VOLUME 1 | 2009

The Altman Group

Governance Compendium Series

The Altman Group

Winner Biennial TOPS Awards 2004, 2006, and 2008
- Highest Rated Proxy Solicitation Firm

SPONSORS:

Society of Corporate Secretaries & Governance Professionals
NASDAQ OMX
National Investor Relations Institute

VOLUME 1 | 2009

The Altman Group
Governance Compendium Series

Contents

The Altman Group

SPONSORS:
Society of Corporate Secretaries & Governance Professionals
NASDAQ OMX
National Investor Relations Institute

Letter from the Editor

The Altman Group is pleased to present the first edition of the Governance Compendium Series. The decision to organize and publish this series reflects our view that all stakeholders, from senior decision-makers to retail shareowners, need to have more timely resources available simply to keep up to date with all of the issues and ideas shaping the ongoing transformation of corporate governance and proxy voting processes. We hope that the *Governance Compendium Series* will not only provide readers with insights and perspectives on what is in the pipeline for the 2010 proxy season, but also what is on the horizon for 2011 and beyond.

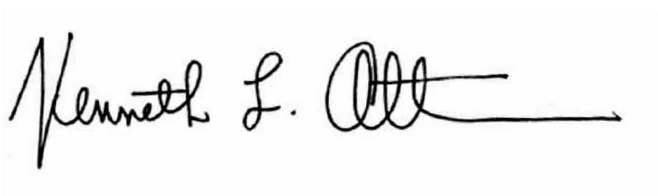
In this issue, you can find contributions covering a wide range of vital topics. After SEC Chairman Mary Schapiro stated on November 4th that a "concept release" on "proxy mechanics" will be forthcoming in coming months, we have chosen to lead off with the text of a letter containing a series of proposals to reform the proxy voting system, which was submitted by The Altman Group to the SEC on October 21, 2009. This is followed herein by a contribution from Carol Bowie of the RiskMetrics Governance Institute and Ted Allen, the editor of *Risk & Governance Weekly* (RiskMetrics), who detail the views of RiskMetrics concerning a range of recent developments and proposals under consideration at the SEC and before the U.S. Congress, including such issues as: the impact of Amended NYSE Rule 452 (which goes into effect on January 1, 2010), a legislative proposal from Senator Charles Schumer (the "Shareholder Bill of Rights Act of 2009" [S. 1074]), various proposals regarding advisory votes on compensation (from the SEC, U.S. Treasury, and in Congress), as well as proposed rules from the SEC on such issues as direct "proxy access" and changes to rules governing corporate disclosures (including with regard to compensation programs, director qualifications, board leadership structures, and more timely information on proxy vote results at annual meetings). Discussing many of these same issues, Martin Lipton, David A. Katz and Laura A. McIntosh, of Wachtell, Lipton, Rosen & Katz, offer critical insights while arguing that "few of the proposed reforms are truly new and nearly all are ill-conceived." John F. Grossbauer, who is a Partner at Potter Anderson & Corroon LLP, analyzes recent proposals and developments from the perspective of possible responses by Delaware corporations. Roy J. Katzovicz, the Chief Legal Officer of activist investor Pershing Square Capital Management, L.P., offers his insights on the "tectonic trends in corporate governance," with a particular focus on the SEC's proposed rules on proxy access. Anne Simpson, a Senior Portfolio Manager (Global Equities) and the manager of corporate governance at CalPERS, also argues her case for giving corporate governance reforms a "push," and adopting in particular what she calls the "governance gold standard of proxy access." Last, but not least, Steve Wolosky and Adam W. Finerman of Olshan Grundman Frome Rosenzweig & Wolosky LLP provide informative perspectives on a range of recent SEC and Congressional initiatives.

Looking out to the horizon, Richard Ferlauto, the Director of Corporate Governance and Pension Investment at the American Federation of State, County and Municipal Employees (AFSCME), offers his arguments for why "the discussion of shareowner rights ought to evolve into serious consideration of the responsibilities of both directors and shareowners…It is not just about directors any longer; investors and the agents of beneficial owners, such as mutual funds, need to come under equal scrutiny."

We also wanted to provide readers with some perspectives on proactive communications strategies for navigating all of the changes in corporate governance and shareholder activism. In this context, Joele Frank and Jeremy Jacobs, of Joele Frank, Wilkinson Brimmer Katcher, deliver a number of critical insights in their contribution to this Compendium.

On a final note, I would like to extend our appreciation to all who made this publication possible. We owe our deepest gratitude for the authors who have kindly contributed so many insightful articles for this Compendium. Moreover, we are indebted to the many staff and contractors of The Altman Group who helped prepare this publication, including Steven Horowitz, Francis Byrd, James Burke, and Jim Stanton (Stanton Design Group).

Thank you all,



Kenneth L. Altman
President, The Altman Group, Inc.

Practical Solutions to Improve the Proxy Voting System

A proposal submitted to: The Securities and Exchange Commission
by Kenneth L. Altman, President, The Altman Group, Inc.

