

The Shareholder Bill of Rights Act of 2009

June 17, 2009

On May 19, 2009, Senators Charles Schumer (D-N.Y.) and Maria Cantwell (D-Wash.) introduced The Shareholder Bill of Rights Act of 2009.¹ Although it is too soon to predict whether the bill has any realistic chance of passage, it is an important development in the current debate about whether additional regulation of corporate governance matters is warranted. If adopted, the bill would result in the most significant changes to the corporate governance requirements applicable to US public companies since the Sarbanes-Oxley Act of 2002. According to Senators Schumer and Cantwell, the bill is intended to "increase accountability and oversight at publicly traded corporations."² The bill is supported by major pension funds, labor unions and consumer groups. Opponents of the bill include, among many others, the Business Roundtable, an association of chief executive officers of leading US companies. The Business Roundtable summed up the view of many opponents, stating that the bill "is an unnecessary intrusion into matters governed by state corporation law, as well as matters currently being addressed by the Securities and Exchange Commission, stock exchanges and public company boards" and that "the one-size-fits-all nature of this bill and the uncertainty it will generate will distract company management and boards from the essential tasks of weathering the economic downturn and restoring shareholder value."³

The bill would add a new Section 14A to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which would:

- Require companies to have annual advisory votes on executive compensation ("say-on-pay");
- Require companies to make disclosure about and have advisory votes on "golden parachute" arrangements;
- Provide shareholders with the ability to include director nominees in companies' proxy statements;

¹ The text of the Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. (2009) is available [here](#).

² See Senator Schumer's press release, "Schumer, Cantwell Announce 'Shareholder Bill of Rights' to Impose Greater Accountability on Corporate America," dated May 19, 2009, available [here](#).

³ See Business Roundtable press release, "Business Roundtable Statement on Senator Schumer's Proposed Shareholder Bill of Rights Act," dated May 19, 2009, available [here](#).

- Require companies to have an independent chairperson of the board;
- Require companies to provide for annual elections of the board of directors;
- Require companies to provide for the election by majority of votes cast of director nominees in an uncontested election; and
- Require companies to establish a risk committee of the board of directors comprised entirely of independent directors.

The bill leaves open a number of questions as to the scope and time of applicability of its provisions. All of the bill's operative provisions contemplate rulemaking by the Securities and Exchange Commission ("SEC"), either to carry out its provisions or establish rules thereunder (bullets 1 through 3 and 7 above) or to prohibit stock exchanges from listing companies that are not in compliance with the provisions (bullets 4 through 7 above). However, except for the proxy access provision (bullet 3 above), all provisions arguably stand on their own and may themselves impose requirements on companies even in the absence of SEC rules. The say-on-pay provisions (bullets 1 and 2 above) and the risk committee provision (bullet 7 above) would impose their requirements only following a one-year period after the enactment of the bill. The requirements of the bill appear to apply to all companies (US and non-US), except that the say-on-pay requirements, which are specifically tied to the SEC's proxy rules, appear not to apply to foreign private issuers.⁴ The bill would authorize the SEC to exempt certain issuers "based on the size of the issuer, market capitalization, public float, number of shareholders of record, or other criteria" from certain of its provisions.

In a related development, on June 12, 2009, Rep. Gary Peters (D-Mich.) introduced the Shareholder Empowerment Act of 2009,⁵ which is similar to the Shareholder Bill of Rights Act of 2009 in many respects, but includes additional requirements. The Peters bill would also:

- Eliminate broker non-votes in uncontested elections⁶;

⁴ Pursuant to Exchange Act Rule 3a12-3(b), the proxy rules do not apply to foreign private issuers (as defined in Exchange Act Rule 3b-4(c)).

⁵ The text of the Shareholder Empowerment Act of 2009, H.R. 2861, 111th Cong. (2009) is available [here](#).

⁶ Currently, New York Stock Exchange ("NYSE") Rule 452 permits brokers to exercise discretionary voting authority concerning "routine" matters with respect to shares for which proxy soliciting materials have been transmitted, but voting instructions have not been received by the 10th day preceding the meeting date. Uncontested director elections are among the matters considered "routine" under Rule 452. On February 26, 2009, the NYSE re-submitted a proposal to the SEC that would amend Rule 452 to provide that the election of directors is no longer deemed to be a "routine" matter, thereby eliminating broker discretionary voting in director elections (except with respect to registered investment

- Require that advisers for executive employment contracts or compensation agreements retained by the board or a board committee be independent and report solely to the board or committee;
- Require clawbacks of unearned bonus, incentive or equity payments awarded based on fraud or financial statements that require restatement;
- Prohibit severance payments to senior executives who are terminated for "poor performance" as determined by the board of directors; and
- Require additional disclosure about performance targets.

