

Federal Initiatives Affecting Corporate Law

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In recent weeks, leading legislators and regulators have announced a series of initiatives arising, in one way or another, out of the recent economic crisis. None of these proposals has been enacted, but their common threads indicate growing momentum for greater federal involvement in public company corporate governance matters, a realm historically left largely to state law.

In addition to these legislative and regulatory initiatives, President Obama today announced a plan to overhaul federal regulation of the financial services industry. The President's recommendations would reshape the financial industry regulatory landscape, enhance regulation of financial services firms, and launch new programs to protect consumers of financial products and services. If adopted, these proposals would have important consequences on banks and other financial services firms (including venture capital and private equity firms), but they do not appear to have significant direct consequences to businesses in other industries. Consistent with some of the other initiatives described below, the President's proposal calls for non-binding shareholder votes for executive compensation at public companies, expanded protections for whistleblowers and expanded sanctions for enforcement. It also calls for clarification of fair value accounting standards and directs financial accounting standard setters to make substantial progress towards development of a single set of high quality global accounting standards by the end of 2009.

Senator Schumer's Shareholder Bill of Rights

Sen. Charles Schumer introduced a comprehensive Shareholder Bill of Rights that would create new federal mandates for the corporate governance of public companies.

PROPOSAL	CONTEXT
Shareholder Votes on Executive Compensation and Golden Parachutes. Require companies to allow advisory shareholder votes on executive compensation and golden parachute arrangements in connection with change-in-control transactions.	Under state corporate laws, boards of directors set compensation without shareholder approval. Similar "say-on-pay" proposals have been adopted by some companies in recent years, and TARP recipients will be required to submit compensation to shareholders for an advisory vote.
Shareholder Access to Proxy for Board Nominations. Shareholders owning at least 1% of a company's voting securities for two years would be allowed to nominate directors and have the nominees included in the company's proxy statement.	Currently, shareholders are not permitted to use the company's proxy materials if they wish to nominate Board members. Instead, to reach the voting shareholders, proponents of an opposition slate must create, file and distribute their own proxy materials.
Independent Board Chair. Require the Board chairperson to be independent, including not having served as an employee of the company.	Existing law permits the CEO to also serve as chairman of the board of directors; some companies elect in their bylaws to separate the functions
Annual Election of All Directors. All board members would be required to stand for election annually.	As permitted by state laws, many companies currently have classified boards of directors, often with one-third of the directors up for election each year, with directors serving three-year terms.

PROPOSAL	CONTEXT
<p>Majority Voting. To be elected in uncontested elections, directors must receive a majority of the votes cast. Incumbents not receiving a majority vote must submit a resignation and the board must accept it.</p>	<p>State laws generally provide that directors are elected by a plurality of votes cast, so they can be elected even if the number of votes withheld exceeds the votes in favor. In the past three years, many corporations have voluntarily adopted some form of majority voting in response to shareholder activism.</p>
<p>Risk Committees. Companies would be required to establish a board risk committee, consisting of independent directors.</p>	<p>State law and exchange listing requirements do not require a risk committee. Stock exchanges do require an independent audit committee and, effectively, an independent compensation committee.</p>

Other Legislation

Congressman Gary Peters recently introduced another bill, the “Shareholder Empowerment Act of 2009,” that goes beyond Senator Schumer’s bill in certain respects. For example, this legislation would also

- Require clawbacks of incentive pay in the event of fraud, financial restatements or other causes,
- Prohibit severance payments to executives terminated for poor performance,
- Require additional disclosure of specific performance targets used for bonuses, incentive compensation and equity compensation.

Amendments to the Schumer bill and other competing legislative proposals are likely in coming weeks. Specifics of the ultimate legislation are uncertain, but a wide range of federal initiatives are on the table.

SEC Proposal Regarding Proxy Access

The SEC recently proposed rules that would allow eligible shareholders to nominate directors in opposition to a management slate and have their nominees included in the company’s annual meeting proxy statement. To be eligible, shareholders must hold a specified percentage of the company’s voting securities, which varies depending on the company’s public float:

- Large accelerated filer (\$700 million public float) – stockholdings of 1% or more;
- Accelerated filer (\$75 million public float) – stockholdings of 3% or more;
- Non-accelerated filer (below \$75 million public float) – stockholdings of 5% or more.

Geithner and Schapiro Statements Regarding Executive Compensation

On June 10, 2009, Treasury Secretary Timothy Geithner and SEC Chairman Mary Schapiro released statements addressing executive compensation reforms. The Geithner statement was made in the specific context of compensation for executives at financial institutions, but the principles may be applied to public company executives generally. The coordination of these developments is noteworthy.

Key elements of the Geithner statement include:

- Proper measurement of incentive compensation requires a wide range of internal and external metrics, not just stock price.
- The time horizon of executive incentive compensation payouts should align with the time horizon of risks associated with executive decision-making, for example, with longer holding periods required for equity awards.
- Compensation committees should conduct risk assessments and avoid encouraging imprudent risk taking.
- Companies should re-examine whether golden parachutes and retirement packages are appropriately aligned with shareholder interests.
- Citing a lack of transparency and accountability in compensation setting, Secretary Geithner proposed legislation to provide advisory “say-on-pay” power to shareholders and to make compensation committees more independent.

The Schapiro statement indicates that the SEC is considering a package of new compensation disclosures:

- How a company and its board manage risk.
- The company's overall approach to compensation, including its effect on risk taking.
- Compensation consultant conflicts of interest.
- Director nominees' experience and qualifications to serve on the board or particular committees.

Summary

Each of these recent proposals requires action by Congress or one or more federal agencies before going into effect. Each is likely to be actively opposed as unduly intrusive into matters of state law and deleterious to long-term investor value creation. Even seemingly straightforward proposals will raise many issues and competing principles or interests. Nonetheless, the common themes of proxy access and focus on long-term compensation and accountability for risk-taking appear to be matters that are at the forefront of the policy debate in Washington. While it is difficult to predict the specific details of reforms, it does seem likely that the general concepts reflected in current proposals will be reflected in new legislation or regulation, and in the not too distant future.

For more information on this or related matters, please contact any member of your Fenwick & West client team.

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