

[Alerts and Updates]

U.S. Senate and SEC Corporate Governance Proposals

May 22, 2009

In the wake of the continuing economic crisis, growing discontent among shareholders has resulted in increased political momentum toward providing public company shareholders with a greater voice in corporate governance matters. In response, on May 19, 2009, Sen. Charles Schumer (D-N.Y.) introduced a bill, cosponsored by Sen. Maria Cantwell (D-Wash.), to Congress known as the Shareholder Bill of Rights Act of 2009 (the "Shareholder Bill"). Among other things, the Shareholder Bill would grant shareholders of public companies a "say on pay" in the form of advisory votes on executive compensation and would require the U.S. Securities and Exchange Commission (the "SEC") to adopt rules to make it easier for public company shareholders to include their own director nominees in the proxy solicitation materials of companies subject to the SEC's proxy rules. On May 20, 2009, in a 3-2 vote, the SEC voted to propose new proxy rules that, although somewhat different from the provisions of the Shareholder Bill, would grant certain public company shareholders that ability (the "Proposed SEC Rules"). The Shareholder Bill and Proposed SEC Rules each represent a significant expansion of shareholder power in regard to corporate governance matters and may pose a challenge to state law. These proposals, if adopted, may have a profound impact on U.S. public companies.

The Shareholder Bill

The Shareholder Bill is designed to provide shareholders with enhanced authority over the nomination and election of directors and compensation of public company executives.

The Shareholder Bill notes that "both executive management and boards of directors have failed . . . to enact compensation policies that are linked to long-term profitability of their institutions, to appropriately analyze and oversee enterprise risk, and, most importantly, to prioritize the long-term health of their firms and their shareholders" and a "lack of accountability" of boards and management to shareholders. The Shareholder Bill also proclaims that the widespread failure of corporate governance has been among the "central causes" of the financial and economic crises currently facing the United States that has resulted in the loss of "trillions of dollars in shareholder value."

Specifically, the Shareholder Bill would amend the Securities Exchange Act of 1934 (the "Exchange Act") by requiring that:

- In connection with any proxy, consent or other solicitation for which the SEC proxy solicitation rules require executive compensation disclosure, a separate resolution, subject to shareholder vote, must be included to approve executive compensation as disclosed in the accompanying proxy solicitation materials;
- A separate shareholder vote must be provided to approve any agreement or understanding, providing for "golden parachute" compensation payable to any of the issuer's executive officers in connection with a solicitation relating to a proposed acquisition, merger, consolidation or proposed sale or other disposition of substantially all of the assets of an issuer;
- Any shareholder, or group of shareholders acting pursuant to an agreement, that has beneficially owned at least one percent of the issuer's voting securities for at least two years prior to the date of the next scheduled annual meeting of the issuer, must be permitted to use the issuer's proxy solicitation materials for the purpose of nominating members to the board of directors;

- The chairperson of the board of directors of an issuer must be independent, as determined in accordance with the SEC's independent director rules and the listing standards of the exchange on which the issuer's securities are listed, and must not have previously served as an executive officer of the issuer, thereby separating the functions of chairperson and CEO;
- Issuers must provide in their governing documents that each member of the board of directors of the issuer will be subject to annual election by the shareholders, thereby precluding a staggered board of directors;
- Directors in uncontested elections must be elected by a majority of the votes cast for each nominee and, for contested elections, directors must be elected by a plurality of the voters entitled to vote and represented at such meeting;
- Directors not elected to a new term in an uncontested election must tender their resignations to the board of directors, and the board of directors must accept such resignations; and
- Issuers must establish a risk committee composed of independent directors responsible for the establishment and evaluation of the issuer's risk management practices.

Furthermore, the Shareholder Bill, with respect to shareholder approvals of executive compensation and golden parachute compensation, provides that the shareholder vote will not be binding on the board of directors but rather will be advisory and will not be construed as: (1) overruling a decision by the board; (2) creating or implying any change to the current fiduciary duties of such board; (3) creating or implying any additional fiduciary duty by such board; or (4) restricting or limiting the ability of shareholders to make proposals for inclusion in such proxy materials related to executive compensation. It is likely that the SEC regulations that would be adopted would require timely disclosure in a Form 8-K or other form of the issuer's explanation as to why the board of directors chose not to adopt the shareholders' decision.

The Proposed SEC Rules

The purpose of the Proposed SEC Rules is to "facilitate the rights of shareholders to nominate directors on corporate boards." The SEC will solicit public suggestions and comments for 60 days.