Weaknesses in the proxy plumbing system are emerging as a priority for policy-makers. Indeed, a number of companies responding to the Proposing Release from the Securities and Exchange Commission on "Facilitating Shareholder Director Nominations"[1] ("Proxy Access") urged the Commission to first address plumbing issues such as the NOBO/OBO system, issues arising from share lending/borrowing practices, and the role of proxy advisory firms. In this paper we will examine systemic problems affecting all public companies, and offer some proposals on how to fix them. It is our hope that the proposals detailed below will help further shift the discussion at a policy-making level from one of reviewing complaints and assessing problems to one of working out practical solutions.

Let us start by acknowledging comments from SEC Chairman Mary Schapiro at the July 1, 2009 SEC Open Meeting in which she stated that the Commission will commence a review of the proxy voting and shareholder communications system this year. It was also welcome news to hear Chairman Schapiro state on September 17, 2009, that: "… eliminating broker non-votes in director elections, along with the potential for proxy access in the 2010 proxy season, will place a greater spotlight on some of the long-smoldering concerns about the mechanics of the proxy voting process within the United States. I have committed to looking at these additional issues — including OBO/NOBOs, and the role of proxy advisory and voting services — in the next few months."[2] Another constructive development was the announcement by the SEC's Investor Advisory Committee that it has formed three subcommittees that will focus on investor education, investor protection, and the mechanics of shareholder voting and communications. There were also reports in early October that the SEC has delayed action on proxy access in order to have additional time to review the more than 500 comment letters submitted to it in response to its proposed rules on that subject. Some of those letters, as we detail in a forthcoming report,[3] urged the SEC to focus on reforming the proxy voting system.

Last, but not least, a proposing release from the SEC dated October 14, 2009,[4] indicated that the Commission is considering modifications to Notice & Access ("N&A") provisions and "soliciting comment on…how best to advance the Commission's regulatory interest in informed shareholder participation" as steps to address steep declines in response rates for retail shareowners resulting from implementation of N&A. As a result of these deliberations, we hope that a careful and comprehensive assessment of proxy plumbing issues will lead to proposals from the SEC to reform a system that is now widely perceived by publicly-traded corporations to be working against the long-term interests of companies and shareholders.

Impact of Amended Rule 452

The NYSE and SEC are, whether intentionally or not, in the process of creating a tiered system of corporate voting that is correlated with the composition of a company's shareholder base. The SEC's recent approval of Amended NYSE Rule 452, which eliminates the right of brokerage firms to vote clients'

1 "SEC: Facilitating Shareholder Director Nominations [Release Nos. 33–9046; 34–60089; IC– 28765; File No. S7–10–09]," Federal Register, Vol. 74, No. 116, Thursday, June 18, 2009.

2 Chairman Mary L. Schapiro, "Address to Transatlantic Corporate Governance Dialogue," Sept. 17, 2009. http://www.sec.gov/news/speech/2009/spch091709mls.htm

3 The Altman Group, Content Analysis: Comments on the Proposed Rule "Facilitating Shareholder Director Nominations" (scheduled for release in the second half of October 2009).

4 Securities and Exchange Commission,"Amendments to Rules Requiring Internet Availability of Proxy Materials" [Release Nos. 33-9073; 34-60825; IC-28946; File No. S7-22-09]. October 14, 2009. http://www.sec.gov/rules/proposed/2009/33-9073.pdf

uninstructed shares in routine director elections, will have a disproportionately negative impact on smaller companies. These companies, with generally smaller market capitalizations (in particular those with stock prices below $5 per share) and a relatively large percentage of their shares held by retail shareowners, will face challenges from both a smaller volume of votes from brokerage firms in favor of the board's nominees, and investors/groups with narrow and short-term interests that will seek to take advantage of the changed playing field. Moreover, many millions of retail investors have relied for decades, even generations, on their brokers to exercise their voting rights in director elections, and will be blind-sided by Amended Rule 452 next year because they will still be expecting their brokers to vote for them (and thus be effectively disenfranchised). This is likely to be a far larger group of shareowners than some policy-makers are expecting.

The idea that Rule 452 needed changing had been championed for years by a small number of activist investors. The initiative for revising Rule 452 gained momentum after the high visibility of the Walt Disney board election in 2004. Some contend that this election for directors was decided by the uninstructed broker vote. Recent investor opposition to board nominees at large financial institutions, including Citibank, Washington Mutual and Bank of America, where a number of directors were likely elected on the strength of the uninstructed broker vote, may also have been a catalyst for recent SEC approval of the amendment to NYSE Rule 452.

Concern by regulators that votes by brokers for non-responding clients are a form of "empty voting" (in which the brokerage firm exercises a vote without having an economic interest) apparently bolstered support at a policy-making level for Amended Rule 452. Recently, Commissioner Elisse B. Walter commented that the amendments to NYSE Rule 452: "are designed to help assure that voting rights on critical matters like director elections are exercised by those with an economic interest in the company, rather than by brokers…I do not share the skeptics' view that, by returning the right to vote to shareholders, the amendments to Rule 452 will in fact disenfranchise retail shareholders. To the contrary, these amendments will ensure that the ballots cast by retail shareholders reflect their own decisions, not the decisions of their brokers."[5] The SEC has been using language indicating that all director elections are "critical," while there is a stated objective in the SEC's order approving Amended Rule 452 of ensuring that director elections are "determined by those with an economic interest in the company."[6] Consistent with these standards, Amended Rule 452 needs to be followed by additional reforms, including measures to address such issues as "empty voting" by activists and others, and steps to enable companies to engage more retail shareholders in the director election process (including reform of the OBO/NOBO system).