Advisory Vote on Executive Compensation ("Say-on-Pay") and "Golden Parachute" Arrangements

The bill would require an advisory vote by shareholders on "the compensation of executives as disclosed pursuant to the compensation disclosure rules of the [SEC]" in the company's proxy statement. In addition, any proxy solicitation materials with respect to an acquisition, merger, consolidation or the sale or other disposition of substantially all of the assets of an issuer would require disclosure and an advisory vote of shareholders to approve "any agreements or understandings . . . with any principal executive officers of such issuer (or of the acquiring issuer, if such issuer is not the acquiring issuer) concerning any type of compensation (whether present, deferred, or contingent) that are based on or are otherwise related to the acquisition, merger, consolidation, sale, or other disposition, and that have not been subject to a shareholder vote." However, any advisory vote by shareholders on executive compensation ("say-on-pay") or any "golden-parachute" arrangements would not be binding on the board of directors.

The "say-on-pay" movement, whose supporters perceive executive compensation as excessive, has gained momentum in recent years in the United States. Several companies have given shareholders an advisory vote on executive compensation, either voluntarily or as a result of related shareholder proposals. Companies participating in the Troubled Asset Relief Program are now specifically required to give shareholders an annual "say-on-pay" advisory vote.⁷ The bill is not the first attempt to legislate "say-on-pay." "Say-on-pay" legislation was previously introduced

companies). See SEC Release No. 34-59464 (February 26, 2009). The proposal requires the approval of the SEC, which has not yet acted on the proposal.

⁷ Section 111(e) of the Emergency Economic Stabilization Act of 2008, as amended by Section 7001 of the American Recovery and Reinvestment Act of 2009.

in the Senate by then Senator Barack Obama (D-Ill.)⁸ and the House of Representatives by Rep. Barney Frank (D-Mass.).⁹ On May 7, 2009, Senator Richard Durbin (D-Ill.) introduced a bill, the Excessive Pay Shareholder Approval Act,¹⁰ which would amend Section 16 of the Exchange Act to require a supermajority (60 percent or more) shareholder vote to approve "excessive pay" (i.e., compensation exceeding 100 times the average compensation of all employees) to any employee of a public company and require proxy materials to include additional information on (i) the amount of compensation for the lowest-paid and highest paid employees as well as the average amount of compensation paid to all employees and (ii) the number of employees who are paid more than 100 times the average compensation.

On June 10, 2009, Treasury Secretary Timothy Geithner issued a statement calling for Congress to enact "say-on-pay" legislation authorizing the SEC to require all public companies to include in their annual proxy statement a non-binding shareholder resolution requesting approval or disapproval of the company's executive compensation as disclosed in the proxy statement.¹¹ Secretary Geithner's statement also calls for legislation authorizing the SEC to provide shareholders a non-binding vote to approve or disapprove "golden parachutes" in proxy solicitation materials prepared for shareholder meetings relating to mergers, acquisitions or other change in control transactions.¹² SEC Chairman Mary Schapiro also supports "say-on-pay" shareholder advisory votes.¹³

Proxy Access

The bill also would direct the SEC to adopt rules "relating to the use by shareholders of proxy solicitation materials supplied by the issuer for the purpose of nominating individuals to membership on the board of directors." These rules are not permitted to provide for such access unless a shareholder or group of shareholders has owned beneficially at least 1 percent of the issuer's voting securities for at least two years. If enacted, the bill would also clarify that the SEC has "full authority to determine the

⁸ Shareholder Vote on Executive Compensation Act, S. 1181, 110th Cong. (2007), available [here](#).

⁹ Shareholder Vote on Executive Compensation Act, H.R. 1257, 110th Cong. (2007), available [here](#).

¹⁰ The text of this bill is available [here](#).

¹¹ Treasury Secretary Geithner's statement is available [here](#).

¹² For more information on Secretary Geithner's statement, see Dewey & LeBoeuf client alert, "Treasury Secretary Geithner and SEC Chairman Schapiro Issue Statements on Executive Compensation," dated June 11, 2009, available [here](#).

¹³ See The Washington Post, "SEC Chief Backs 'Say-on-Pay,'" January 24, 2009, available [here](#).

use of the issuer proxy with regards to the nomination and election of directors by shareholders."

