stockholder Proposals.

Broker non-votes and abstentions by stockholders from voting (including brokers holding their clients' shares of record who cause abstentions to be recorded) will be counted towards determining whether or not a quorum is present. However, because broker non-votes and abstentions are not voted affirmatively or negatively, they will have no effect on the approval of any of the proposals, except where brokers may exercise their discretion on routine matters, as discussed above.

10. Can I vote in person at the Annual Meeting?

For stockholders with shares registered in the name of a brokerage firm or bank or other similar organization, you will need to obtain a legal proxy from the broker, bank, or other nominee that holds your shares before you can vote your shares in person at the Annual Meeting. For stockholders with shares registered directly in their names with Computershare, you may vote your shares in person at the Annual Meeting.

---

11. What do I need to do to attend the Annual Meeting in person?

Space for the Annual Meeting is limited. Therefore, admission will be on a first-come, first-served basis. Registration will open at 9:00 a.m. Pacific Time and the Annual Meeting will begin at 11:00 a.m. Pacific Time.

Register in Advance

We encourage you to RSVP for the meeting and print your admission ticket at www.proxyvote.com. You will need the 16-digit control number printed on the proxy materials. On the day of the meeting you will be required to present a valid government photo identification along with the admission ticket. Please register by June 9, 2015.

Register at the Stockholder Meeting

To register at the meeting, please bring the following documents:

1. Valid government photo identification, such as a driver's license or passport; and
2. Beneficial stockholders holding their shares through a broker, bank, trustee, or other nominee will need to bring proof of beneficial ownership as of April13, 2015, the record date, such as their most recent account statement

   reflecting their stock ownership prior to April 13, 2015, a copy of the voting instruction card provided by their broker, bank, trustee, or other nominee, or similar evidence of ownership.

Use of cameras, recording devices, computers, and other electronic devices, such as smart phones and tablets, will not be permitted at the Annual Meeting. Photography and video are prohibited at the Annual Meeting.

Please allow ample time for check-in. Parking may be limited. For security reasons, stockholders should be prepared to pass through metal detectors prior to entering the Annual Meeting. Please note that large bags and packages will not be allowed at the Annual Meeting. Persons will be subject to search.

20170319

12. Can I vote by telephone or Internet?

For beneficial stockholders with shares registered in the name of a brokerage firm or bank, a number of brokerage firms and banks are participating in a program that offers telephone and Internet voting options. Stockholders should refer to the voting instruction form provided by their brokerage firm or bank for instructions on the voting methods they offer. Registered stockholders with shares registered directly in their names with Computershare will also be able to vote using the telephone and Internet. If your shares are held in an account at a brokerage firm or bank participating in this program or registered directly in your name with Computershare, you may vote those shares by calling the telephone number specified on your proxy or accessing the Internet website address specified on your proxy instead of completing and signing the proxy itself. The giving of such a telephonic or Internet proxy will not affect your right to vote in person should you decide to attend the Annual Meeting. The telephone and Internet voting procedures are designed to authenticate stockholders' identities, to allow stockholders to give their voting instructions and to confirm that stockholders' instructions have been recorded properly.

The Notice provides information on how to access the proxy, which contains instructions on how to vote via the Internet or by telephone.

13. How will my proxy be voted?

The proxy accompanying this proxy statement is solicited on behalf of our board of directors for use at the Annual Meeting. Stockholders are requested to complete, date, and sign the accompanying proxy and promptly return it in the enclosed envelope. All signed, returned proxies that are not revoked will be voted in accordance with the instructions contained therein. Signed proxies that give no instructions as to how they should be voted on a particular proposal at the Annual Meeting will be voted in accordance with the recommendation of our board of directors set forth in this proxy statement: in the case of the election of directors, as a vote "for" the election of all nominees presented by the board of directors; in the case of the ratification of Ernst & Young LLP as our independent registered public accounting firm, as a vote "for" such ratification; in the case of the re-approval of the Section 162(m) limits of our 2012 Plan, as a vote "for" such re-approval; and in the case of each of the three Stockholder Proposals, as a vote "against" each such proposal. In the event that sufficient votes for the proposals are not received by the date of the Annual Meeting, the persons named as proxies may propose one or more adjournments of the Annual Meeting to permit further solicitations of proxies. Any such adjournment would require the affirmative vote of the majority of the outstanding voting power of the shares present in person or represented by proxy and entitled to vote at the Annual Meeting, provided a quorum is present.

14. How do I change or revoke my proxy?

Any person signing a proxy in the form accompanying this proxy statement has the power to revoke it prior to the Annual Meeting or at the Annual Meeting prior to the vote pursuant to the proxy. A proxy may be revoked by a writing delivered to us stating that the proxy is revoked, by a subsequent proxy that is signed by the person who signed the earlier proxy and is delivered before or at the Annual Meeting, by voting again on a later date on the Internet or by telephone (only your latest Internet or telephone proxy submitted prior to the Annual Meeting will be counted), or by attendance at the Annual Meeting and voting in person. Please note, however, that if a stockholder's shares are held of record by a broker, bank or other nominee and that stockholder wishes to vote at the Annual Meeting, the stockholder must bring a legal proxy to the Annual Meeting.

15. Who will tabulate the votes?

We have designated a representative of the Veaco Group as the Inspector of Elections who will tabulate the votes.

16. How can I make proposals or make a nomination for director for next year's annual meeting?

You may present proposals for action at a future meeting or submit nominations for election of directors only if you comply with the requirements of the proxy rules established by the SEC and our amended and restated bylaws, as applicable. In order for a stockholder proposal or nomination for director to be considered for inclusion in our proxy statement and form of proxy relating to our annual meeting of stockholders to be held in 2016, the proposal or nomination must be received by us at our principal executive offices no later than January 2, 2016. Stockholders wishing to bring a proposal or nominate a director before the annual meeting to be held in 2016 (but not include it in our proxy materials) must provide written notice of such proposal to our Secretary at our principal executive offices between February 12, 2016 and March 13, 2016 and comply with the other provisions of our amended and restated bylaws.

20170319

17. Who pays for the expenses of solicitation?

The expenses of soliciting proxies to be voted at the Annual Meeting will be paid by us. Following the original mailing of the proxies and other soliciting materials, we or our agents may also solicit proxies in person, by telephone, or email. Following the original mailing of the proxies and other soliciting materials, we will request that banks, brokers, custodians, nominees, and other record holders of our Class A common stock and Class B common stock forward copies of the proxy and other soliciting materials to persons for whom they hold shares of Class A common stock and Class B common stock and request authority for the exercise of proxies. We will reimburse banks, brokers, custodians, nominees, and other record holders for reasonable charges and expenses incurred in forwarding soliciting materials to their clients.

Stockholders voting via the telephone or Internet should understand that there may be costs associated with telephonic or electronic access, such as usage charges from telephone companies and Internet access providers, which must be borne by the stockholder.

EXECUTIVE OFFICERS, DIRECTORS, AND CORPORATE GOVERNANCE

The following table provides information regarding our executive officers and directors as of March 31, 2015:

Name	Age	Position(s)
Mark Zuckerberg	30	Chairman and Chief Executive Officer
Sheryl K. Sandberg	45	Chief Operating Officer and Director
David M. Wehner	46	Chief Financial Officer
Christopher K. Cox	32	Chief Product Officer
David B. Fischer	42	Vice President, Business and Marketing Partnerships
Mike Schroepfer	40	Chief Technology Officer
Colin S. Stretch	45	Vice President, General Counsel, and Secretary
Marc L. Andreessen (1)(3)	43	Director
Erskine B. Bowles (1)	69	Director
Susan D. Desmond-Hellmann (1)	57	Director
Donald E. Graham* (2)(3)	69	Director
Reed Hastings (2)(3)	54	Director
Jan Koum	39	Director
Peter A. Thiel (2)	47	Director

* Lead Independent Director
(1) Member of the audit committee
(2) Member of the compensation committee
(3) Member of the governance committee

Mark Zuckerberg is our founder and has served as our Chief Executive Officer (CEO) and as a member of our board of directors since July 2004. Mr. Zuckerberg has served as Chairman of our board of directors since January 2012. Mr. Zuckerberg attended Harvard University where he studied computer science. We believe that Mr. Zuckerberg should serve as a member of our board of directors due to the perspective and experience he brings as our founder, Chairman, and CEO, and as our largest and controlling stockholder.

Sheryl K. Sandberg has served as our Chief Operating Officer (COO) since March 2008 and as a member of our board of directors since June 2012. From November 2001 to March 2008, Ms. Sandberg served in various positions at Google, Inc., most recently as Vice President, Global Online Sales & Operations. Ms. Sandberg also is a former Chief of Staff of the U.S. Treasury Department and previously served as a consultant with McKinsey & Company, a management consulting company, and as an economist with The World Bank. In addition to serving as our COO, Ms. Sandberg has been a member of the board of directors of the Walt Disney Company since December 2009. Ms. Sandberg previously served as a member of the board of directors of Starbucks Corporation from March 2009 to March 2012. Ms. Sandberg holds an A.B. in economics from Harvard University and an M.B.A.
from Harvard Business School. We believe that Ms. Sandberg should serve as a member of our board of directors due to the perspective and experience she brings as our COO.

