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# CEO Succession Considerations

Presented by

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# Management Development and Succession Planning

## **In CEO succession, there is . . .**

- The long-term development and assessment of internal candidates
  - Coaching
  - Career transitions through various roles
  - Regular assessment by internal and external processes
  - Regular review of the internal candidates with the board

**And then there is the process of making the transition – which is the larger focus of this discussion**

# CEO Succession Planning – Overview

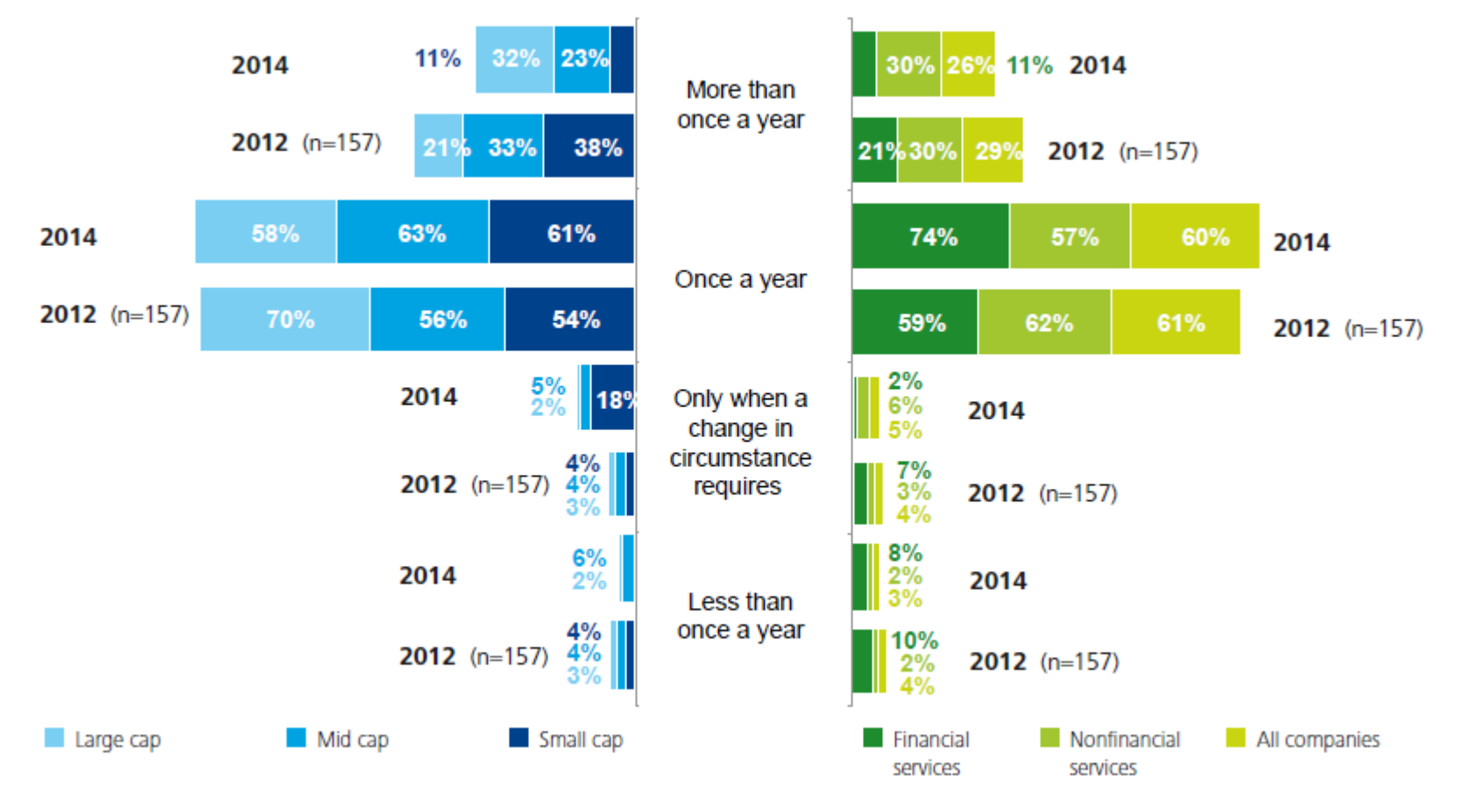
- CEO succession planning is considered one of the board’s most important oversight responsibilities
  - SEC has identified succession planning as one of the board’s “key functions”
  - NYSE-listed companies are required to address their CEO succession policy in their corporate governance guidelines (Nasdaq companies do not have the same requirement)
- Inadequate succession planning for senior management may be viewed as evidence of insufficient board oversight and scrutiny of management
- CEO succession planning should address both expected transitions and emergencies

# CEO Succession Planning – The Numbers



# CEO Succession Planning – The Numbers (cont.)

How often does the full board review CEO succession plans?



