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SEC Priorities for 2009 and Federal and State Legislative Initiatives Strengthen Stockholder Rights

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Proxy Access and Other SEC Priorities in the Coming Months

On March 26, 2009 the Securities and Exchange Commission ("SEC") Chairman Mary Schapiro testified before the U.S. Senate Committee on Banking, Housing and Urban Affairs.[1] She stated that stockholder proxy access will be a "critical part of the Commission's agenda in the coming months."[2] Additionally, Chairman Schapiro listed the following activities that the SEC's Division of Corporation Finance is expected to undertake in 2009:

- stockholder advisory votes on executive compensation ("say-on-pay") for companies in the Troubled Asset Relief Program ("TARP");
- enhanced disclosure regarding director qualifications; and
- enhanced disclosure regarding conflicts of interests with compensation consultants.

Already on the SEC's 2009 agenda is the proposal by the New York Stock Exchange ("NYSE") to prohibit broker discretionary voting for the election of directors.

These SEC initiatives, together with the Delaware legislature's proposed amendments to the Delaware General Corporation Law ("DGCL") regarding proxy access and the federal congressional proposals regarding say-on-pay would strengthen stockholder voting rights and increase stockholder involvement in corporate governance. Please watch for our future client advisories for developments concerning these SEC initiatives and legislative proposals.

Stockholder Proxy Access

In her testimony, Chairman Schapiro stated that the SEC has not done enough to support fair corporate voting for stockholders. She underscored that stockholder proxy access would provide "meaningful opportunities for a company's owners to nominate its directors."[3] Chairman Schapiro made it clear that stockholders need comprehensive information not only for trading but also for voting on corporate directors.

Stockholder Advisory Votes on Executive Compensation

On February 24, 2009, the SEC issued interpretations on the say-on-pay provisions contained in the 2009 American Recovery and Reinvestment Act ("ARRA"). The ARRA requires that all public companies that receive TARP funds must offer stockholders a non-binding vote on executive compensation. The SEC's interpretation made the say-on-pay provision immediately effective and applicable to proxy statements filed with the SEC after February 17, 2009. Then on February 26, 2009 the SEC updated its interpretations to clarify that stockholders must have a non-binding vote on executive compensation this year. Additional interpretations are expected as companies begin to implement this provision.

Enhanced Disclosure regarding Compensation Consultant Conflicts of Interest and Director Qualifications

Disclosure of conflicts of interest among compensation consultants who perform services

other than executive compensation consulting had been the subject of federal congressional hearings in December 2007. Following the hearings, a report by the U.S. House of Representatives Committee on Oversight and Government Reform analyzed public disclosure by issuers and concluded that many conflicts of interest were not disclosed in SEC filings despite the fact that consultants were compensated by the executives whose pay they were hired to assess.

Disclosure of director qualifications beyond the current biographical information that is now required would serve to further Chairman Shapiro's goal of providing stockholders with comprehensive information to inform stockholder voting decisions.

Broker Voting

The SEC is currently considering a NYSE rule proposal[4] that would eliminate the ability of brokers to vote the shares of holders who fail to vote at uncontested elections of directors. Presently, shares that are not voted by stockholders can be voted by the broker that maintains the accounts in which their shares are held. The NYSE is proposing to amend NYSE Rule 452 which permits brokers to vote on "routine" proposals when the beneficial owner of the stock does not provide "specific" voting instructions to the broker at least 10 days before a scheduled meeting. NYSE Rule 452 includes voting at uncontested elections of directors as a routine matter. The proposal's comment period expired Friday, March 27, 2009. If the proposed amendment is approved by the SEC on or before August 31, 2009, then it will be applicable to proxy voting for stockholder meetings held on or after January 1, 2010.[5] Companies that are registered under the Investment Company Act of 1940 are excepted from the proposed rule change.

Delaware Legislation

On March 18, 2009, the Delaware House of Representatives passed House Bill 19 that includes two amendments to the DGCL.[6] These amendments create two new sections of the DGCL which expressly authorize, but do not require, Delaware corporations to adopt bylaws to permit proxy access and reimbursement for proxy expenses. While these new sections are only permissive, stockholders have the ability to amend corporate bylaws and thus may adopt these new sections over the objections of their boards.