David M. Wehner has served as our Chief Financial Officer (CFO) since June 2014. Mr. Wehner joined us in November 2012 as our Vice President, Corporate Finance and Business Planning. From August 2010 until November 2012, Mr. Wehner served as Chief Financial Officer at Zynga Inc., a provider of social game services. From February 2001 to July 2010, Mr. Wehner served in various positions at Allen & Company, an investment bank, including as a Managing Director from November 2006 to July 2010 and as a director from December 2005 to November 2006. Mr. Wehner holds a B.S. in Chemistry from Georgetown University, and an M.S. in Applied Physics from Stanford University.

Christopher K. Cox has served in various positions with us since October 2005, most recently as our Chief Product Officer (CPO). Mr. Cox joined us as a software engineer and helped build the first versions of key Facebook features, including News Feed. Mr. Cox holds a B.S. in symbolic systems with a concentration in artificial intelligence from Stanford University.

David B. Fischer has served in various positions with us since April 2010, most recently as our Vice President, Business and Marketing Partnerships. From July 2002 to March 2010, Mr. Fischer served in various positions at Google, including most recently as its Vice President, Global Online Sales & Operations. Prior to joining Google, Mr. Fischer served as Deputy Chief of Staff of the U.S. Treasury Department and was an associate editor at the U.S. News & World Report, L.P., a news magazine company. Mr. Fischer holds a B.A. in government from Cornell University and an M.B.A. from the Stanford University Graduate School of Business.

Mike Schroepfer has served in various positions with us since September 2008 and is currently our Chief Technology Officer (CTO). From December 2005 to August 2008, Mr. Schroepfer served as Vice President of Engineering at Mozilla Corporation, an Internet company. Prior to Mozilla, Mr. Schroepfer served in various positions at Sun Microsystems, Inc., an information technology company, including as Chief Technology Officer of its data center automation division. He also co- founded CenterRun, Inc., a developer of application provisioning software, which was acquired by Sun Microsystems. In addition to serving as our CTO, Mr. Schroepfer previously served as a member of the board of directors of Ancestry.com Inc. from January 2011 to December 2012. Mr. Schroepfer holds a B.S. and an M.S. in computer science from Stanford University.

Colin S. Stretch has served as our Vice President, General Counsel, and Secretary since July 2013. Mr. Stretch first joined us in February 2010 as Deputy General Counsel. From 2002 to 2010, Mr. Stretch was a partner at Kellogg Huber Hansen Todd Evans & Figel, PLCC, a law firm. Earlier in his career, Mr. Stretch served as a law clerk for U.S. Supreme Court Justice Stephen Breyer and for Judge Laurence Silberman of the U.S. Court of Appeals for the D.C. Circuit. Mr. Stretch holds an A.B. in Government from Dartmouth College and a J.D. from Harvard Law School.

Marc L. Andreessen has served as a member of our board of directors since June 2008. Mr. Andreessen is a co- founder and has been a General Partner of Andreessen Horowitz, a venture capital firm, since July 2009. Previously, Mr. Andreessen co-founded and served as the Chairman of the board of directors of Opsware, Inc. (formerly known as Loudcloud Inc.), a software company. He also served as Chief Technology Officer of America Online, Inc., an Internet services company. Mr. Andreessen was a co-founder of Netscape Communications Corporation, a software company, serving in various positions, including Chief Technology Officer and Executive Vice President of Products. In addition to serving on our board of directors, Mr. Andreessen currently serves as a member of the boards of directors of the Hewlett-Packard Company and several private companies. Mr. Andreessen previously served as a member of the board of directors of eBay Inc. from September 2008 to October 2014. Mr. Andreessen holds a B.S. in computer science from the University of Illinois at Urbana- Champaign. We believe that Mr. Andreessen should serve as a member of our board of directors due to his extensive experience as an Internet entrepreneur, venture capitalist, and technologist.

Erskine B. Bowles has served as a member of our board of directors since September 2011. Mr. Bowles is President Emeritus of the University of North Carolina and served as President from January 2006 through December 2010. Mr. Bowles has also been a Senior Advisor and non-executive vice chairman of BDT Capital Partners, LLC, a private investment firm, since January 2012. From February 2010 until December 2010, he served as Co-Chair of the National Commission on Fiscal Responsibility and Reform. Mr. Bowles has been a Senior Advisor since 2001 and was Managing Director from 1999 to 2001 of Carousel Capital LLC, a private investment firm. He was also a partner of Forstmann Little & Co., an investment firm, from 1999 to 2001. Mr. Bowles began his career in corporate finance at Morgan Stanley & Co. LLC and subsequently helped found and ultimately served as Chairman and Chief Executive Officer of Bowles Hollowell Connor & Co., an investment banking firm. He also was a founder of Kitty Hawk Capital, a venture capital firm. Mr. Bowles served as White House Chief of Staff from 1996 to 1998 and Deputy White House Chief of Staff from 1994 to 1995. In addition to serving on our board of directors, Mr. Bowles currently serves as a member of the boards of directors of Morgan Stanley, Belk, Inc., and Norfolk Southern Corporation. Mr. Bowles also served as a member of the board of directors of General Motors Company from June 2005 to April 2009 and Cousins Properties Incorporated from August 2003 to May 2012. Mr. Bowles holds a B.S. in business from the University of North Carolina at Chapel Hill and an M.B.A. from Columbia University Graduate School of Business. We believe that Mr. Bowles should serve as a member of our board of directors due to his extensive experience in the financial services industry and academia as well as his distinguished public service.

Susan D. Desmond-Hellmann has served as a member of our board of directors since March 2013. Dr. Desmond- Hellmann has served as the Chief Executive Officer of the Bill & Melinda Gates Foundation since May 2014. Prior to the Bill & Melinda Gates Foundation, Dr. Desmond-Hellmann was the Chancellor and Arthur and Toni Rembe Rock Distinguished Professor, University of California, San Francisco (UCSF), where she served since August 2009. From 2004 through 2009, Dr. Desmond-Hellmann served as President of Product Development at Genentech, where she was responsible for pre-clinical and clinical development, business development, and product portfolio management. She joined Genentech in 1995. Prior to joining Genentech, Dr. Desmond-Hellmann was associate director of clinical cancer research at Bristol-Myers Squibb Parmaceutical Research Institute. In addition to serving on our board of directors, Dr. Desmond-Hellmann currently serves as a member of the board of directors of The Procter & Gamble Company. Dr. Desmond-Hellmann holds a B.S. in Pre-Med and an M.D. from the University of Nevada, Reno, and an M.P.H. from the University of California, Berkeley.

We believe Dr. Desmond-Hellmann should serve as a member of our board of directors due to her extensive leadership and technology experience.

Donald E. Graham has served as a member of our board of directors since March 2009. Mr. Graham has served as the Chief Executive Officer of Graham Holdings Company (formerly, The Washington Post Company), an education and media company, since 1991 and as Chairman of its board of directors since 1993. Mr. Graham holds an A.B. in English history and literature from Harvard University. We believe that Mr. Graham should serve as a member of our board of directors due to his extensive experience in the media industry, including serving in a variety of senior leadership roles with Graham Holdings Company. In accordance with our corporate governance guidelines, Mr. Graham will have reached the mandatory retirement age of 70 by the time of the Annual Meeting and therefore is not being nominated for reelection to our board of directors at the Annual Meeting.

Reed Hastings has served as a member of our board of directors since June 2011. Mr. Hastings has served as the Chief Executive Officer and Chairman of the board of directors of Netflix, Inc., a provider of an Internet subscription service for movies and television shows, since 1999. Prior to Netflix, Mr. Hastings served as Chief Executive Officer of Technology Network, a political service organization for the technology industry. Mr. Hastings served as Chief Executive Officer of Pure Atria Software, a maker of software development tools, from 1991 until it was acquired by Rational Software Corporation in 1997. Mr. Hastings previously served as a member of the board of directors of Microsoft Corporation from March 2007 to November 2012. Mr. Hastings holds a B.A. in mathematics from Bowdoin College and an M.S.C.S. in computer science from Stanford University. We believe that Mr. Hastings should serve as a member of our board of directors due to his extensive experience with technology companies.

Jan Koum has served as a member of our board of directors since October 2014. Since February 2009, Mr. Koum has served and continues to serve as Co-Founder and CEO of WhatsApp Inc. (WhatsApp), a cross-platform mobile messaging application company and our wholly-owned subsidiary. Mr. Koum attended San Jose State University where he studied math and computer science. Mr. Koum left San Jose State University before achieving a degree. We believe that Mr. Koum should serve as a member of our board of directors due to the perspective and experience he brings as the Co-Founder and CEO of WhatsApp.