On May 20, 2009, one day after the introduction of the bill in the Senate, the SEC voted 3-2 to propose proxy access rules that, among other things, would give shareholders of the largest US companies who have owned at least 1 percent of the company's voting securities for a period of at least one year and meet certain other requirements the right to include director nominees in the company's proxy statement.¹⁴

In April, the Delaware legislature enacted new Sections 112 and 113 of the Delaware General Corporation Law, which will become effective August 1, 2009. The new provisions specifically authorize, but do not require, Delaware corporations to adopt bylaws that require a corporation to include shareholder nominees in the corporation's proxy materials and/or to reimburse shareholders for expenses incurred in connection with soliciting proxies for the election of directors.

Corporate Governance Standards

The bill would require companies to (i) have an independent chairperson of the board of directors, (ii) hold an annual election of each member of the board, (iii) adopt a majority-voting standard for uncontested elections and (iv) establish a risk committee of the board.

Independent Chairperson

Companies would be required to provide, either in their governing documents (i.e., charter or bylaws) or in a public statement of corporate policy, that the chairperson of its board of directors must be independent and must not have previously served as an executive officer of the company. Accordingly, the CEO would no longer be permitted to serve as chairperson of the board of directors. Independence would be determined in accordance with the rules of the exchange on which the company's securities are listed. However, given that no person who has previously served as an executive officer of the company would be eligible to serve as chairperson, the independence requirements applicable to chairpersons would be more stringent than the current stock exchange director independence requirements.¹⁵

¹⁴ For additional details on the SEC's proposed proxy access rules, see Dewey & LeBoeuf Client Alert, "Proxy Access Developments," of May 27, 2009, which is available [here](#).

¹⁵ For example, under Section 303A.02(b)(i) of the NYSE Listed Company Manual, a director is deemed not to be independent if the director is, or has been within the last three years, an employee of the listed company. Therefore, a person who served as an executive officer of the listed company more than three years ago would be independent for director independence purposes, if the person is not for other reasons deemed not to be independent and the board of directors determined in accordance with Section 303A.02(a) of the NYSE

The advantages and disadvantages of separating the roles of chairman and chief executive officer have been discussed for many years¹⁶ and there appears to be a trend towards separating the roles. However, more than 60 percent of the S&P 500 companies still have a combined chairman/CEO.¹⁷ Although "most American corporations have been well-served by a structure in which the CEO also serves as chairman of the board,"¹⁸ more and more corporate governance participants express the view that "some form of independent leadership is required, either in the form of an independent chairman or a designated lead or presiding director."¹⁹ Some take the view that the separation of the chairman and CEO roles should be the default and that companies who choose to combine the two roles should explain why doing so is in the company's best interest.²⁰ However, most proponents of separating the chairman and CEO role agree that the decision as to the form of independent board leadership should be made by a company's board of directors based on the company's specific situation and not be mandated by federal statute.

RiskMetrics Group generally recommends a vote for shareholder proposals requiring that the chairman's position be filled by an independent director, unless the company, among other things, meets the following criteria: (i) a designated lead director with clearly delineated and comprehensive duties, (ii) two-thirds independent board, (iii) all independent key committees, (iv) established governance guidelines and (v) the absence of "problematic governance and management practices."²¹

SEC Chairman Schapiro has said that the SEC is actively considering a package of new proxy disclosure rule proposals, one of which would call for greater disclosure about the particular leadership structure chosen by a

Listed Company Manual that the person does not have a material relationship with the listed company.

¹⁶ For a summary of the arguments for and against separating the chairman and CEO roles, see Yale School of Management—The Millstein Center for Corporate Governance and Performance, Policy Briefing No. 4: Chairing the Board—The Case for Independent Leadership in Corporate North America (March 2009) ("Chairing the Board Briefing"), available [here](#).

¹⁷ See Yale School of Management—The Millstein Center for Corporate Governance and Performance press release, "Corporate Board Chairmen Call on Public Companies to Separate Board Chair and CEO Roles," of March 30, 2009, available [here](#).

¹⁸ Business Roundtable, Principles of Corporate Governance (2005), page 15, available [here](#).

¹⁹ National Association of Corporate Directors (NACD), Key Agreed Principles to Strengthen Corporate Governance for US Publicly Traded Companies (October 2008) ("NACD Key Agreed Principles"), Principle V. (Independent Board Leadership), available [here](#).

²⁰ See NACD Key Agreed Principles, Principle V. (Independent Board Leadership) and Chairing the Board Briefing.

²¹ RiskMetrics Group, US Proxy Voting Guidelines Concise Summary (January 15, 2009), available [here](#).

board, including disclosure on whether that structure includes an independent chairman or combines the positions of CEO and chairman.²²

Annual Director Elections

The bill would require companies to provide in their governing documents that each member of the board of directors must be elected by shareholders on an annual basis. Companies would no longer be permitted to have a classified board of directors.

