

May 20, 2009

Regulatory & Legislative Corporate Governance Initiatives

At the Spring 2009 meeting of the Council of Institutional Investors, Securities and Exchange Commission (SEC) Chairman Mary L. Schapiro announced the SEC's current corporate governance agenda. This agenda is largely in response to market events over the last several quarters and covers four broad areas in which the SEC is currently considering or plans to consider new regulation.

Similarly, on May 19, 2009, Sen. Charles Schumer introduced a bill in the Senate that aims to overhaul a number of governance areas, many of which overlap with those areas targeted for reform by the SEC. Given the SEC's agenda combined with Sen. Schumer's legislation, it seems only a matter of time before companies will have to incorporate some new governance regime into their operations. The purpose of this legal alert is to provide an overview of the major areas of regulatory reform outlined by Chairman Schapiro and included in Sen. Schumer's legislation so that they are best prepared to respond to new requirements as they are implemented.

SEC Regulatory Action

As mentioned above, the SEC's corporate governance agenda focuses on four broad areas:

- Market Infrastructure;
- Disclosure Reform;
- Proxy Access; and
- Regulation of Market Professionals and Intermediaries.

This legal alert focuses on anticipated regulatory reform in the areas of proxy access and disclosure reform.

Proxy Access. At an open meeting of the SEC on May 20, 2009, the SEC plans to consider a rule proposal relating to proxy access that will be designed to ensure that investors have an increased opportunity to nominate directors. It is expected that shareholders, or groups thereof, who have held at least one percent of issuers' voting securities for at least one year prior to submitting a proposal will have proxy access to nominate directors.

Disclosure Reform. During her speech, Chairman Schapiro announced that the SEC plans to consider reform of disclosure requirements relating to a number of items, including director experience, board leadership structure, executive compensation, and risk management over the next few months.

With regard to director nominees' experience, in June the SEC plans to propose rules to enhance disclosure. Currently, companies are required to include a description of a director nominee's experience during the past five years. During her speech, Chairman Schapiro expressed doubt at the sufficiency of such disclosure, stating that enhanced disclosure regarding a nominee's experience, qualifications and skills may be necessary for stockholders to make informed proxy voting decisions.

Chairman Schapiro also indicated that the SEC will be considering new disclosure requirements regarding board leadership structure. Specifically, such disclosure may require a company to explain its

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reasons for choosing its leadership structure, e.g., for selecting an independent chairman of the board or a combined chairman/chief executive officer.

In the area of compensation, Chairman Schapiro called for an expansion of the disclosure currently required, both in terms of the information covered as well as the persons for whom disclosure is required. Any additional disclosure requirements relating to compensation will likely be guided based on the following three principles:

- Effective governance of compensation;
- Effective alignment of compensation with prudent risk-taking – in particular, stockholders should fully understand how compensation structures and practices drive an executive’s risk-taking; and
- Effective supervisory oversight and engagement by a company’s stakeholders.

For example, conflicts of interest between a company and its hired compensation consultants was one specific area highlighted that is likely to be addressed. In addition, new compensation disclosure requirements are expected to require disclosure that goes beyond decisions relating to named executive officers (as defined in § 402 of Regulation S-K) in an effort to enhance disclosure regarding a company’s overall compensation approach.

In addition to addressing risk management in the context of compensation, the SEC is also planning to propose new rules regarding how companies, and in particular their boards, manage risk generally. Such rules would be designed to elicit disclosure that provides shareholders with better insight into how companies and their boards manage risks.

Senate Legislation

On May 19, 2009, Sen. Charles Schumer introduced legislation in the Senate aimed at providing shareholders with increased authority over the nomination, election and compensation practices of public companies. This legislation, known as the Shareholder Bill of Rights Act of 2009, dovetails with the SEC’s corporate governance agenda in many areas. Specifically, Sen. Schumer’s legislation, if adopted, will amend the Securities Exchange Act of 1934, as amended, by adding a new § 14A that in effect will require companies to:

- Submit executive and golden parachute compensation to shareholders for approval annually;
- Provide shareholders with greater access to their proxies;
- Appoint independent chairmen to their boards;
- Mandate majority vote requirements in uncontested director elections; and
- Establish risk committees. These requirements are discussed in greater detail below

Say on Pay and Say on Severance. The proposed legislation requires that any proxy or consent solicitation for a meeting of shareholders that includes compensation disclosure also include a non-binding shareholder vote on the compensation of executives as disclosed in the proxy. Similarly, companies would also be required to provide shareholders with a non-binding vote on severance pay packages in connection with a merger, acquisition, consolidation, or other disposition of substantially all of the assets of an issuer. The legislation as proposed specifically notes that such votes shall not change existing or create any new fiduciary duties owed by directors.

Proxy Access. With regard to shareholder access to proxies, the proposed legislation requires the SEC to establish rules relating to shareholders’ ability to use issuers’ proxy solicitation materials for the purpose of nominating directors. Such a rule would overhaul the current proxy rules, which permit issuers

to exclude proposals relating to the nomination of directors. Consistent with the SEC's expected proposal, the legislation requires that the rule established provide that a shareholder, or a group of thereof, that has beneficially owned in aggregate at least one percent of an issuer's voting securities for at least two years prior to the date of the issuer's next annual meeting has access to the issuer's proxy to nominate a director.

Board Elections, Structure and Leadership. Sen. Schumer's legislation requires that the SEC establish rules directing the national securities exchanges to amend their listing requirements to impose certain requirements relating to the election of directors and structure and leadership of boards of directors.

These rules would require that the chairperson of the board of a listed company be independent, as defined by the rules of the exchange on which the company is listed, and would prohibit such companies from maintaining classified boards. Instead, directors would be elected on an annual basis. In addition, in an uncontested election, director nominees of a listed company would be required to be elected by a majority of votes cast. In the event of a contested election where the number of director nominees was greater than the number of directors to be elected, directors would be elected by the vote of a plurality of the shares present and entitled to vote.

Companies listed on a national securities exchange would also be required to establish a risk committee, consisting wholly of independent directors. The risk committee would be responsible for the establishment and evaluation of the company's risk management practices.

Conclusion

The SEC's corporate governance agenda and Sen. Schumer's proposed legislation illustrate the importance of corporate governance reform to legislators and regulators. Although many commentators believe that Sen. Schumer's legislation, in its current draft at least, is unlikely to be passed because it includes many items that potentially contravene state law, his bill illustrates the increasingly widespread belief that corporate governance reform is necessary. To be best prepared to adopt such a regime, companies may want begin reviewing their corporate governance documentation now.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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