Peter A. Thiel has served as a member of our board of directors since April 2005. Mr. Thiel has served as President of Thiel Capital, an investment firm, since 2011, a Partner of Founders Fund, a venture capital firm, since 2005, and President of Clarium Capital Management, a global macro investment manager, since 2002. In 1998, Mr. Thiel co-founded PayPal, Inc., an online payment company, where he served as Chief Executive Officer, President, and Chairman of its board of directors from 2000 until its acquisition by eBay in 2002. Mr. Thiel holds a B.A. in Philosophy from Stanford University and a J.D. from Stanford Law School. We believe that Mr. Thiel should serve as a member of our board of directors due to his extensive experience as an entrepreneur and venture capitalist, and as one of our early investors.

Executive Officers

Our executive officers are designated by, and serve at the discretion of, our board of directors. There are no family relationships among any of our directors or executive officers.

Board of Directors

Our board of directors may establish the authorized number of directors from time to time by resolution. The current authorized number of directors is nine. In accordance with our corporate governance guidelines, Mr. Graham will have reached the mandatory retirement age of 70 by the time of the Annual Meeting and therefore is not being nominated for reelection to our board of directors at the Annual Meeting. Our current directors, excluding Mr. Graham, if elected, will continue to serve as directors until the next annual meeting of stockholders and until his or her successor has been elected and qualified, or until his or her earlier death, resignation, or removal.

Our board of directors held twelve meetings during 2014. The board of directors also acted three times by unanimous written consent. No member of our board of directors attended fewer than 75% of the aggregate of the total number of meetings of the board of directors (held during the period for which he or she was a director) and the total number of meetings held by all committees of the board of directors on which such director served (held during the period that such director served). Members of our board of directors are invited and encouraged to attend each annual meeting of stockholders.

Board Leadership Structure

Mark Zuckerberg, our founder and CEO, serves as Chairman of our board of directors and presides over meetings of the board of directors, and holds such other powers and carries out such other duties as are customarily carried out by the Chairman of our board of directors. Mr. Zuckerberg brings valuable insight to our board of directors due to the perspective and experience he brings as our founder and CEO, and as our largest and controlling stockholder. Mr. Graham currently serves as our Lead Independent Director and presides over portions of regularly scheduled meetings at which only our independent directors are present, serves as a liaison between the Chairman and the independent directors, and performs such additional duties as the board of directors may otherwise determine and delegate. In accordance with our corporate governance guidelines, Mr. Graham will have reached the mandatory retirement age of 70 by the time of the Annual Meeting and therefore is not being nominated for reelection to our board of directors at the Annual Meeting. Following the Annual Meeting, Dr. Desmond-Hellmann will serve as our Lead Independent Director. Generally, every regular meeting of our board of directors includes a meeting of our independent directors without management present.

Controlled Company Status

Because Mr. Zuckerberg controls a majority of our outstanding voting power, we are a "controlled company" under the corporate governance rules of the NASDAQ Stock Market LLC (NASDAQ). Therefore, we are not required to have a majority of our board of directors be independent, nor are we required to have a compensation committee or an independent nominating function. In light of our status as a controlled company, our board of directors has determined not to have an independent nominating function and to have the full board of directors be directly responsible for nominating members of our board.

Director Independence

The rules of NASDAQ generally require that a majority of the members of a listed company's board of directors be independent. In addition, the listing rules generally require that, subject to specified exceptions, each member of a listed company's audit, compensation, and governance committees be independent. Although we are a "controlled company" under the corporate governance rules of NASDAQ and, therefore, are not required to comply with certain rules requiring director independence, we have nevertheless opted, under our Corporate Governance Guidelines, to have a majority of the members of our board of directors be independent and to have compensation and governance committees comprised solely of independent directors.

Audit committee members must also satisfy the independence criteria set forth in Rule 10A-3 under the Securities Exchange Act of 1934, as amended (Exchange Act). In order to be considered independent for purposes of Rule 10A-3, a member of an audit committee of a listed company may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee: accept, directly or indirectly, any consulting, advisory, or other compensatory fee from the listed company or any of its subsidiaries; or be an affiliated person of the listed company or any of its subsidiaries.

Our board of directors has determined that none of our non-employee directors has a relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director and that each of these directors is "independent" as that term is defined under the rules of NASDAQ. Our board of directors has also determined that Messrs. Andreessen and Bowles, and Dr. Desmond-Hellmann, who comprise our audit committee, Messrs. Graham, Hastings, and Thiel, who comprise our compensation committee, and Messrs. Andreessen, Graham, and Hastings, who comprise our governance committee, satisfy the independence standards for those committees established by applicable SEC rules, NASDAQ rules and applicable rules of the Internal Revenue Code of 1986, as amended (Code). Mr. Graham, who is not standing for reelection to our board of directors at the Annual Meeting, will cease being a member of our board of directors effective immediately after the Annual Meeting.

20170319

Following the Annual Meeting, the governance committee and the compensation committee will be replaced by the compensation and governance committee. For more information, see "—Board Committees."

Classified Board

So long as the outstanding shares of our Class B common stock represent a majority of the combined voting power of common stock, we will not have a classified board of directors, and all directors will be elected for annual terms. As of the close of business on April 13, 2015, the outstanding shares of Class B common stock represented a majority of the combined voting power of our common stock.

However, our restated certificate of incorporation and our amended and restated bylaws provide that when the outstanding shares of our Class B common stock represent less than a majority of the combined voting power of common stock, we will have a classified board of directors consisting of three classes of approximately equal size, each serving staggered three-year terms. At such time, our directors will be assigned by the then-current board of directors to a class. Upon expiration of the term of a class of directors, directors for that class will be elected for three-year terms at the annual meeting of stockholders in the year in which that term expires. As a result, only one class of directors will be elected at each annual meeting of our stockholders, with the other classes continuing for the remainder of their respective three-year terms. Each director's term continues until the next annual meeting of stockholders and until his or her successor has been elected and qualified, or until his or her earlier death, resignation, or removal.

In addition, when the outstanding shares of our Class B common stock represent less than a majority of the combined voting power of our common stock and we have a classified board, only our board of directors may fill vacancies on our board. Any additional directorships resulting from an increase in the number of directors will be distributed among the three classes so that, as nearly as possible, each class will consist of one-third of the total number of directors.

The classification of our board of directors, if implemented, may have the effect of delaying or preventing changes in our control or management.

Board Committees

Our board of directors has established an audit committee, a compensation committee, and a governance committee, each of which have the composition and responsibilities described below. Members serve on these committees until their resignations or until otherwise determined by our board of directors. Each of these committees has a written charter. Current copies of the charters of the audit committee, compensation committee, and governance committee are available on our website at http://investor.fb.com/governance.cfm.

Following the Annual Meeting, the governance committee and the compensation committee will be combined to form a single compensation and governance committee, which will have similar responsibilities to the responsibilities described below for each of the compensation committee and the governance committee. Our compensation and governance committee will be comprised of Messrs. Andreessen, Hastings, and Thiel. Mr. Hastings will be the chairman of the compensation and governance committee. A copy of the charter of the compensation and governance committee will be available on our website following the Annual Meeting.

Audit Committee

Our audit committee is comprised of Messrs. Andreessen and Bowles, and Dr. Desmond-Hellmann. Mr. Bowles is the chairman of our audit committee, is our audit committee financial expert, as that term is defined under SEC rules, and possesses financial sophistication as defined under the rules of NASDAQ. The designation does not impose on Mr. Bowles any duties, obligations or liabilities that are greater than are generally imposed on members of our audit committee and our board of directors. Our board of directors has adopted a charter for our audit committee. As more fully described in its charter, our audit committee is directly responsible for, among other things:

- selecting the independent registered public accounting firm to audit our financial statements;
- ensuring the independence of the independent registered public accounting firm;
- discussing the scope and results of the audit with the independent registered public accounting firm, and reviewing, with management and that firm, our interim and year-end operating results;
- developing procedures to enable submission of anonymous concerns about accounting or auditing matters;
- considering the adequacy of our internal accounting controls and audit procedures;
- reviewing related party transactions;
- pre-approving all audit and non-audit services to be performed by the independent registered public accounting firm;
- and overseeing our internal audit function.

During 2014, the audit committee met in person or by telephone, or acted by unanimous written consent, nine times.