Absent a withhold vote campaign, the impact of changes to Rule 452 on non-contested director elections at most large- and mega-cap companies will be small. The vast majority of shares of NYSE-listed companies, along with certain NASDAQ OMX-listed companies, are primarily held by institutional investors that vote in high percentages, year in and year out. Even if a mega-cap NYSE company has 150,000 retailshareholders, the impact of Amended Rule 452 on proxy votes from these shareowners will likely be very small in percentage terms compared with that of a smaller company having low institutional ownership and as few as several thousand retail shareholders.

The impact of Amended Rule 452 on smaller companies, including many of those listed on the NASDAQ OMX exchange, will be much more significant. The market capitalizations and generally lower stock prices for NASDAQ-listed companies tend to lead to higher levels of retail ownership, and therefore broker votes (in percentage terms), when compared to the average NYSE-listed issuer. Furthermore, many institutions have policies that prohibit purchases of shares of a company with a price of less than $5. All of which has contributed to the formation of a marketplace in which many small-cap companies have 40-50%, or more, of their shares regularly voted on routine issues by brokerage firms.

The impact of Amended Rule 452 on small/micro-cap companies was central to an earlier proposal

5 Commissioner Elisse B. Walter, "SEC Rulemaking – Advancing the Law to Protect Investors," Comments before the 48th Annual Corporate Counsel Institute (Northwestern University School of Law, Oct. 2, 2009. http://www.sec.gov/news/speech/2009/spch100209ebw.htm

6 SEC Release No. 34-60215, File No. SR-NYSE-2006-92: "Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452…" July 1, 2009. http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf

from The Altman Group to exempt such companies from the rule. In comments submitted for the SEC's review of Amended Rule 452, The Altman Group urged the SEC to consider expanding the NYSE's exemption from the prohibition in NYSE Rule 452 on broker discretionary voting in director elections to include not only registered investment companies, but also small-cap companies (due to their disproportionately large retail shareholder bases). The SEC did not expand the exemption, but did note in its order approving the amendments that it "understands the concerns raised" (citing, at note 154, "Altman Group Letter; ICI 4 Letter, and Sutherland Letter").[7]

Impact of Notice & Access on Voting by Retail Shareowners

To their credit, regulators have started to address the issue of sharp declines in retail shareowner response rates due to implementation of notice and access. The SEC published, on October 14, 2009, a proposing release to change the notice and access model to: (1) "provide additional flexibility regarding the format of the Notice of Internet Availability of Proxy Materials that is sent to shareholders"; (2) create "a new rule that will permit issuers and soliciting shareholders to include explanatory materials regarding the process of receiving and reviewing proxy materials and voting"; and (3) adopt "revisions to the timeframe for delivering a Notice to shareholders when a soliciting person other than the issuer relies on the notice-only option."[8] The SEC indicated in the release that it is proposing these changes because:

"(W)e are concerned by statistics indicating lower shareholder response rates to proxy solicitations when the notice-only option is used. According to Broadridge, the percentage of 'retail' shares voted by shareholders in issuers using the notice-only option for distribution to some portion of their beneficial owners is lower than the percentage in issuers that exclusively use the full-set delivery option to provide proxy materials to their shareholders. In addition, when comparing between shareholders in issuers that used both the notice-only and full set delivery options, the response rates of retail shares voted by shareholders that received notice-only was half that of shareholders that received full set delivery. With regard to the effect on voting by retail account holders, rather than retail shares voted, statistics provided by Broadridge indicate even lower voting response rates for retail accounts that received notice-only instead of full-set delivery."

As reported by Broadridge, data on "retail voting response" rates at companies using N&A for votes during the period from 7/1/08 to 6/30/09 showed that the percentage of retail accounts voted were: 64.26% of those who previously requested to always receive full package materials; 72.31% of those who responded to a notice and requested a full package of materials; and 19.8% of those who received a full package because the issuer chose to send full package materials to a subset of shareholders. In sharp contrast, a mere 4.03% of retail accounts that received only a notice voted their shares. The total percentage of retail accounts voted was just 12.72%.[9]

Commissioner Luis A. Aguilar commented earlier this year on N&A implementation: "As many of you are aware, the number of shareholders who voted through companies using the notice and access model dropped dramatically. Retail investor voting, in particular, plummeted. Some reports indicated less than 5 percent of individual investors voted at meetings held by companies that used e-proxy in late 2007 and early 2008. Other statistics compared the level of participation by the same investors before and after the notice and access model was put in place, and found decreases of over 30% for large investors, and over 60% for smaller investors…(W)e should make sure that cost savings come without compromising effectiveness and adversely impacting an investor's exercise of their rights. That seems to have happened here, and we need to fix e-Proxy or scrap it."[10]