# Emergency Plan

## Key details

- Delegation to key board members
- “Name in the envelope”
  - Confirm that that individual is ready and able to take the helm
  - Who should know?
- Role as interim CEO
- Communication plan
  - Among directors
  - PR readiness

**But the “name in the envelope” should ideally be the result of some amount of development, grooming and reviewing**

**With this, we turn to look at non-emergency scenarios . . .**

# CEO Succession Planning – Key Steps

## Key Steps to Effectuate Potential CEO Transition

- Speed of and atmosphere of transition – ranges from planned and collegial, to accelerated but not precipitous to precipitous (e.g., over a weekend) – we will focus on the planned, collegial process
- Confidentiality vs. forward-looking statement
- Develop candidate profile for successor CEO
- Identify and evaluate internal candidates
- Retain executive search firm to identify external candidates
- Consider role and compensation of successor CEO
- Evaluate costs and potential risks associated with departure of current CEO
- Develop communications strategy related to CEO transition
- Satisfy applicable public disclosure obligations

# Developing a CEO Succession Plan

**Best practice is for board to lead and be accountable for the development, implementation and review of the company's CEO succession plan, which can include:**

- Assignment of succession planning duties to a standing or special committee of the board
- Succession planning routinely reviewed and discussed by the full board
- Ongoing dialogue with CEO and opportunity for board to discuss succession planning without CEO (e.g., executive session)
- Ongoing review of role of CEO, as well as CEO performance
- Coverage of both expected transitions and emergencies
  - Emergency plan often identifies an interim CEO pending appointment of longer-term successor
  - In an emergency, having a pre-planned protocol is particularly important – who to contact and how, etc.
  - Understanding of the personalities and the politics involved
- Establishment of succession time frames
- Development of candidate profile based on culture and company strategy
- Development and evaluation of both internal and external candidates
  - Access for all board members to internal candidates
  - Use of search firm to identify external candidates
- Preservation of flexibility for board to tailor actions to the particular circumstances of the departure



# CEO Succession Planning – Hiring Considerations

## Whether selecting an internal or external candidate, board should:

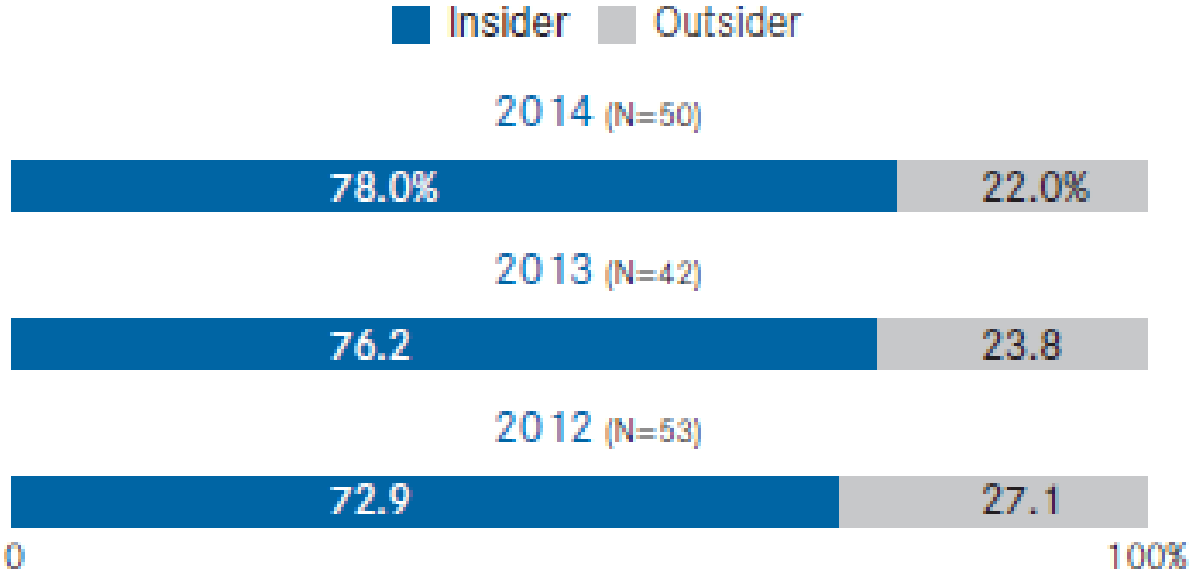
- Establish methodology for evaluation of candidates and provide for thorough vetting
  - Consider the pros and cons of establishing a board-level special-purpose CEO search committee
    - **Pros:** Special-purpose committee able to focus solely on CEO search and, if desired, can be specifically remunerated for their efforts
    - **Cons:** Creating special-purpose committee would depart from existing delegation of CEO succession efforts to Compensation Committee and may also be less efficient, given that Compensation Committee will, in any event, be required to approve the departing and incoming CEOs' compensation
      - Only a small fraction of companies delegate CEO succession planning to a board-level special purpose CEO search committee—for nonfinancial services companies, only 0.8% use a stand-alone CEO search committee, while 57.7% rely on the full board for CEO succession planning; 23.6% assign the responsibility to the nominating/corporate governance committee and 15.4% assign the responsibility to the compensation committee  
(source: The Conference Board)
  - Consider retaining an executive search firm
  - Consider vetting at least three candidates, as a best practices guide