20170319

Compensation Committee

Our compensation committee is comprised of Messrs. Graham, Hastings, and Thiel. Mr. Graham is the chairman of our compensation committee. Each member of this committee is a non-employee director, as defined pursuant to Rule 16b-3 promulgated under the Exchange Act, and an outside director, as defined under Section 162(m) of the Code. Our board of directors has adopted a charter for our compensation committee. As more fully described in its charter, our compensation committee is responsible for, among other things:

- reviewing and approving, or recommending that our board of directors approve, the compensation of our executive officers;
- reviewing and recommending to our board of directors the compensation of our directors;
- reviewing and approving the terms of any compensatory agreements with our executive officers;
- administering our equity incentive plans, including making equity grants thereunder;
- reviewing and making recommendations to our board of directors with respect to incentive compensation and equity plans; and
- establishing and reviewing our overall compensation philosophy.

The charter for our compensation committee allows the committee from time to time to delegate its authority to subcommittees and to our officers, as it may be deemed necessary or appropriate. In December 2013, our compensation committee authorized the formation and delegation of certain authority to an equity subcommittee. The current members of the equity subcommittee are Ms. Sandberg and Mr. Wehner, and the members, acting either individually or jointly, have the authority to review and approve restricted stock units (RSUs) to employees and consultants, other than to directors and our executive officers. The compensation committee has not adopted a written charter for the equity subcommittee.

During 2014, the compensation committee met in person or by telephone, or acted by unanimous written consent, ten times.

During 2014, the equity subcommittee of the compensation committee acted by unanimous written consent, fourteen times.

Governance Committee

Our governance committee is comprised of Messrs. Andreessen, Graham, and Hastings. Mr. Andreessen is the chairman of our governance committee. Our board of directors has adopted a charter for our governance committee. As more fully described in its charter, our governance committee is responsible for, among other things:

- reviewing developments in corporate governance practices;
- developing and recommending our corporate governance guidelines and policies, and evaluating their sufficiency;
- reviewing proposed waivers of the code of conduct (or delegate its ability to grant such waivers for our employees other than executive officers or senior financial officers);
- overseeing the process of evaluating the performance of our board of directors; and
- advising our board of directors on corporate governance matters.

During 2014, the governance committee met in person or by telephone, or acted by unanimous written consent, three times.

Policy Regarding Nominations

The policy of our board of directors is to encourage the selection of directors who will contribute to our mission to make the world more open and connected. Our board of directors is responsible for identifying and nominating members for election to our board of directors. The board of directors considers recommendations from directors, stockholders and others as it deems appropriate, including our founder, Chairman, CEO, and controlling stockholder, l\fr. Zuckerberg. Our board of directors may review from time to time the appropriate skills and characteristics desired of members of the board.

Say on Pay

Section 951 of the Dodd-Frank Act, 15 U.S.C. §78n-1, establishes that

"[n]ot less frequently than once every 3 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to approve the compensation of executives. . . ."

The annual proxy statements distributed to shareholders includes solicitations for votes in favor or against candidates seeking seats on the board of directors. The Say on Pay provisions are to be included in the proxy statement

---

In addition to the Say on Pay provision in Section 951, Section 953(b) of the Dodd-Frank Act instructs the SEC to mandate disclosure of "(A) the median of the annual total compensation of all employees of the issuer, except the chief executive officer . . . ; (B) the annual total compensation of the chief executive officer . . . ; and (C) the ratio of the amount described in subparagraph (A) to the amount described in subparagraph (B)."

~~1. *Corporate Cultures in General: Creating Ethical Climates, Adopting a Dual Board Structure, and Modifying the Fiduciary Duty of Directors and Officers to Act in the Long-Term Interests of Their Corporation*........ 354~~

~~2. *Compensation of Managers*........ 357~~

~~VIII. CONCLUSION........ 361~~

I. INTRODUCTION

The financial crisis of 2007–2009 was preceded by a period of financial firms[1] seeking short-term profit regardless of long-term consequences.[2] Numerous market participants engaged in myopic behavior, including mortgage originators, securitizers, credit default-swap sellers, rating agencies, and investors. Contrary to the efficient market hypothesis, market prices of subprime mortgage-related securities failed to reflect underlying risk in the wake of a massive decline in lending, underwriting, and rating standards and over reliance on the risk reduction capacities of derivative transactions and on models that failed to account, among other things, for low-frequency economic shocks. The CEO of Citibank, Charles Prince, conceded a motivation for short-termism: while acknowledging that the "party would end at some point," he claimed that "as long as the music is playing, you've got to get up and dance."[3] For some time the stock and credit markets were fooled by this myopic behavior but when reality intruded with housing prices declining, subprime mortgages defaulting, short-term credit markets freezing up, and sellers of credit default swaps being unable to meet their obligations, the bubble ultimately collapsed, taking with it much of the economy. The profits earned during this period proved to be illusionary except for those market participants who were highly compensated during the bubble[4] and for those institutions who got out in time or bet against the markets.[5] The financial crisis seriously and adversely affected

1. The term "financial firm" in this Article refers to any organization primarily engaged in lending or investing, regardless of its legal classification (e.g., limited partnership, limited liability company, corporation). The term includes investment and commercial banks, pension funds, mutual funds, hedge funds, structured investment vehicles, and mortgage finance companies.

2. For a detailed discussion of the financial crisis, see *infra* Part III.

3. This statement has been used to explain the behavior of banks leading up to the mortgage crisis although Prince claims that he made this statement in reference to leveraged corporate lending rather than mortgage lending. *Ex-Citi CEO Defends "Dancing" Quote to U.S. Panel*, REUTERS (Apr. 8, 2010), http://www.reuters.com/article/idUSN0819810820100408 [hereinafter *"Dancing" Quote*]. Similar dynamics, however, operated in these two areas. Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 971, 1039–43 (2009). Like Prince, the economist John Maynard Keynes referred to the "Musical Chairs" game to explain how market participants function in his seminal book, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 155–56 (1936).

4. *E.g.*, Lucian A. Bebchuk et al., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008*, 27 YALE J. ON REG. 257, 259–60 (2010) (finding that the "top executive teams of Bear Stearns and Lehman Brothers derived cash flows of about $1.4 billion and $1 billion respectively from cash bonuses and equity sales during 2000–2008").

5. Goldman Sachs was one of the top underwriters of collateral debt obligations until the market crashed in summer 2007, although it began betting against the mortgage market in December 2006. Bethany McLean, *The Bank Job*, VANITY FAIR, Jan. 2010, at 125, *available at* http://www.vanityfair.com/business/features/2010/

employment, consumer spending, home ownership, retirement plans, the finances of federal, state, and local governments, and the world economy as a whole.[6]

Contributing to the financial crisis was short-termism or myopia, which is defined as the excessive focus of corporate managers, asset managers, investors, and analysts on short-term results, whether quarterly earnings or short-term portfolio returns, and a repudiation of concern for long-term value creation and the fundamental value of firms.[7] For a nonfinancial firm, it involves seeking to increase its current stock price or profits by inflating current earnings at the expense of the long-term health of the firm. This behavior may include decreasing discretionary expenses, under-investing in long-term assets, or taking on excessive risk to maximize short-term earnings.[8] For a financial firm, short-termism involves the same behaviors in order to increase its current stock price or profits. It may include investing in assets with hidden risks and taking on excessive debt to bolster short-term firm profits or portfolio returns. It may also include using short-term trading strategies that ignore the fundamental value of firms which, on average, result in losses.[9] Additionally, it may include using nonfinancial firms as short-term arbitrage opportunities, that is, using voting rights to pressure firms to provide immediate payback to owners, such as through dividend payouts, stock repurchases, or selling off assets or a division.[10] When firms use short-termism to bolster their current stock price or profits it is referred to as "earnings management" or, alternatively, "managerial myopia."[11]

The business community identified short-termism as a serious problem prior to the financial crisis, and has since denounced it more emphatically. Short-termism is the subject of important research reports, policy statements, and recommendations from the

---

01/goldman-sachs-200101#gotopage1.

6. Jennifer S. Taub, Enablers of Exuberance: Legal Acts and Omissions that Facilitated the Global Financial Crisis (Sept. 4, 2009) (unpublished manuscript), *available at* http://ssrn.com/abstract=1472190.

7. CFA CENTER FOR FIN. INTEGRITY & BUS. ROUNDTABLE INST. FOR CORPORATE ETHICS, BREAKING THE SHORT-TERM CYCLE: DISCUSSION AND RECOMMENDATIONS ON HOW CORPORATE LEADERS, ASSET MANAGERS, INVESTORS AND ANALYSTS CAN REFOCUS ON LONG-TERM VALUE 3 (2006) [hereinafter BREAKING THE SHORT-TERM CYCLE], *available at* http://www.darden.virginia.edu/corporate-ethics/pdf/Short-termism_Report.pdf; *see also Short-termism*, REVERSO.NET, http://dictionary.reverso.net/english-definitaion/Short-termism (last visited Dec. 16, 2011) (defining short-termism as "the tendency to focus attention on short-term gains, often at the expense of long-term success or stability"). Short-termism is problematic when it is sought at the expense of long-term success or stability, which is the sense that the term "short-termism" is used in this Article. In fact, short-termism not only contributed to the recent global financial crisis, but it also led to the financial scandals of the early 2000s involving Enron, Worldcom, and other such companies. Paul M. Healy & Krishna G. Palepu, *The Fall of Enron*, 17 J. ECON. PERSP. 3, 9–11 (2003); Alfred Rappaport, *Economics of Short-Term Performance Obsession*, 61 FIN. ANALYST J. 65, 69 (2005).