Classified boards have served as an important anti-takeover device for many years. However, there has been a trend in recent years to de-classify boards, in part as a result of shareholder proposals and proxy voting recommendations, with a majority of the largest US companies no longer having a classified board. RiskMetrics Group considers classified boards problematic and recommends votes for proposals to repeal classified boards and to elect all directors annually.²³

Majority Voting

The bill would require that directors be elected by majority of the votes cast in uncontested elections. Plurality voting would be permitted only in contested elections, i.e., elections where the number of nominees exceeds the number of directors to be elected. The bill would also require that any incumbent director who is not re-elected to a new term in an uncontested election tender his or her resignation to the board of directors. The board would be required to (i) accept such resignation, (ii) determine the date on which the resignation shall become effective and (iii) make that date public.

The trend in recent years towards majority voting in director elections continues and more than two-thirds of the largest US companies have adopted some form of majority voting. This trend is supported by recent corporate governance best practices recommendations, such as the NACD Key Agreed Principles, which provide that "[c]ompanies should adopt majority voting through appropriate provisions in articles of incorporation or bylaws (to the extent consistent with state law). In an uncontested election, a candidate who fails to win a majority of the votes cast should be required to tender his or her resignation, and the nominating/governance committee should recommend to the board whether to accept or reject the resignation, depending on the

²² See SEC press release, "Chairman Schapiro Statement on Executive Compensation," dated June 10, 2009, available [here](#), and Chairman Schapiro's Testimony Before the Subcommittee on Financial Services and General Government on June 2, 2009, available [here](#).

²³ See RiskMetrics Group, 2009 US Proxy Voting Guidelines Summary (December 24, 2008), available [here](#).

circumstances."²⁴ RiskMetrics Group generally recommends a vote for shareholder proposals with respect to majority voting in uncontested elections. It also strongly encourages companies to adopt a director resignation policy that addresses holdover directors who did not receive a majority.²⁵

Unlike typical majority voting standards that have been adopted by many companies, the bill would *require* the board of directors to accept the resignation of an incumbent director who is not re-elected.

Risk Committee

The bill would require companies to establish a risk committee that is comprised entirely of independent directors. The responsibility of the risk committee would be to establish and evaluate the risk management practices of the company.

As of 2008, only approximately three percent of S&P 500 companies had a standing risk committee of the board.²⁶ Consistent with stock exchange listing requirements, most boards of directors have delegated oversight of risk management to the audit committee.²⁷ However, stock exchange rules recognize that some companies may find it desirable to manage and assess risks through mechanisms other than the audit committee (e.g., to reduce the workload of the audit committee) and do not require that the audit committee be the sole body responsible for risk assessment and management. Such other mechanisms include the creation of a separate risk committee, which may or may not be a board committee. If a separate risk committee is charged with risk assessment and oversight (or some other mechanism for risk assessment and oversight is used), the audit committee must still review the risk management process in a general manner and discuss policies with respect to risk assessment and oversight.²⁸

If the bill were adopted, companies would lose the flexibility to determine the risk oversight structure that best fits their particular circumstances. Instead they would be required by law to create a board risk committee, possibly creating the need to increase the size of the board and recruit additional independent directors to staff the new committee.

²⁴ NACD Key Agreed Principles, Principle IX. (Shareholder Input in Director Selection).

²⁵ See RiskMetrics Group, 2009 US Proxy Voting Guidelines Summary (December 24, 2008), available [here](#).

²⁶ See SpencerStuart 2008 Board Index (November 2008), available [here](#).

²⁷ Section 303A.07(c)(iii)(D) of the NYSE Listed Company Manual provides that the audit committee must have the responsibility to "discuss policies with respect to risk assessment and risk management."

²⁸ Official Commentary to Section 303A.07(c)(iii)(D) of the NYSE Listed Company Manual.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

No part of this publication may be reproduced, in whole or in part, in any form, without our prior written consent.

© 2009 Dewey & LeBoeuf LLP
All rights reserved.

For further information on
Dewey & LeBoeuf,
please visit www.dl.com

Conclusion

The bill reflects a one-size-fits-all federally mandated approach to corporate governance. If adopted, key corporate governance practices that until now were governed by state corporate law would become subject to a federal statute, eliminating a company's ability to choose corporate governance structures that best fit its particular circumstances. Even if the bill is not adopted, it appears likely that some of the corporate governance requirements included in the bill will be mandated in one form or another over the next twelve months.

For more information, please contact William S. Lamb at (212) 259-8170 or blamb@dl.com, Elizabeth W. Powers at (212) 259-8662 or epowers@dl.com, K. Oliver Rust at (212) 259-8571 or krust@dl.com, or your Dewey & LeBoeuf relationship partner.