# CEO Succession Planning – Hiring Considerations (cont.)

- Understand that the process will take several months, unless there are existing candidates whom the board has been considering seriously
- Ensure that decision is consistent with prior succession planning decisions or communications, or, if it is not, have a clear rationale for deviation
  - Until decision has been reached, maintain confidentiality of board discussions
  - Once decision has been announced, articulate the board's rationale for the decision
- Understand that, as long as process is thorough and the successor is not a board member, evaluation of the board's discharge of its fiduciary duty of care will be subject to the "business judgment rule"
- If a board member is selected to serve as interim CEO, consider implications for board member's ability to serve on board committees after stepping down from CEO (e.g., service on board committees may be impacted due to NYSE and other independence requirements)

# CEO Succession Planning – Internal Promotions vs. Outside Hires

## Inside promotions and outside hires (2012–2014)



Source: The Conference Board, based on data from company IR websites, 2015.

# CEO Succession Planning – Professional Qualifications and Skills



# CEO Succession Planning – Internal Candidates

- Best practice is for the board to evaluate internal candidates, as well as external candidates
- Develop internal candidate profile based on culture and company strategy
  - Leadership qualities:
    - Cultural fit (ability to engage, collaborate and inspire)
    - Breadth of perspective (multiple-level thinker, strategic thinker)
    - Effectiveness at execution and follow-through (decisiveness, persuasiveness, accountability, discipline)
  - Review of the company strategy and the candidates' ability to drive strategy (growth-oriented leader, transformation leader, turnaround leader, cost-cutting leader, etc.)
- Extend search down throughout the company to develop and identify internal talent
- Provide all board members with exposure to internal candidates
- Review and evaluate any candidates identified by CEO

# CEO Succession Planning – External Candidates

## **Develop external candidate profile based on company strategy and culture**

- Ensuring a proper corporate fit is critical for all candidates, although there may be a greater risk in this regard with external candidates

## **Engage an executive search firm to identify and assess candidates**

- Executive search firms generally have access to a larger pool of candidates and can assist the board with screening and evaluation of candidates
- Critical to maintain confidentiality of search process—ensure that executive search firm and external candidates are bound by agreements to maintain confidentiality of all nonpublic information (including the fact of the recruitment process itself)
  - Key to identify executive search firm that regularly works with public companies
  - If search process is leaked, company may have additional disclosure requirements (e.g., Regulation FD)

## **Evaluate existing compensation and benefits of external candidates, including any compensation that would be forfeited, to assess costs associated with hire**

- Consider potential impact of any existing restrictive covenants on the candidate's ability to serve as CEO (e.g., non-compete, non-solicit, confidentiality)

## **Conduct thorough background check, including verification of educational and professional background**

# Role and Compensation of Successor CEO

## Role of Successor CEO

- Consider whether successor CEO should be appointed as board chairman
  - There is a growing trend among a number of US companies to split the CEO/chairman

## Compensation of Successor CEO

- Consider compensation for successor CEO:
  - What compensation and benefits will be offered?
  - Will the company offer make-whole grants for forfeited compensation from former company?
  - Will the company offer new-hire equity grants and/or signing bonus?
  - Will an employment or severance agreement be entered into?
  - What restrictive covenants will be imposed (e.g., limits on competition or solicitation of employees and/or customers)?