8. Sanjee Bhojraj & Robert Libby, *Capital Market Pressure, Disclosure Frequency-Induced Earnings/Cash Flow Conflicts, and Managerial Myopia*, 80 ACCT. REV. 1, 3 (2005). It may also involve investing in a project in conformity with the market's beliefs concerning the value of the project. Natalie Mizik, *The Theory and Practice of Myopic Management*, 47 J. MARKETING RES. 594, 594 (2010) (describing short-termism as "overemphasiz[ing] strategies with immediate payoffs at the expense of strategies with superior but more distant payoffs . . .").

9. Joseph E. Stiglitz, *Using Tax Policy to Curb Speculative Short-Term Trading*, 3 J. FIN. SERV. RES. 101, 106 (1989).

10. *See infra* Part IV.D (exploring financial firms' use of nonfinancial firms as short-term arbitrage opportunities).

11. *See infra* Part II (discussing managerial myopia and earnings management).

20170319

business community.[12] Common to all of these is the belief that short-termism is pervasive in business decision making and is deleterious to the U.S. and world economy.[13] Scholars have also joined business leaders in their concern about short-termism.[14] Research discussed later in this Article has demonstrated the pernicious effects of short-termism on the well-being of corporate America.[15] Relevant to the financial crisis, one report concluded that "short-term visions are the cause for market volatility and the instability of financial institutions."[16]

This Article provides a comprehensive exploration of why financial and nonfinancial firms engage in short-termism and how to mitigate it. It explains how market and internal firm dynamics contribute to short-termism by considering various structural, informational, behavioral, and incentive problems operating within firms and in markets. Structural explanations include consideration of how biases in financial firms cause them to incur ever-increasing debt levels during periods when the economy is strong and interest rates low, leading such firms to a state of financial fragility.[17] This

---

12. On September 9, 2009 the Aspen Institute issued its report, OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT [hereinafter OVERCOMING SHORT-TERMISM], *available at* http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/overcome_short_state0909_0.pdf. This report was signed by Berkshire Hathaway CEO Warren Buffett, Vanguard Group founder John Bogle, and retired IBM CEO Louis Gerston, Jr., among other noted business leaders. In January 2010, a subcommittee of the Committee for Economic Development, a nonprofit group composed of over 200 senior executives and university leaders, also issued a policy brief which focused on problems of financial market short-termism and its impact on decision making in nonfinancial firms. POLICY AND IMPACT COMMITTEE OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT, RESTORING TRUST IN CORPORATE GOVERNANCE: THE SIX ESSENTIAL TASKS OF BOARDS OF DIRECTORS AND BUSINESS LEADERS (Jan. 2010) [hereinafter RESTORING TRUST], *available at* http://www.ced.org/images/library/reports/corporate_governance/cgPolicyBrief0110.pdf. Likewise, in 2006, prior to the financial crisis, the CFA Center for Financial Integrity and the Business Roundtable Institute for Corporate Ethics issued their joint research report, BREAKING THE SHORT-TERM CYCLE, *supra* note 7. In that same year, The Conference Board published its report by Matteo Tonello which was based on meetings with industrial leaders and major investors, REVISITNG STOCK MARKET SHORT-TERMISM (Conference Bd. Inc., Research Report No. R-1386-06-RR, 2006) [hereinafter REVISITNG SHORT-TERMISM], *available at* http://papers.ssrn.com/so13/papers.cfm?abstract_id=938466.

13. OVERCOMING SHORT-TERMISM, *supra* note 12, at 2 (expressing concern for the "influence of money managers, mutual funds and hedge funds—and those intermediaries who provide them capital—who focus on short-term stock price performance, and/or favor high-leverage and high-risk corporate strategies designed to produce high short-term returns," and the problems and risks presented by this influence); RESTORING TRUST, *supra* note 12, at ix, xii, 10, 14–15 (reporting on the need to discourage directors from giving into financial market short-termism and to modify executive compensation that drives short-termism within firms); BREAKING THE SHORT-TERM CYCLE, *supra* note 7, at 3 (expressing the views of the Panel that "an obsession with meeting short-term expectations of varying constituencies too often hinders corporate managers and all types of investors from focusing on long-term value creation"); REVISITING SHORT-TERMISM, *supra* note 12, at 5 (raising concerns about short-termism on the part of corporations and investors that "undermines confidence in the soundness of the underlying economy, favors opacity on strategic goals, and encourages opportunistic behaviors by a few to the detriment of the many").

14. The reader is directed to the many articles by economic and legal scholars cited in this Article.

15. *See infra* text accompanying notes 90–97, 188–97 (discussing the negative consequences of short-termism on firms and society in general).

16. REVISITING SHORT-TERMISM, *supra* note 12, at 42. *See also* Emeka Duruigbo, Tackling Shareholder Short-Termism and Managerial Myopia 16, 46 (Apr. 4, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1802840.

17. *See infra* Part IV.A (discussing Hyman Minsky's financial instability theory).

20170319

Article also includes consideration of the advantages to asset managers in investing their assets under management in short-term assets.[18] In addition, it examines informational and technological changes in markets that have led financial firms to utilize short-term trading strategies[19] and changes in the business models and organizational forms of such firms that contribute to short-termism.[20]

Informational problems also cause short-termism as managers take advantage of their control over information to fool markets through signaling and signal jamming behavior and as informational problems and problematic financial models create markets for lemons in which firms are unable to differentiate their securities from the securities of other firms.[21] Informational problems also create competitive pressure for managers to behave in ways that are inimical to the long-term health of their firms. These competitive pressures may cause asset managers to invest their assets under management in short-term assets[22] and may present firm managers with a prisoner's dilemma in which the dominant strategy is participating—or what Prince called "dancing"[23]—in an irrational market because of the inadequacy of market signals to coordinate properly the actions of market participants.[24] The failure of market prices to reflect the long-term values of nonfinancial firms also provides the grounds for financial firms to use nonfinancial firms as short-term arbitrage opportunities through takeovers or shareholder activism.[25] Myopic behavior may also occur, however, in efficient informational markets if managers believe they can fool the markets or shareholders prefer short-term results and focus on short-term information.

Behavioral biases also play a role in encouraging short-termism. There is hyperbolic discounting which refers to the priority of the present or the tendency of individuals to heavily discount the future.[26] Behavioral concepts, such as the availability hypothesis and threshold heuristic, explain how individuals tend to discount or disregard low-frequency events in their analysis, a case of disaster myopia.[27] Another behavioral concept, the

18. *See infra* Part IV.B (describing the consequences of competition among asset managers for investment funds).

19. *See infra* Part IV.C (exploring developments in securities markets regarding short-term trading and the relationship between short-term trading and earnings management).

20. *See infra* Part VI.A (exploring the cultures of financial firms due to changes in business models, organizational forms, and individual incentive arrangements).

21. *See infra* Parts V.B–C (discussing signaling and signal jamming in addition to the lemons problem); Patrick Bolton et al., *Executive Compensation and Short-Termist Behaviour in Speculative Markets*, 73 REV. ECON. STUD. 577, 578 (2006) [hereinafter *Executive Compensation*] (noting that "[t]here is growing evidence that stock prices can deviate from fundamental values for prolonged periods of time"); Adam Brandenburger & Ben Polak, *When Managers Cover Their Posteriors: Making the Decisions the Market Wants to See*, 27 RAND J. ECON. 523, 525 (1996) (discussing myopia as based on informational asymmetries between corporate managers on the one hand and shareholders and creditors on the other hand); Andrei Shleifer & Robert W. Vishny, *Equilibrium Short Horizons of Investors and Firms*, 80 AM. ECON. REV. 148, 149 (1990) (discussing myopia as based on informational asymmetries between asset managers on the one hand and fund beneficiaries on the other hand); Mizik, *supra* note 8, at 597 (stating that the "incentives for myopic behavior increases with the market's inability to recognize and evaluate the long-term consequences of managerial actions").

22. *See infra* Part IV.B (analyzing the consequences of competition among asset managers).

23. *"Dancing" Quote*, *supra* note 3.

24. *See infra* Part V.A (describing firm behavior in a prisoner's dilemma context).

25. *See infra* Part IV.D (exploring the role of activist shareholders and short-termism).