Next year, the situation will only get worse. Amended NYSE Rule 452 goes into effect on January 1, 2010, and will result in steep declines in total retail votes. Companies struggling to bolster

7 Ibid., p.40.

8 Securities and Exchange Commission, "Amendments to Rules Requiring Internet Availability of Proxy Materials" [Release Nos. 33-9073; 34-60825; IC-28946; File No. S7-22-09]. October 14, 2009. http://www.sec.gov/rules/proposed/2009/33-9073.pdf

9 Broadridge, "Notice and Access: Statistical Overview of Use With Beneficial Owners," as of June 30, 2009. http://www.broadridge.com/notice-and-access/NAStatsStory.pdf

10 Commissioner Luis A. Aguilar, "Increasing Accountability and Transparency to Investors," Remarks at "The SEC Speaks 2009," Washington, D.C., February 6, 2009. http://www.sec.gov/news/speech/2009/spch020609laa.htm

retail votes due to the impact of Amended NYSE Rule 452 will be less likely to adopt or continue using N&A. Our assessment is that the Commission likely acted to propose rule changes with regard to notice and access in order to both address lower levels of shareowner participation than anticipated (in response to a worsening situation, since retail shareowners were already voting at low levels on instructional proposals before the advent of N&A) and to hopefully mitigate further declines in retail voting that companies will experience next year if they use N&A in an Amended Rule 452 environment. Focusing simply on declining rates of participation under N&A misses the much more significant trend reflected in what were very low levels of retail shareowner participation even before N&A was first implemented. Moreover, institutional owners, who control a large percentage of shares outstanding for most companies, vote a much greater percentage of the shares they own than do retail owners (who vote, even under a traditional proxy distribution method, at well under 50% of shares held). For a number of reasons described both here and below, the right of retail shareowners to fully participate, and have a voice, in the election of directors (even if through the uninstructed vote from brokers) has now been marginalized to such a degree that it is simply untrue to say that their interests will be adequately represented going forward.

The new Proposing Release from the SEC admitted that the proposed changes will only start to address the problem: "We note that there appears to have been some confusion among shareholders regarding the operation of the notice and access model…There may be other reasons why shareholder participation under the notice and access model, especially by individual shareholders, is lower, and we are soliciting comment on why the participation rates are lower and how best to advance the Commission's regulatory interest in informed shareholder participation."[11]

Our view is that regulators should focus on advancing a broader system-wide objective of increasing retail shareowner participation in the voting process. As we explain in more detail in the next section, a combination of factors has accelerated the rate of decline in total retail participation, both as a percentage of shares held by retail shareowners and by the number of owners voting. These factors reflect a systemic challenge for the SEC: one that can only be adequately addressed through broader reforms of the proxy voting system that will lead to a substantial improvement in retail shareowner participation rates. Our view is that a critical missing element in the SEC's current array of proposed rules changes is an actual proposal to reform the OBO/NOBO system. Toward that end, we offer a solution in the text below (see All Beneficial Owner "ABO" Proposal).

Exclusion of Retail Shareowners

The combination of Amended Rule 452 and N&A, even in an amended form, will lead to the practical exclusion of many retail shareowners from the corporate election process. The impact of N&A on retail voting has been dramatic, but had no effect on director elections as long as Rule 452 permitted brokers to vote for all non-instructing clients. Looking ahead to 2010, companies face a system in which the only companies likely to be enthusiastic about using N&A will be those with retail ownership bases that are not large enough in percentage terms to warrant spending money to mail all individual investors full sets of proxy materials, and who will therefore save significant dollars by implementing N&A. However, the retail ownership bases of many publicly-traded companies are large enough, and the negative impacts of both N&A and Amended Rule 452 on retail vote totals will be substantial enough, to convince thousands of companies, both large and small, to permanently avoid or stop using N&A, even if the SEC's recently proposed rule changes for N&A result in modestly improved response rates from retail shareowners. This forecast of N&A use might change if companies could obtain the information they need to mount more cost-effective and broader-reaching proxy solicitation campaigns while using N&A.

Unless the systematic exclusion of retail shareowners from corporate elections is dealt with, recent and upcoming changes in the proxy process may undermine the efficacy of the proxy voting system.

Consider the following:

- The elimination of Rule 452 voting on director elections, without providing access to all retail owner names for corporations to contact and solicit, unduly concentrates voting power in the hands of institutional investors (activists in particular) and proxy advisory firms.

11 Securities and Exchange Commission, "Amendments to Rules Requiring Internet Availability of Proxy Materials" [Release Nos. 33-9073; 34-60825; IC-28946; File No. S7-22-09]. October 14, 2009.