Echoing the findings in the Shareholder Bill, the SEC stated in its [press release](#) that the ongoing economic crisis has questioned the accountability of corporate boards and has raised concerns regarding "oversight of management, whether boards are appropriately focused on shareholder interests, and whether boards need to be held more responsible for their decisions regarding such issues as compensation structures and risk management." Citing these concerns, the SEC decided to revisit whether and how the proxy rules should be amended to better enable shareholders to exercise their "fundamental right" to nominate and elect board members.

New Exchange Act Rule 14a-11

The SEC has proposed a new Exchange Act Rule 14a-11, under which certain shareholders would be permitted to include their director nominees in the company's proxy solicitation materials. The proposed rule would not apply if a company's shareholders are otherwise prohibited from nominating a candidate for election as a director by applicable state law or by the company's organizational documents.

Shareholder Requirements

Shareholders would be eligible to have their nominees for director included in the company's proxy solicitation materials if they meet certain ownership thresholds as follows:

- Shareholders owning at least one percent of the voting securities of a "large accelerated filer" (a company with a worldwide market value of \$700 million or more) or of a registered investment company with net assets of \$700 million or more;
- Shareholders owning at least three percent of the voting securities of an "accelerated filer" (a company with a worldwide market value of \$75 million or more but less than \$700 million), or of a registered investment company with net assets of \$75 million or more but less than \$700 million; and
- Shareholders owning at least five percent of the voting securities of a nonaccelerated filer (a company with a worldwide market value of less than \$75 million) or of a registered investment company with net assets of less than \$75 million.

Groups of shareholders would be permitted to aggregate their holdings to meet the ownership thresholds.

In addition to the ownership thresholds, shareholders would be required to have held their securities for a period of at least one year, state in writing their intent to hold such shares through the date of the annual meeting at which the directors are to be elected, and certify that they are not holding their stock for the purpose of changing control of the company, or to gain more than minority representation on the company's board.

Each shareholder, or shareholder group, that satisfies these requirements would be permitted to nominate the greater of one nominee or that number of nominees representing up to 25 percent of the company's board of directors. Thus, if a board has three members, an eligible shareholder would be entitled to nominate one candidate. For boards consisting of eight or more members, each nominee would be permitted to nominate more than one candidate (e.g., an eligible shareholder would be entitled to nominate up to two members for membership on an eight-person board).

Nominating shareholders may not have any direct or indirect agreement with the company regarding such nomination nominee.

Shareholder Nominee Qualifications

Shareholder nominees must satisfy objective director independence standards of the applicable national securities exchange or national securities association, and the nominee's candidacy and election must comply with applicable laws and regulations.

Disclosure Requirements

Nominating Shareholders. In addition to shareholder eligibility and nominee requirements, shareholders nominating a candidate would be required to file a new Schedule 14N with the SEC to disclose the amount and percentage of company securities owned by the nominating shareholder, the length of ownership of the company securities and the nominating shareholder's intent to continue to hold the securities through the date of the meeting. In addition, the nominating shareholder must include a certification that the nominating shareholder is not seeking to change the control of the company or to gain more than minority representation on the board of directors.

Proxy Disclosure. Companies would be required to include disclosure relating to nominating shareholders and shareholder nominees similar to current disclosure requirements with respect to contested elections.

Shareholder Liability

The nominating shareholder or group would be liable for any false or misleading statements in information given to the company and included in its proxy solicitation materials. Likewise, a company would not be responsible for information provided by the shareholder, unless it knows or has reason to know the information is false.

Amended Exchange Act Rule 14a-8(i)(8)

In addition to new Exchange Act Rule 14a-11, the SEC has proposed amendments to current Exchange Act Rule 14a-8(i)(8), which permits companies to exclude shareholder proposals that "relate to an election." The proposed amendment would narrow this so-called "election exclusion" to require companies to allow shareholder proposals by qualifying shareholders to amend the company's governing documents regarding nomination procedures or other director nomination disclosure provisions. The current shareholder eligibility provisions of Rule 14a-8 requiring that a shareholder proponent have continuously held at least \$2,000 in market value (or one percent, whichever is less) of the company's securities entitled to be voted for a period of one year prior to submitting the proposal would continue to apply.

Traditionally, state law has governed the relationship between shareholders and corporations. These proposals, if adopted, would constitute a new federalization of the corporate governance, director nomination and compensation process. Although neither the Shareholder Bill nor the Proposed SEC Rules are intended to be used to cause a change in control of a public company, the opportunities for misuse exist. Clearly, political will exists to accomplish some sort of reform. We will continue to monitor these and other proxy access developments.

For Further Information

If you have any questions regarding the corporate governance proposals presented above, including how they may affect your company, please contact one of the [members](#) of the [Securities Law Practice Group](#) or the lawyer with whom you are regularly in contact.