26. LYNNE L. DALLAS, LAW AND PUBLIC POLICY: A SOCIOECONOMIC APPROACH 53–58 (2005).

27. *See infra* Part V.E (describing disaster myopia as a hypothesis explaining why individuals

20170319

over-optimism bias, causes market participants in a prisoner's dilemma situation to believe that they, unlike others, will find a seat when the dance ends.[28] Over-optimism also encourages banks to continue to increase debt levels as asset values inflate. In addition, the more optimistic beliefs of some investors, often referred to as "dumb money," cause other investors "to pay more than what they believe to be the stock's long-run fundamental value because they think they will be able to sell their shares in the short run" to the more optimistic investors.[29] Herding behavior also accentuates short-termism and causes prices to move away from fundamentals as market participants see more and more participants embracing short-term strategies and assume that these participants must have information that they do not and thus follow the herd.[30] Group dynamics in decision making on boards of directors may also play a role as the group polarization phenomenon causes homogeneous groups to gravitate to more extreme, risky positions.[31]

Incentives certainly exist for short-term behavior and seeking short-term profits.[32] Inadequate market signals and structural factors motivate managers to engage in earnings management. Business motivations that are stock-driven exist for firms to meet earnings targets, such as to build the firm's credibility with capital markets, maintain or increase their stock prices, convey future growth prospects, and achieve desired credit ratings.[33] Achieving these goals may assist the firm in acquiring financing through stock issuances or debt financing on favorable terms and may assist the asset manager in acquiring more assets to manage. Business motivations relating to stakeholders also exist for a firm to meet earnings targets, that is, to assure stakeholders, such as customers, suppliers, and investors, that the business is stable.[34] When meeting earnings targets involves earnings management, attaining these objectives may enable firms to achieve short-term benefits, but for many firms it will result in negative long-term consequences, including the bankruptcies of firms, which were experienced in the aftermath of the recent financial

---

underestimate the likelihood of low-frequency economic shocks).

28. DALLAS, *supra* note 26, at 48–52.

29. *Executive Compensation*, *supra* note 21, at 579; *see infra* Part IV.C.2(b) (discussing the heterogeneous beliefs of investors in speculative markets). "Dumb money" generally refers to individual traders' investments that result in a decrease in total returns. TONI TURNER, SHORT-TERM TRADING IN THE NEW STOCK MARKET 207, 307 (2005); Andrea Frazzini & Owen A. Lamont, *Dumb Money: Mutual Fund Flows and the Cross-Section of Stock Returns*, 88 J. FIN. ECON. 299, 300 (2008) (finding a "dumb money effect" when retail investors reallocate their funds across different mutual funds, reducing their wealth on average in the long run). *See infra* Part IV.C.2.b (discussing how dumb money fuels short-termism).

30. *See infra* Part V.D (exploring why managers neglect private information or fail to seek out relevant information in favor of following the herd).

31. *See infra* text accompanying notes 432–35 (explaining group polarization issues in greater detail).

32. Brandenburger & Polak, *supra* note 21, at 524–26; Mei Cheng et al., Earnings Guidance and Managerial Myopia 6–9 (Nov. 2005) (unpublished manuscript), *available at* http://ssrn.com/abstract=851545. *See infra* Parts VI, VII.C (discussing the impact of incentives on firm cultures).

33. Bhojraj & Libby, *supra* note 8, at 2–3, 17; Cheng et al., *supra* note 32, at 6–9; John R. Graham et al., *Value Destruction and Financial Reporting Decisions*, 62 FIN. ANALYSTS J. 27, 28–29, fig.2 (2006) [hereinafter *Value Destruction*]; John R. Graham et al., *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3, 12 (2005) [hereinafter *Economic Implications*]; David Millon, *Why Is Corporate Management Obsessed with Quarterly Earnings and What Should Be Done About It?*, 70 GEO. WASH. L. REV. 890, 910–11 (2002) (discussing stock as currency for use in stock-for-stock deals and other business transactions).

34. *Value Destruction*, *supra* note 33, at 29–32; *Economic Implications*, *supra* note 33, at 12.

20170319

crisis.[35]

In addition, personal managerial motivations to some degree influenced by a firm's culture explain the desire to meet earnings targets. Managers may lose their jobs, fail to be promoted, or find their opportunities to move to other firms impeded by their failure to meet earnings targets.[36] In addition, managers may suffer a decrease in compensation.[37] To increase their compensation, managers may seek short-term performance to enhance their bonuses (based on accounting-earnings performance), stock compensation (based on stock-price performance), or compensation based on the amount of assets under management that is enhanced by short-term profits that draw additional assets to their funds.[38] Moreover, asset managers may follow the herd because those managers who invest in a conventional manner are less likely to lose their jobs than managers who invest in a nonconventional manner, regardless of the performance of the funds that they manage.[39] In addition, corporate managers may act shortsightedly for business or personal reasons to ward off hostile tender offers.[40]

Finally, trading cultures often produce the conditions for short-termism.[41] Enron changed from a gas pipeline company to an energy trading company to enhance its profits, which contributed to its downfall.[42] Similarly, in recent years investment banks,

---

35. *See infra* text accompanying notes 90–97, 188–95 (providing examples of the effects of short-termism on financial and nonfinancial firms).

36. *Economic Implications*, *supra* note 33, at 12.

37. *See* Cheng et al., *supra* note 32, at 6–9; Patricia M. Dechow & Richard G. Sloan, *Executive Incentives and the Horizon Problem: An Empirical Investigation*, 14 J. ACCT. & ECON. 51, 52 (1991) (finding that CEOs spend less on R&D when they near retirement); Steven R. Matsunaga & Chul W. Park, *The Effect of Missing a Quarterly Earnings Benchmark on the CEO's Annual Bonus*, 76 ACCT. REV. 313, 315, 330 (2001) (finding that CEO bonuses provide CEOs with the incentive to manage earnings to meet benchmarks); RESTORING TRUST, *supra* note 12, at 10 (discussing compensation arrangements designed to increase long-term performance); Rappaport, *supra* note 7, at 65, 73 (claiming that relatively short vesting periods of stock options encourage the management of earnings and the cashing out of options early and opportunistically, and that accelerating vesting of options on a CEO's retirement "adds yet another incentive to short-termism").

38. *See infra* Parts IV.B, V, VII.C.2 (explaining the problematic incentives of corporate and asset managers as they relate to short-termism).

39. JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 31–32 (2006); Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH. U. L. REV. 211, 255 n.246 (2009); Lawrence H. Summers & Victoria P. Summers, *When Financial Markets Work Too Well: A Cautious Case For a Securities Transactions Tax*, 3 J. FIN. SERV. RES. 261, 272 (1989); Taub, *supra* note 6, at 23.

40. If the share price of a company's stock is undervalued, managers may act myopically to signal to the market positive information, such as inflated current earnings, which will raise the price of the company's current stock price. The fear of a takeover due to the company's undervalued stock price may lead managers to focus more on short-term profits rather than long-term objectives. Jeremy Stein, *Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior*, 104 Q.J. ECON. 655, 659 (1989). They may sell off assets or fail to invest in long-term production to ward off a takeover. Due to the possibility that raiders will exploit the mispricing of the company's shares, managers may be motivated to protect shareholders from these raiders. If takeover costs are sufficiently low due to legal or administrative costs so that the threat of a takeover is high enough, managers will engage in myopic signaling behavior. *Id.* This signaling is possible because of informational asymmetries between the managers and shareholders about the fundamental value of their firm. *See infra* Part V.B (discussing signaling and signal jamming).

41. *See infra* Part VI.A (discussing business models, organizational forms, and incentives as contributing to firm culture).

42. William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1278, 1285, 1288 (2002).

20170319

such as Lehman Brothers, Bear Stearns, and Goldman Sachs, experienced a shift in the locus of power internally from investment banking services to trading.[43] Trading operations tend to be unduly focused on end results rather than process, intense competition among individual traders rather than cooperative behavior, individual incentives offering large disparities in employee rewards, success based on short-term profit-making skills, and a self-interested environment generally.[44] These attributes are associated with cultures that are prone to unethical behavior, which includes employees seeking individual short-term gains at the expense of the well-being of their firms and other stakeholders.[45]

Considerable attention has been given to short-termism in financial firms in order to understand the recent collapse of the financial system. Attention has also been given to the impact that the behavior of financial firms has on internal decision making in nonfinancial firms. This Article will address both issues. Concerning the latter issue, financial firms have an impact on nonfinancial firms for two reasons. First, the stock trading strategies of financial firms affect securities prices and in this manner give managers of nonfinancial firms information on short-term behavior that will impact securities prices. Market reactions to failures of nonfinancial firms to meet earnings expectations, for example, cause their managers to engage in earnings management to meet market expectations.[46] Second, financial firms' use or potential use of shareholder voting rights impacts managerial decision making in nonfinancial firms. It may influence managers of nonfinancial firms to shift cash flow to the present by having their firms issue dividends or sell a division to avoid the use of their firm as a short-term arbitrage opportunity by a financial firm in a hostile takeover or through shareholder activism.[47] Unlike the well-known agency cost theory, which holds that agency costs are minimized when managers are disciplined by market pressures, such as through hostile takeovers or managerial compensation tied to stock prices, managerial myopia theories explain why managers "caring too much" about current stock prices leads to myopic decision making.[48] The more managers care about current stock prices, the more incentive they will have to engage in myopic behavior.