- While we have been advocating the need for investor education for 31/2 years, we are skeptical of the long-term impact of such education efforts. Education efforts alone will never succeed in engaging a significant portion of the retail shareowner universe on a sustained basis. As a result, companies must be able to actively engage more retail shareowners in the voting process (our ABO proposal [detailed below] would enable companies, or their agents, to solicit all voters). Experience with soliciting NOBOs via telephone has shown that solicitation campaigns can, at times, boost participation rates to more than 50% of retail shares owned (a better result would be expected with regard to ABOs). The negative impact of Amended Rule 452 on retail shareowner participation in the corporate election process is likely to lead to extreme disappointment and increasing costs for many corporate issuers. One need only look at the percentage of retail shareowners who actually vote under N&A to get a glimpse of what the future may hold with regard to the lack of participation by retail shareowners in elections of directors from 2010 onward. Fortunately, it will be relatively easy to track changes in retail voting. What won't be easy to change are the behavior patterns of literally tens of millions of retail shareowners, who for the most part don't see voting for directors as an important responsibility because no one has ever educated them that it is. In addition, many retail shareowners will not take the time to vote, while others are unlikely to vote without active encouragement (behavior patterns comparable to what is generally seen in state and local elections). The question then is: how many years will it take to get retail shareowners "up the learning curve" on these changes, and then motivated enough to participate in numbers sufficient to create an appropriate balance between retail and institutional participation rates in an Amended Rule 452 environment? Therein lies the crux of the problem. Generations of shareholders have not been educated about the need to involve themselves in the proxy voting process. Now, a radical change in that process is occurring, and a substantial retail investor education effort, which the NYSE Proxy Working Group acknowledged a need for in the spring of 2006, is not even out of the starting gate. In this context, it is easy to understand the distress that many companies feel over having to now grapple with the loss of broker voting on routine director elections.
- The current system of mailing proxy voting forms to street name holders has in itself reduced voting by retail shareowners. The templated Broadridge Voting Instruction Form (VIF), which is used to solicit street name votes, is not easy to read or understand. The generic plastic polywrap mailing package, which is used by Broadridge (and others) to mail proxy materials to shareowners, results in the delivery of a package that is not necessarily identifiable as coming from the company that the investor has a connection to. This has created a disconnect in which shareholders do not associate the materials they receive with the company they have invested in. Fortunately, the Commission's recent proposing release on "Amendments to Rules Requiring Internet Availability of Proxy Materials" indicated that the SEC is now looking closely at how the content of a form (N&A-related, but potentially others) can influence shareowner participation in the election process.
- The interests of retail shareowners have become so marginalized that the current discussion about reforming the process for director elections has, until now, focused on a range of issues, but not yet the right of a company to have open access to the identities of all of its owners and the ability to actively solicit these parties (in order to increase the numbers and percentage of shares represented on instructional proposal votes).

Collectively, these factors and others have contributed to a system in which voter participation by retail shareowners has been declining for the last 30+ years (and at a more rapid pace at companies using N&A), while at the same time the influence of institutional investors and proxy advisory firms has increased sharply. Indeed, there have been rules put in place that require money managers, pension funds, mutual funds and others to take a more active role in voting proxies. Institutions, faced with a fiduciary obligation to vote and forced by the complexity of receiving, analyzing, and acting upon numerous proxy statements, have with good reason turned increasingly to outside parties to assist them. In contrast, retail shareowners holding in street name, who generally lack knowledge of, or the financial resources to hire, a proxy advisory firm, will soon be stripped of an ability to rely on their brokers to vote their shares without specific instructions in uncontested director elections. In addition, some are concerned that the election process in place today can involve synthetic votes, and votes from parties investing for only a few days simply to influence voting results, or votes cast or influenced by non-shareholders. This combination of factors raises questions about inequities in, and the integrity of, the proxy process, which we believe the SEC can address, in part, by enabling direct solicitation by companies of all of their shareholders.

Retail shareholders, as a group, are seeing their influence and interests being marginalized. Over the years there have been remarkably few complaints voiced by retail shareowners over the issue of brokers voting on their behalf. Countless millions of shareowners, along with the NYSE and other regulators (until recently), accepted that there was nothing wrong with this approach to director elections. Now regulators are pulling out a safety net in terms of ensuring that the interests of retail shareowners are at least represented in practice when it comes to routine broker voting on director elections. At the same time, we are likely to see continued block-like voting by certain institutional owners in response to policies they have developed or recommendations made to them by proxy advisory firms. Moreover, the playing field is being restructured without any substantive effort (to date) to address the underlying causes of retail voter apathy, including the need for investor education.

Some thirty years ago most shares were held by registered owners with identities that were known to corporations. In 1976, approximately 71% of securities were held in that manner, while approximately 29% were held in street name. By 2005, some 85% of exchange traded securities were held in street name.[12] As retail held shares transitioned from mostly identified to mostly hidden behind "street names," and institutional ownership moved from nominee registration to bank and brokerage firm registration, primarily through accounts custodied at Depository Trust Company ("DTC"), the question of whether to enable companies to learn the identity of owners was examined on several occasions. The SEC has in the past promoted transparency by putting in place requirements for public filings under SEC Rules 13(f), 13(g) and 13(d), and the NOBO/OBO system (to identify non-objecting owners). While such disclosures only provide partial data as to ownership, historically they were widely seen as generally sufficient for corporate needs in an environment in which levels of retail shareowner participation in director elections were far higher than we are likely to see from 2010 onward. However, the playing field when it comes to retail votes has been changing for a number of years already.