# CEO Departure Considerations

## Cost of Potential Departure of CEO

- Quantify the compensation and benefits entitlements of departing CEO
  - Existing employment agreement, offer letter, equity plans, severance plans, etc.
- Consider whether CEO should execute a release of claims in favor of the company, or whether he or she should be provided with any compensation or benefits that are not contractually required
  - CEO may request additional consideration in exchange for release of claims
    - Consideration could include severance benefits or acceleration of unvested equity awards
    - If consideration is provided, consider the justification and potential shareholder reaction
- Consider requesting compliance with new restrictive covenants
  - CEO may request additional consideration in exchange for agreeing to new restrictions on competition and/or solicitation



# CEO Departure Considerations (cont.)

## Role of Departing CEO

- Consider whether the departing CEO will resign from the board or remain for some period
  - In 2014, 34.8% of departing CEOs remained as executive or non-executive board chairman for at least a brief transition period following termination (source: The Conference Board)
    - In the case of a departing CEO who is also a company founder, there may be a strong rationale for the CEO's continued service as a member of the board
    - However, retention of the departing CEO as a board member may complicate relations with or overshadow the successor CEO
  - If the departing CEO remains on the board, consider whether he should continue to serve as a non-executive board chairman
    - The departing CEO's continued service on the board could facilitate the separation of CEO and chairman duties
    - However, this may exacerbate any complication/overshadowing issues noted above
  - Continued board service may obviate the need for the departing CEO to be retained as a consultant or adviser following termination
- Consider whether CEO will be needed for a transition or consulting period
  - If so, consider whether there should be a consulting, separation or transition agreement and consider compensation for such period

# CEO Departure Considerations (cont.)

## Other Considerations Associated with CEO Departure

- Retention concern of other members of management (especially anyone who was also vying to become the next CEO) and those loyal to them
- Shareholder reaction
  - Consider how shareholders may react to the change in CEO, and any related compensation actions (e.g., severance or other post-termination benefits for departing CEO, compensation and benefits offered to new CEO)
    - In advance of determination and public announcement, formulate strategy for shareholder outreach
    - Once the determination has been made to terminate the CEO and such determination is publicly announced, critical to effectively and persuasively communicate the rationale behind such determination
- Litigation risk
  - Does the CEO have any colorable claims against the company?
  - Is the CEO likely to litigate any disputes?
  - Has the CEO previously raised claims such that any termination may be viewed as retaliatory?
  - Might the CEO engage in whistleblower activity or has the CEO already raised any such claims?

# CEO Succession – Communications

## Communications in connection with CEO Transition

- Critical to manage communications with shareholders, employees, regulators, customers, suppliers, community leaders and other stakeholders
- Disclosure of ongoing search process likely to be considered material nonpublic information—critical to maintain confidentiality of process until determinations have been made and publicly disclosed, unless there will be a gap in time between the departure of the outgoing CEO, or unless there is a leak
  - Executive search firm and candidates should be required to enter into nondisclosure agreements
- Best practice is for board to engage in proactive outreach to stakeholders immediately after transition is announced
  - Many companies retain a communication firm to coordinate a communication strategy with internal investor relations
  - Critical to develop and coordinate a detailed communications plan, including, as appropriate, press releases, media appearances, exclusive articles, scripted town halls, FAQs, statements to regulators, etc.

# CEO Succession – Communications (cont.)

## Goals of communications

- Should be used as an opportunity to assure shareholders of the corporate strategy and demonstrate that the board is acting in the best interests of shareholders
- Should also be used as an opportunity to assure employees and other stakeholders that there is a well thought-out plan during the time of transition and that the company's pre-existing obligations will be honored
- If cultural change is one of the reasons for the CEO transition, it is important to convey this in a manner that does not imply that there was anything amiss in the past