House Bill 19 also includes an amendment that will affect the voting rights of stockholders who have no economic interest in the company. These amendments to the DGCL are currently in Delaware's Senate Committee on Judiciary. If approved, they will, by their own terms, become effective on August 1, 2009.[7]

Proxy Access Amendment

The first amendment creates a new DGCL "Section 112 Access to Proxy Solicitation Materials." This section allows a corporation to adopt bylaws that require the corporation to include in its proxy materials not only individuals nominated by the board of directors, but also nominees submitted by stockholders. Section 112 outlines a non-exclusive list of conditions that the corporation's bylaws may place on the access to its proxy materials. These conditions can, but need not, include requiring a minimum record or beneficial ownership, a duration of ownership, and submission of specified information concerning the stockholder and their nominees. These conditions are authorized in order to minimize election contests by stockholders with minimal economic interest in the corporation. Proxy access may also be conditioned on whether or not a majority of board seats are contested and whether nominations are related to an acquisition of a specified portion of the voting power of the corporation's outstanding voting stock. Additionally Section 112 allows proxy access to be conditioned on the stockholder indemnifying the corporation for any loss from false or misleading information and "any other lawful condition."[8]

Expense Reimbursement Amendment

The second amendment creates a new DGCL "Section 113 Proxy Expense Reimbursement." This section will essentially codify the Delaware Supreme Court's decision in CA, Inc. v. AFSCME Employees Pension Plan.[9] The Delaware Supreme Court held that the bylaw requiring reimbursement of reasonable fees in connection with an election of directors proposed by AFSCME was a proper subject for stockholder action under Delaware law. However, the court found that as drafted it violated the DGCL because it contained "no language or provision that would reserve to CA's directors their full power to exercise their fiduciary duty to decide whether or not it would be appropriate, in a specific case, to award reimbursement at all."[10] The Court then suggested that one solution would be to seek recourse from the Delaware General Assembly.[11]

Section 113 outlines a non-exclusive list of conditions that a corporation may place on the reimbursement of proxy expenses. This list includes conditioning eligibility for reimbursement on the number or proportion of persons nominated by the stockholder or on whether the stockholder previously sought reimbursement for similar expenses. This section also allows limiting the amount of reimbursement "based upon the proportion of votes cast in favor of"[12] the stockholder nominee and limiting reimbursement for elections of directors by cumulative voting. Just as in Section 112, this section allows for "any other lawful condition."[13]

Section 113 allows bylaws similar to those proposed by AFSCME. Section 113 does not, however, require that the bylaw provide the fiduciary out the Court in AFSCME found necessary to ensure the bylaw did not violate the DGCL. In light of the Court's opinion in AFSCME, it remains to be seen whether Delaware courts will invalidate bylaws adopted pursuant to Section 113 if they do not contain a fiduciary out or whether they will read a fiduciary out into such bylaws.

Empty Voting Amendment

House Bill 19 also includes an amendment to Section 213(a) that will permit a board of directors to fix separate dates for stockholders entitled to vote at a meeting and stockholders entitled to notice of meeting.[14] This amendment is designed to strip voting power from stockholders who have no economic interest in the company by allowing a board to set a record date that is nearer to the meeting date and therefore more representative of the stockholder base. This "empty voting" is a concern because it negates the presumption that stockholders will vote consistent with their desire to maximize their ownership in the company.

Federal Legislation

On March 1, 2007, Congressman Barney Frank proposed H.R. 1257, a bill to provide stockholders with an advisory vote on executive compensation (say-on-pay). The House passed the bill April 20, 2007, but it subsequently stalled in the Senate. Given the current economic and political climate, and especially in light of the uproar over AIG bonuses, there is speculation that Congressman Frank's legislation will be given new life.

Congressman Frank has not yet proposed a new bill, but it is likely that if a say-on-pay bill is passed it will be similar to his 2007 bill, which is effectively identical to the say-on-pay provision found in the ARRA.

Both Congressman Frank's 2007 bill and the ARRA provide that at every annual meeting the stockholders must make a nonbinding vote to approve the compensation of the corporation's executives. Both bills stress that this nonbinding vote will not be construed as overruling a decision by the board or create any additional fiduciary duties for the board.[15]

While the ARRA prohibits golden parachutes for senior executives and the next five most highly-compensated employees, Congressman Frank's bill would provide for a nonbinding stockholder vote on golden parachutes in proxy statements involving an acquisition, merger, consolidation, proposed sale, or other disposition of substantially all the assets of an issuer.

Endnotes

[1] Available at http://www.sec.gov/news/testimony/2009/ts032609mls.htm.

[2] Id.

[3] Id.

[4] SEC Release No. 34-59464, "Notice of Filing of Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors and Codify Two Previously Published Interpretations That Do Not Permit Broker Discretionary Votes for Material Amendments to Investment Advisory Contracts" (2/26/09).

[5] If the SEC does not approve the proposed amendment on or before August 31, 2009, then the effective date will be delayed to a date which is at least four months after the approval date, and which does not fall within the first six months of the calendar year.

[6] 2009 Bill Text DE H.B. 19.

[7] Id. at Section 15.

[8] Id. at Section 1.

[9] CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (Del. 2008) ("AFSCME")

[10] Id. at 240.

[11] Id.

[12] Section 2, 2009 Bill Text DE H.B. 19.

[13] Id.

[14] Id. at Section 4.

[15] 110 H.R. 1257 and 111 H.R. 1.

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