Various factors have contributed to retail shareowners voting less often, and representing a smaller percentage of the total number of shares voted at annual meetings on instructional proposals (director elections will become instructional in 2010). First, and foremost, has been the growing power of institutional investors, who now control a much larger percentage of the floats of most publicly-traded companies compared to a generation ago. Retail shareowners are also busier today, and more apathetic about proxy voting. Retail shareowners who are contacted and asked to vote generally give two reasons for why they have not voted: 1) they thought that their broker would take care of voting for them; or 2) they consider their positions "small," and wonder whether their votes would really matter. However, these factors alone cannot fully explain the scale of the decline in retail voting, at least on a percentage of shares held basis.

In light of the Commission's recently released proposals for rule changes affecting notice and access, it is clear that the SEC is keenly aware of the substantial impact that the design of a "form" can have on retail owner participation in corporate elections. Transfer agents, who routinely mail materials to registered shareholders, suggest that they get higher response rates from first mailings than Broadridge does as the proxy agent for virtually all brokers. What could cause this disparity? The Voting Instruction Form used by Broadridge may be a factor. The VIF itself is confusing, does not "feel" as if it has come from the actual corporate issuer, and is not easy to understand or complete. From the issuer's perspective, the VIF cannot be customized, is not user-friendly, and is not the form that is actually filed with the SEC. In addition, among the other differences between transfer agent mailings to registered owners and Broadridge mailings to street name holders are the mail and solicitation advantages that can be realized with direct mailings and solicitation calls to registered owners as compared to problems with how street name accounts are now handled (with mailing delays, high costs, and limitations on who can be called [NOBOs only]). We now have in place a system with a vendor determining for corporate America what the voting forms being mailed to street name shareholders look like, while low response rates when using these forms can create the need for more mailings. Years ago, when companies

12 Reports and data as cited in SEC Release No. 34-60215, File No. SR-NYSE-2006-92: "Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452…" July 1, 2009.

delivered proxy materials directly to brokerage firms, it was the company proxy card that was usually mailed in a brokerage firm envelope, thereby creating a more direct link between a corporation, a shareowner, and the firm that the shareowner held shares through. (We acknowledge that the proxy card with appointment language may not be the appropriate instrument to send to street name holders.) Even today, before Amended Rule 452 takes effect, many corporations seeking to pass instructional proposals are compelled to complete follow-up mailings through Broadridge due to high rates of retail shareowners failing to return the first VIF sent to them and the inability of companies to solicit OBOs. Use of the VIF instead of a more user friendly form has likely contributed to the long-term decline in retail voting, while a similar problem with regard to notices sent to retail shareowners for N&A appears to have accelerated that decline. When solicitation calls are limited to NOBOs in difficult solicitation campaigns, more mailings become a necessity not a luxury. With more and more unlisted phone numbers and cell phones reducing the universe of NOBOs that can be contacted by telephone, follow-up mailings through Broadridge, with associated increases in cost, will become even more prevalent in the future -- unless there are changes to the existing system. Moreover, as a result of significant staffing declines in proxy departments at brokerage firms, which have been driven, in part, over the last thirty years by moves to outsource certain operations to Broadridge, there has also been a substantial downgrading of support to corporations that seek help from brokerage firms in securing the votes of non-responding beneficial owners.

All of these factors indicate that the “street name” solicitation system does not work as well as the direct communications system available for mailing and contacting shareholders who own shares in their own name and not through a broker or bank. Certainly, given that retail shareholders who vote are generally supportive of management, but much less likely to vote than are institutional shareholders, the SEC must move to create a balance between the rights of a company to secure votes from all retail shareowners holding in street name, and the current system which can easily produce a tidal wave of votes against a board member or board recommended proposal from institutions and activists who vote themselves, or from others whose vote is influenced, or cast, by a proxy advisory firm.

That is where things stand today. It is not a system designed to encourage retail shareowner

participation in the voting process. Change is necessary. While we welcomed news on October 14th that the SEC has proposed changes to notice and access rules, we do not believe that changes adopted will result in a significant increase in retail shareowner participation rates. A more targeted approach to getting more retail shareowners involved in voting at company meetings is needed. Moreover, it is also clear that total votes cast in non-contested director elections will decline at virtually every public company annual meeting held in 2010. In light of this prospect, the SEC should consider reforms that would help companies increase total voter participation. Our recommended strategy starts with the following proposal.

All Beneficial Owner (ABO) Proposal

Let us begin by offering some background on the development of our thinking on what we call the ABO proposal. As proxy solicitors, we are constantly impressed by the fact that a significant percentage of NOBOs contacted by telephone because they have not yet voted their shares for a particular company’s meeting do then take the time to vote their shares. The high level of interest and involvement by nonresponding retail shareowners when “engaged in the process” convinces us, more than anything else, that access to all shareowner names under an ABO system will help to improve rates of retail owner participation in the proxy voting process.