# CEO Succession – Public Disclosure

## Public Disclosure in connection with CEO Transition

- Generally, companies do not announce the commencement of a CEO search and this does not trigger an 8-K unless there will be a gap in time between the departure of the outgoing CEO and the appointment of a permanent CEO, or unless there is a leak
  - If information is unintentionally released, public disclosure of CEO search must be made immediately
- Form 8-K filed within 4 business days following determination of CEO's termination
  - 8-K filing obligation is triggered by the determination or agreement, not the actual termination, but discussions or negotiations alone about whether to terminate CEO do not trigger obligation to file an 8-K
  - If departing CEO also resigns as director, the 8-K must disclose such resignation
  - Any new material agreements entered into must be disclosed within 4 business days after such entry
- Form 8-K filed within 4 business days following appointment of new CEO
  - If new CEO is appointed to board, the 8-K must disclose such appointment
- Agreements with departing or new CEO must be filed as exhibits to the company's next 10-Q (or 10-K)

# CEO Succession – Public Disclosure (cont.)

- Proxy disclosure of two CEOs and their compensation
- Additional NYSE reporting requirements
  - Issue press release on day of the termination/appointment to comply with NYSE immediate release policy
  - If any sign-on equity grant is made outside of the company's shareholder approved equity plan, must comply with NYSE notice and press release requirements
    - Promptly following the grant of the sign-on equity award, the company must disclose the material terms of the award, including the recipient and number of shares in a press release
  - NYSE notice requirements require prompt notice concerning changes in board composition
    - As a listed company, the company must submit an interim written affirmation disclosing any changes

# CEO Succession – Post-Transition

## **Monitor the first 100 days**

- Who will do the monitoring?
- How to measure success?
- Checking in with the new CEO and others

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As a partner in Davis Polk's Corporate Department and head of the Executive Compensation Group, Mr. FitzGerald counsels clients on matters involving senior executive compensation and benefits, both in the ordinary course of clients' business and in the context of mergers and acquisitions, new ventures, and restructurings.

**PROFESSIONAL HISTORY**

- Partner, 2000-present
- Associate, Davis Polk, 1997-2000
- Associate, Pillsbury Winthrop, 1995-1997
- Associate, Fried, Frank, Harris, Shriver & Jacobson, 1991-1995

**ADMISSIONS**

- State of New York

**EDUCATION**

- B.S., Cornell University, 1987
- J.D., Brooklyn Law School, 1991



# Dennis S. Hersch

PRESIDENT, N.A. PROPERTY, INC.



Dennis S. Hersch is the President of N.A. Property, Inc., through which he has acted as a business advisor to Mr. and Mrs. Leslie H. Wexner since February 2008. He was a Managing Director of J.P. Morgan Securities Inc. from December 2005 through January 2008, where he served as the Global Chairman of its Mergers & Acquisitions Department. Mr. Hersch was a partner of Davis Polk & Wardwell LLP from 1978 until December 2005.

Mr. Hersch has served as a director of PJT Partners since September 2015, L Brands, Inc. since 2006, and was a director of Clearwire Corporation from November 2008 until June 2013.

## PROFESSIONAL HISTORY

- N.A. Property, Inc., 2008-Present
- J.P. Morgan Securities Inc., 2005-2008
- Davis Polk Partner, 1978-2005
- Davis Polk Associate, 1970-1978

## ADMISSIONS

- State of New York

## EDUCATION

- A.B., Economics, Brooklyn College, 1967
  - *cum laude*
- J.D., New York University, 1970
  - *cum laude*
  - Articles Editor, *Annual Survey of American Law*

# Kyoko Takahashi Lin

PARTNER



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Ms. Lin is a partner in Davis Polk's Corporate Department, practicing in the Executive Compensation Group. She advises boards, companies, compensation committees and individual executives on executive compensation, equity-based incentives, deferred compensation, severance plans and other compensatory arrangements, with particular emphasis on issues arising in mergers and acquisitions transactions, initial public offerings and new and joint ventures.

She also advises on employment and consulting arrangements, the applicability of securities and tax laws to executives and employers, the design and implementation of equity compensation plans and general employment-related matters. Ms. Lin is co-editor of the "Davis Polk Briefing: Governance" blog, which covers current topics in corporate governance, securities law and executive compensation.