The organization of this Article is as follows. Part II provides an introduction to managerial myopia based on the organizational behavior literature on this subject. This Part discusses the actions firms take to manage earnings and the adverse financial impact earning management has on the long-term health of firms. Part III provides the factual background for the Article by revisiting the financial crisis of 2007–2009 with a review of conditions leading to the crisis. This Part discusses factors generating the demand for mortgage-related securities and the role of lax lending, underwriting, and credit rating

---

43. *See infra* notes 378–80 (explaining the shift in power from investment banking service providers to aggressive traders).

44. *See infra* text accompanying notes 375–76 (contending that trading firms have problematic characteristics that lead to an enhanced likelihood of unethical conduct).

45. *Id.*

46. *See infra* Part IV.C.2 (discussing two strands of literature on the impact of short-term trading on earnings management).

47. *See infra* Part IV.D (explaining how through shareholder activism, financial firms can cause nonfinancial firms to engage in short-termism).

48. Stein, *supra* note 40, at 655.

20170319

standards. It discusses the freezing up of credit markets due to excessive leverage and the lack of transparency in securities and derivative markets. This Part presents facts showing that the originate-to-distribute explanation for lax lending and underwriting standards does not explain the entire story as securitizers were left with substantial liabilities relating to mortgage-related securities, indicating myopic decision making. Parts IV through VI explore the causes of short-termism and are the heart of the Article. These Parts explore informational, structural, behavioral, and incentive problems leading to short-termism.

Based on the foregoing, Part VII discusses the regulatory responses to mitigate the effects of short-termism, including an evaluation of the relevant provisions of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank Act).[49] Given the data and explanations provided in this comprehensive analysis, it would be wise for regulators, in working out and implementing the details of the new financial reforms, to consider the multiple causes of short-termism explored in this Article. Generally, such an approach requires changes within firms and markets to orient activities toward creating long-term value. It also requires firm and regulatory attention to factors that lead to excessive risk taking. In addition, changes are necessary to modify irrational economic pressures that are incompatible with the long-term health of firms. Attention to the individual incentives of market participants is also necessary to engender a long-term orientation and a greater sense of personal responsibility for the consequences of their activities on others.

The problem of short-termism, as shown in this Article, is not attributed to one source but requires attention to a number of facets.[50] To decrease informational problems in markets leading to short-termism,[51] this Article proposes responses to short-termism in general and responses of particular relevance to the financial crisis. Regarding informational responses to short-termism in general, a reexamination of financial reporting obligations is necessary to focus market participants on long-term value and true drivers of business success.[52] Additionally, this Article recommends the provision of information and education to investors regarding the nature of their investments (whether long-term or short-term), the likely consequences of switching funds, and the trading costs of the mutual funds in which they invest, which are not presently included in the expense ratios disclosed to investors.[53] Informational responses to short-termism

49. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). In reading about the causes of short-termism in this Article, the reader will inevitably grapple with a number of issues. One important issue is whether individual business persons are to blame for short-termism because of various external market forces and institutional and cultural influences that also contribute to it. Opinions may differ on this subject but it is crucial to understand that virtually everyone is in agreement that individual business persons and their firms must reexamine their behavior and take steps to decrease short-termism in order to ensure the long-term health of their firms and the financial system. In addition, business persons should work toward supporting the creation of institutions and external forces that support long-term objectives.

50. REVISITING SHORT-TERMISM, *supra* note 12, at 5 (noting that "aspects of the entire system must be adjusted *all at the same time* for there to be change—adjusting just one part of the system will be insufficient for meaningful change").

51. *See infra* Part VII.A (discussing regulatory responses to informational problems in markets).

52. *See infra* Part VII.A.1.a (exploring ways to increase attention to a firm's long-term prospects).

53. *See infra* Part VII.A.1.b (discussing proposed changes in the information provided to investors so they

20170319

regarding the financial crisis would include the adoptions of additional disclosures and due diligence obligations for underwriters, issuers, and credit rating agencies to increase the accuracy of market signals.[54] Additionally, improved disclosure to investors about derivatives would include disclosures on such matters as the risks associated with derivative transactions, the financial ability of firms to meet their obligations in these transactions, and the financial exposure of firms to such transactions.[55] Finally, the losses that sophisticated investors suffered as a result of the financial crisis require a rethinking of exemptions from disclosures based on supposed investor sophistication.[56]

This Article also proposes structural changes to counter short-termism in general and short-termism of particular relevance to the financial crisis. Regarding structural responses of particular relevance to the financial crisis, this Article proposes prohibiting speculative derivative transactions (not hedging transactions) or, alternatively, allowing the trading of only standardized derivatives, subject to disclosure and position limit regulations.[57] In addition, because of the conflict of interest of credit rating agencies arising from the issuer-pay model—where issuers pay for the rating of their securities—the government utility model is recommended for the selection of credit rating agencies for initial and subsequent ratings with the participation of users of ratings in the selection process.[58] The government should not seek to increase the number of credit rating agencies or increase the competition among them because increased competition among credit rating agencies has been shown to cause higher ratings and more downgrades of ratings.[59] An appropriate government agency should also oversee the introduction of complex financial products with uncertain valuations and have the authority to ban or modify their characteristics to protect purchasers and the economy as a whole.[60]

Finally, this Article proposes structural changes through safety and prudential regulation of the traditional and "shadow" banking system because of the increased risk introduced into the financial system by debt secured by increasingly toxic assets.[61] This

---

are informed about information relevant to their investment decisions).

54. *See infra* Parts VII.A.2.a–b (discussing ways to increase the accountability of issuers, underwriters, and credit rating agencies through disclosures and due diligence obligations).

55. *See infra* Part VII.A.2.c (discussing disclosures regarding derivative transactions); Janis Sarra, Credit Derivatives Market Design, Creating Fairness and Sustainability 1, 4 (Oct. 1, 2008) (unpublished manuscript), *available at* http://ssrn.com/abstract=1399630.

56. *See infra* text accompanying notes 475–76 (explaining that a significant amount of subprime mortgage-related securities issued prior to the financial crisis were issued pursuant to exemptions from registration); Jennifer S. Taub, *The Sophisticated Investor and the Global Financial Crisis*, *in* CORPORATE GOVERNANCE FAILURES: THE ROLE OF INSTITUTIONAL INVESTORS IN THE GLOBAL FINANCIAL CRISIS 188, 190 (James P. Hawley et al. eds., 2011) (explaining the problems with relying on sophisticated investors to monitor and understand complex financial products); Taub, *supra* note 6, at 2–3, 20, 57 (discussing the "myth" of the sophisticated investor and private offerings). *Cf.* Steven L. Schwarcz, *Rethinking the Disclosure Paradym in a World of Complexity*, 2004 U. ILL. L. REV. 1, 7 (2004) (recommending prohibiting conflicts of interest for disclosure-impaired transactions regardless of whether sophisticated investors are involved).

57. *See infra* Part VII.B.1.a (discussing standardized derivatives and position limits).

58. *See infra* Part VII.B.1.b (discussing reforming the issuer-pay model of credit rating agencies).

59. *See infra* text accompanying notes 557–58 (discussing a study on the change from an investor-pay model to an issuer-pay model).

60. *See infra* Part VII.B.1.c (discussing the regulation of complex financial products and consumer Ponzi debt).

61. *See infra* Part VII.B.1.d (proposing functional regulation, risk-based capital requirements for the traditional and shadow banking system, and eliminating the tax advantage of debt over equity). The shadow

20170319

Article seeks consistency between the regulation of traditional banking and shadow banking. The objective is to have coordinated and functionally equivalent regulation of the traditional and shadow banking systems, rather than regulation of legal institutional type, in order to avoid inconsistent regulations, bureaucratic conflict, regulatory arbitrage, and distortions in the economic system. This Article recognizes the necessity of risk-based capital requirements for participants in the traditional and shadow banking systems while acknowledging the limitations of this kind of protection for the financial system. This Article also advocates regulatory attention to debt levels, kinds of debt—such as hedged, speculative, and Ponzi debt, rapid asset-price increases out of line with standard variables, and the tax preference given to debt over equity.