In July 2006 we communicated with Catherine Kinney, then President of the NYSE, to express our opposition to the Proxy Working Group (PWG) proposal to amend Rule 452. We also commented on the composition of the PWG, as we felt it had a disproportionately large-cap view of the world. In that communication, we first proposed that the NYSE not seek implementation of its proposed change to Rule 452 unless two things occurred: 1) an All Beneficial Owner approach for corporate meetings be implemented in conjunction with any change to Rule 452; and 2) implementation of a comprehensive investor education effort. The need for a robust investor education effort is something that the SEC acknowledged in its July 1, 2009 order approving Amended Rule 452: “The Commission supports the Proxy Working Group’s efforts to develop, and encourages the NYSE and its member firms to implement, an investor education effort to inform investors about the amendments to NYSE

Rule 452, the proxy voting process, and the importance of voting."[13] Unfortunately, as of mid-October 2009, it was quite clear that there will be insufficient time for the NYSE and its member firms to educate all investors about the rule change before it goes into effect in January 2010.

On July 1, 2007, we communicated to the SEC our opposition to the PWG proposal and reiterated our recommended approach. An ABO model was proposed by us as a reasonable counter-balance to a proposed change to Rule 452. In that communication, and again in a letter dated March 27, 2009, in response to an SEC request for comments on the proposed change in Rule 452, we suggested that the SEC tie any implementation of a changed Rule 452 to the elimination of the distinction between NOBOs and OBOs, and the establishment of ABOs, at least with regard to record dates for annual or special meetings. While others have called for a complete elimination of the distinction between NOBOs and OBOs, with all shareholder names available to the company at all times, and with nominee registration an option for shareholders, we have proposed the ABO methodology as a practical solution to address mailing and solicitation issues through the disclosure of all shareowner names only for use at annual and special meetings, and for a limited number of other circumstances.

We are expanding our request for ABO access to include information requests for corporate actions, including rights offerings, exchange offers and tender offers, as well as for required and voluntary regulatory mailings by mutual funds and other issuers. All securities, including equity and debt, would be subject to ABO rules. The OBO/NOBO distinction would also be replaced by ABO for noteholders and bondholders in any instance where a corporate debtor is either: (1) negotiating a plan of reorganization under Chapter 11 of the Bankruptcy Code, or is seeking creditor approval of such a plan; or (2) negotiating, or has submitted, a "pre-packaged" plan for the approval of its creditors.

The ABO solution requires no new technologies, and only marginal changes in existing software, to be implemented. Nor does this solution require substantial new spending by banks or brokers. For ABO to work it merely requires the SEC to amend a rule that would permit Broadridge, or any other party acting in a similar capacity, to share all names (NOBOs and OBOs, collectively ABOs) with an issuer. The rule change would allow companies the right to request a complete list (i.e., an ABO, or All Beneficial Owners, list) of all their shareholders as of a specific record date. Under ABO, the names of all shareowners (indicating shares held) would be disclosed, including those shareholders who have registered their shares through a nominee account. Companies would not be required to request an ABO list, but would be guaranteed the right to do so. All foreign accounts must also be required to be identified under our ABO methodology. Our vision is not focused exclusively on U.S. markets. Foreign depositories (peers of the DTC), as well as global and local custodians domiciled outside of the U.S., should also be required to identify all beneficial owner names.

Additional costs incurred as a result of initiatives like ABO, which seek to correct major deficiencies in the proxy voting system and deal with issues surrounding the accuracy and fairness of proxy vote counts, are a necessary price to pay for ensuring integrity in the voting process. It is reasonable to consider that corporations ordering an ABO list pay some nominal fee to offset these costs, just as they currently do for a NOBO list. On the other hand, an ABO solution might lead to cost savings for companies and dissidents by reducing the expense associated with mailings to shareholders and proxy solicitation campaigns (because parties will be able to focus solicitation efforts on their larger retail holders with positions held in street name). Confident that they can get the votes they need under ABO, this may actually generate more interest from corporations in using notice and access. If the SEC ultimately decides against the complete elimination of the distinction between NOBOs and OBOs, we believe our ABO proposal, which limits a company's access to an ABO list to generally no more than one or several days per year, adequately addresses the question that some will raise about any new disclosure system being used to "track trading."

With increasing numbers of companies adopting majority voting for director elections (and the possibility that the U.S. Congress might eventually mandate majority voting for all public corporations), companies (large and small) will be facing ever growing numbers of close votes, that is, votes in which small swings in total votes cast from any segment of the shareholder base may determine

13 Ibid., p.21.

the final outcome. We expect to see substantial growth in the number of situations in which the votes, or non-votes, of even a small percentage of the retail shareholder base could be the difference between a director remaining on the board or having to tender a resignation. Moreover, the SEC is currently considering new rules on "proxy access," and reviewing an array of proposals from companies in response to its Proposing Release on "Facilitating Shareholder Director Nominations," which raise the prospect of a sharply escalating number of proxy contests over coming years. Numerous companies submitting comments to the SEC on Proposed Rule 14a-11 have proposed an array of new vote "thresholds," e.g., to determine eligibility for resubmissions of shareholder nominations. (The Altman Group will soon publish a comprehensive study of all 500+ letters submitted to the SEC on proxy access, which we will forward to the SEC.) While we wait for the SEC's decision, sometime in early 2010, on proposed rules for proxy access, the trend is clear - there will be a very sharp increase over coming years in the number of proxy fights and close votes.