## WORK HIGHLIGHTS

### *M&A*

- PartnerRe's pending acquisition by EXOR
- Shire plc's acquisitions of ViroPharma, Lumena Pharmaceuticals, NPS Pharmaceuticals and Foresight Biotherapeutics
- Comcast's:
  - NBCUniversal joint venture with General Electric
  - Acquisitions of BuzzFeed, Ingresso.com, FreeWheel Media, Fandango, Patriot Media Cable Systems and shares of ARRIS Group
- C1 Financial's acquisition by Bank of the Ozarks
- Prosensa's acquisition by BioMarin Pharmaceutical
- Citigroup's sale of its subsidiary OneMain Financial to Springleaf
- Bertelsmann's combination with Pearson of their trade book publishing companies, Random House and Penguin Group
- Mitsubishi UFJ Lease & Finance Company's acquisition of Jackson Square Aviation, Engine Lease Finance and Beacon Intermodal Leasing
- Morgan Stanley's sale of its TransMontaigne and global oil merchanting businesses

# Kyoko Takahashi Lin (cont.)

PARTNER

## ***IPOs***

- Affimed
- Delphi Automotive
- Fogo de Chão
- Markit
- Sprouts Farmers Market

## ***Other Matters***

- McGraw Hill Financial, Inc. and Standard & Poor's Financial Services LLC in connection with lawsuits brought by the SEC, DOJ and the Attorneys General of numerous states concerning the ratings of residential mortgage-backed securities

Other clients that Ms. Lin has advised on compensation and benefits issues include ABM Industries, First BanCorp., GAIN Capital, IHS Inc., Marsh & McLennan Companies, Pattern Energy, Quicksilver Resources, Ruby Tuesday, SLM (Sallie Mae) and VF.

## **RECOGNITION**

Ms. Lin is recognized as a leading Executive Compensation lawyer:

- *Chambers USA* – "Leading Individual," Employee Benefits and Executive Compensation, New York, 2015

## **MEMBERSHIPS**

- Member, American Bar Association and New York State Bar Association

## **PROFESSIONAL HISTORY**

- Partner, 2006-present
- Associate, 1996-2006

## **ADMISSIONS**

- State of New York

## **EDUCATION**

- A.B., Government, Harvard College, 1993
- J.D., Harvard Law School, 1996

# Marc O. Williams

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Mr. Williams is a partner in Davis Polk's Corporate Department, concentrating in mergers and acquisitions, private equity transactions, corporate governance and related matters.

## WORK HIGHLIGHTS

- ConAgra's separation into two independent public companies, sale of its private label operations to Treehouse Foods, acquisition of Ralcorp and its cooperation agreement with JANA Partners
- Tyson Foods' acquisition of Hillshire Brands and sale of its poultry businesses in Mexico and Brazil
- AstraZeneca's acquisition of ZS Pharma
- Santander's acquisition of GE Capital's Mexican mortgage business and ING's Mexican mortgage business
- Freeport-McMoRan's acquisition of Phelps Dodge, its dispositions of its Candelaria/Ojos mining interests and an ownership interest in Morenci Mine and various other transactions
- Comcast's acquisition of NBCUniversal
- Emerson's acquisition of Avocent, dispositions of its LANDesk and motors businesses and pending spin-off of its Network Power business
- Roche's unsolicited (and ultimately successful) acquisition of Ventana Medical Systems
- Roche's acquisitions of Anadys, InterMune, Memory Pharmaceuticals, Mirus Bio and Marcadia and its majority investment in Foundation Medicine
- Belmond in its successful defense against an unsolicited offer from Indian Hotels
- VF Corporation's acquisitions of Timberland and Nautica
- Citi's disposition of its commercial real estate loan portfolio through various transactions
- Old Lane's sale to Citigroup
- Aetna's acquisition of Schaller Anderson
- Various transactions for Comcast, including an investment in a new public company formed by the combination of the high-speed wireless businesses of Sprint Nextel and Clearwire

# Marc O. Williams (cont.)

PARTNER

- FirstGroup's acquisition of Laidlaw International
- Texas Instruments' sale of its Sensors & Controls business to Bain Capital
- Argosy Gaming's acquisition by Penn National
- FedEx's acquisition of Kinko's

## RECOGNITION

- Named "Rising Star of 2013" in M&A – *Law360*
- Named "Up & Coming" in New York: Corporate/M&A: The Elite – *Chambers USA 2014*
- Named "Dealmaker of the Week" – *The AmLaw Daily 2012*
- Listed as a leading lawyer in *IFLR1000*

## OF NOTE

- Member, Corporation Law Committee, New York City Bar Association

## PROFESSIONAL HISTORY

- Partner, 2006-present
- Associate, 1998-2006

## ADMISSIONS

- State of New York

## EDUCATION

- B.A., Amherst College, 1995
  - *magna cum laude*
- J.D., Harvard Law School, 1998
  - *magna cum laude*