This Article also proposes structural changes that counter short-termism in general. Short-term trading has an impact on prices and earnings management as well as on the norms of the marketplace in placing emphasis on short-term profits.[62] It is desirable for the economy as a whole to encourage long-term investments. This Article calls for a reexamination of direct methods for discouraging short-term trading.[63] In this regard, an excise tax on securities transactions, including debt and derivatives, would create incentives for long-term investments and would also provide resources for a fund used to address the negative consequences of short-term trading. In addition, this Article recommends modifying capital gain and loss taxation as well as repealing mutual fund rules that require quick redemptions to discourage short-term trading.[64]

Another structural response to short-termism in general concerns the use, or threatened use, of voting rights by short-term traders to pressure firms to engage in short-termism. Corporate recapitalizations and state corporation law should empower long-term shareholders.[65] The determination of which shareholders are long-term shareholders may take into account the portfolio characteristics of shareholders as well as the duration of their share ownership in the firm. To further buttress the long-term orientation of long-

---

banking system

> refers to nondepository banks and other financial entities like investment banks, hedge funds, [off-balance sheet entities] and money market funds involved in facilitating the creation of credit across the global financial system, but whose members are not subject to regulatory oversight. They borrow money in the short term and take that money to invest in long-term assets. The shadow banking system also refers to unregulated activities by regulated institutions.

Shadow Banking System Law & Legal Definition, USLEGAL, http://definitions.uslegal.com/s/shadow-banking-system/ (last visited Dec. 16, 2011). Thus, the shadow banking system refers to financial intermediaries, other than traditional banks, who engage in typical banking activities. Like traditional banks, they "stand between savers at one end and borrowers at the other," that is, they channel "savings into investments." Jennifer S. Taub, *What We Don't Talk About When We Talk About Banking*, *in* HANDBOOK OF THE POLITICAL ECONOMY OF THE FINANCIAL CRISIS 2 (Gerald Epstein & Martin H. Wolfson eds., 2011). Unlike traditional banks, however, they do not rely on customer deposits but on short-term borrowing and other sources of funding. Because their funding is not provided by customer deposits, they escaped banking-type regulations prior to the financial crisis. *Id.* at 3.

62. *See infra* Part IV.C (discussing short-term trading, "transient" institutional investors, and earnings management).

63. *See infra* Part VII.B.2.a (proposing the adoption of a securities transaction tax, modifying taxes on capital gains/losses, and changing mutual fund quick redemption provisions).

64. *Id.*

65. *See infra* Part VII.B.2.b (discussing the empowerment of long-term shareholders through shareholder voting rights).

20170319

term shareholders, governments should also consider rules encouraging the unwinding of share ownership over a period of years, such as tax incentives for doing so. In addition, they should exclude from voting those shares that are hedged through equity swaps or borrowing arrangements, to prevent voting inimical to the best interests of the firm.

Regulatory responses to short-term incentives in firms are also important. Firm cultures play an important role in fostering short-term incentives. Many of the foregoing recommendations would assist in improving the culture of firms to focus on the long-term. Additional matters also warrant attention. It is desirable to impose a fiduciary duty on directors and officers to act primarily in the long-term interests of their firms.[66] Such a duty would require directors and officers to focus directly on the long-term objectives of their firms when considering business decisions and would have an expressive function, that is, an effect on beliefs concerning the value of long-term behavior that over time may become an internalized business norm. The imposition of a fiduciary duty on a broader range of market professionals would also have the impact of changing the institutional setting in which they operate and the roles that they perceive themselves as playing.[67]

A firm's reward structures, which directly impact individual incentives, influence a firm's culture.[68] It is desirable to base a substantial portion of the compensation of managers on the long-term health of their firms, such as through deferred compensation arrangements, risk-adjusted compensation measures, and a reduction in the frequency with which compensation is increased due to higher performance measures.[69]

Board structure is also important to incentives.[70] To increase the probability of more informed, accountable board decision making, diversity of perspectives on boards is encouraged to minimize group think and the group polarization phenomenon—which results in more extreme positions such as excessive risk taking. Additionally, a dual board structure—distinct from the European two-tiered board structure—is proposed for greater managerial accountability and to counter the trend in the United States toward centralization of managerial power in the CEO, leading to less CEO accountability.[71] The

---

66. *See infra* Part VII.C.1 (proposing the creation of ethical cultures, the adoption of a dual board structure, and modifying the fiduciary duty of directors to act in the long-term interest of their corporations); Nadelle Grossman, *Turning a Short-Term Fling into a Long-Term Commitment: Board Duties in a New Era*, 43 U. MICH. J.L. REFORM 905, 959–69 (2010) (proposing a fiduciary duty of directors to act in the long-term interests of their corporations).

67. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824 (2010) (requiring a study by the SEC on the obligations of brokers, dealers, and investment advisers when providing investment advice); *id.* § 913(g) (providing that the SEC may promulgate rules imposing a fiduciary duty on brokers and dealers when they furnish personalized investment advice about securities to a retail customer). *See, e.g.*, Barbara Black, *How to Improve Retail Investor Protection After the Dodd–Frank Wall Street Reform and Consumer Protection Act*, 13 U. PA. J. BUS. L. 59 (2010); Thomas Lee Hazen, *Stock Broker Fiduciary Duties and the Impact of the Dodd–Frank Act*, 15 N.C. BANKING INST. 47 (2011).

68. *See infra* Parts VI, VII.C (discussing firm cultures and regulatory responses to individual short-term incentives in firms).

69. *See infra* Part VII.C.2 (discussing compensation arrangements to encourage long-term performance). In addition, the disclosure of the average time horizon of managerial compensation would enlighten investors and may cause desirable changes over time in compensation arrangements. David I. Walker, *The Challenge of Improving the Long-Term Focus of Executive Pay*, 51 B.C. L. REV. 435, 436, 456, 468 (2010).

70. *See infra* Parts VI.B, VII.C.1 (discussing cultures of non-financial firms and regulatory responses, including a dual board structure, to improve those cultures).

71. Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 SAN DIEGO L. REV. 781,

changes outlined in this Article enhance the likelihood of creating an environment in firms that would support and encourage managers to engage in activities that improve the long-term value of their firms and avert the short-termism that contributed to the financial crisis of 2007–2009.

II. Managerial Myopia or Earnings Management

Earnings management comes in two forms: accounting earnings management and real earnings management.[72] Accounting earnings management involves either the direct manipulation of numbers or the use of off-balance sheet transactions to obscure the fundamental value of a firm.[73] This kind of earnings management received a great deal of attention as an explanation for the financial scandals of the early 2000s involving such companies as Enron and WorldCom.[74] Enron engaged in a famous example of accounting earnings management when it created a large gain on its books by purportedly "selling" its unprofitable venture in broadband to a special purpose entity—although this transaction was not a sale because the entity remained controlled by Enron.[75] A more recent example of accounting earnings management occurred in 2008 when Lehman Brothers Holding entered into its infamous Repo 105 transactions to hide its borrowing.[76] It reported its borrowing through repurchase transactions as sales, thus boosting its earnings at the end of quarters.[77] More garden-variety examples of accounting earnings management are accomplished by increasing or decreasing levels of accounting accruals, such as accounts receivables, inventory, accounts payable, deferred revenue, accrued liabilities, and prepaid expenses to assure that the company meets quarterly-earnings targets or presents a favorable impression to the markets. These more garden-variety types of accounting earnings management involving the manipulation of accruals declined after the passage of the Sarbanes–Oxley Act of 2002 (SOX),[78] which Congress passed in response to Enron and other financial scandals. There is, however, no evidence that other forms of accounting earnings management, such as off-balance sheet

816–18 (2003) [hereinafter *Multiple Roles of Corporate Boards*]; Lynne L. Dallas, *Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson*, 54 Wash. & Lee L. Rev. 91, 92–97 (1997) [hereinafter *Dual Board*].

72. Mizik, *supra* note 8, at 594–95 (noting that "real" earnings management is also referred to as "real-activity based" earnings management and a narrower term for accounting earnings management is "accrual-based" earnings management). Some scholars limit the term "myopia" to real earnings management. *Id.* at 598 (stating that "[w]hen managers manipulate discretionary accruals, they only affect the timing of earnings recognition . . . and do not alter either the amount or the temporal flow of true economic profits. Conversely, myopic management alters operational practices and can diminish true economic profits.").

73. Mark W. Nelson et al., *How Are Earnings Managed? Examples from Auditors*, Acct. Horizons 17, 29 (2003).

74. Michael C. Jensen, *Agency Costs of Overvalued Equity*, 34 Fin. Mgmt. 5, 6–7 (2005); Rappaport, *supra* note 7, at 69.

75. Wilmarth, *supra* note 3, at 999 (mentioning additionally that various banks "structured prepaid commodity swaps (prepays) that allowed Enron to receive disguised bank loans while reporting the transactions as cash flow from operations").

76. Jacob Goldstein, *Repo 105: Lehman's 'Accounting Gimmick' Explained*, NPR (Mar. 12, 2010), http://www.npr.org/blogs/money/2010/03/repo_105_lehmans_accounting_gi.html.

77. *Id.*

78. Daniel A. Cohen et al., *Real and Accrual-Based Earnings Management in the Pre- and Post-Sarbanes–Oxley Periods*, 83 Acct. Rev. 757, 757–59, 770 (2008).