If weaknesses in the current proxy voting system are allowed to continue in this environment, then pressure for change will mount as parties lose close votes that could otherwise have been won given full access to all shareholder names. Retail shareowners are far more likely to support management in a contested election or challenging proposal vote than are larger owners or accounts influenced by proxy advisory firms. The ABO model, in our view, is the only workable and fair solution for both companies and dissidents alike, each of which will gain an opportunity to actively solicit heretofore unknown holders.

Some activists, pleased with the steady move toward large owners consolidating their power in corporate elections, may oppose the ABO concept simply because it allows a company to contact all of its retail shareholders (who are generally supportive of management) and gain a comprehensive accounting of all parties that own its shares, including non-filers such as small hedge funds and institutional owners. Of course, since ABO names would be available to all parties engaged in proxy contests (depending on applicable state statutes), any such opposition should be discounted.

Arguments about a need to protect clients from direct contact with the companies they are invested in ring hollow. Many foreign markets require greater levels of disclosure to companies of beneficial ownership – all without negative consequences for market participants. Use of NOBO lists in the U.S. by corporations over the last 25 years has not created confidentiality problems for either brokerage firms or their clients.

In our view, no reasonable argument can be made to deny a company the right to obtain and use for solicitation purposes a fully transparent and reconciled list of its own shareholders in order to establish who actually has the right to vote at a meeting. This "right" is one held by all of a company's shareholders, and not just large or sophisticated owners. It is a shareholder right to expect that the proxy voting process will be structured to maximize participation from all shareholders rather than be tilted in favor of particular groups of shareholders, including those required by regulation or law to vote, or parties that may even be capable of gaming the process. In a speech delivered on May 20, 2009, SEC Chairman Mary Schapiro declared that shareholders have a "fundamental right to nominate and elect members to company Boards of Directors."[14] If we assume that nearly all of the shareholders who will exercise the "fundamental right to nominate" directors will come from the ranks of activists, institutions and other sophisticated shareholders, then we must expect regulators to put into place policies that will ensure that all shareholders, including retail shareowners, are actively encouraged through various solicitation techniques to participate in the process to "elect members to company Boards of Directors." What concerns us most is ensuring that the "elect" part of Chairman Schapiro's statement is ultimately interpreted to mean that all retail shareowners have a fundamental right to fully participate in the election of directors, and not be effectively excluded as a result of rules and processes governing the proxy voting system.

When it comes to identifying and communicating directly with all their securities holders, solvent companies should not have fewer rights than a company operating under the protection of the U.S. Bankruptcy Code. In 1991, Bankruptcy Judge Harold Abramson ordered that the names of all securities holders be identified to enable direct solicitation of them, both NOBO and OBO, in the Southland

14 Chairman Mary L. Schapiro, "Statement at SEC Open Meeting on Facilitating Shareholder Director Nominations," May 20, 2009. http://www.sec.gov/news/speech/2009/spch052009mls.htm

Corporation bankruptcy case. The Judge ordered all securityholder names to be disgorged, both debt and equity holders, in part to ensure that there was a direct audit trail from the vote cast by a securityholder to the tabulation of the securityholder's vote. This situation also led to this author playing a role, nearly eighteen years ago, in developing a new vote methodology still in use today by public companies in the United States.

As a result of questions of law raised by the Abramson decision in Southland concerning, among other issues, numerosity and duplicative voting (issues under the bankruptcy code of some importance), the law firm Weil, Gotshal & Manges asked me to devise a methodology that would enable public company debtors, in cases where a pre-packaged bankruptcy vote was being used (meaning there is no judge to order the disgorgement of securityholder records), to complete votes under the rigorous standard set by Judge Abramson. The method developed, which I coined the Ballot/Master Ballot voting system, has been the standard vote methodology used in public company bankruptcy cases in the U.S. for more than 15 years and has been used in many hundreds of public company bankruptcy votes. The Ballot/Master Ballot voting system is one of two standard securityholder voting methodologies used in the U.S. since 1991. The other is the corporate election system, which is under review at this time. It is also interesting to note that when Broadridge mails bankruptcy voting materials they use actual beneficial owner ballot forms provided to them, and not a VIF. Under an ABO system a debtor could, without a court order, identify and solicit votes from all creditors in the same way a corporation could identify and solicit all of its owners with regard to an annual or special meeting.

Our ABO and related proposals (discussed below) are a call for companies to have the right to obtain more comprehensive "ownership" information, and to be able to use that information for mailing and solicitation purposes. We are not seeking to make it a requirement that they do so. The current system creates tremendous disparities in terms of direct shareholder communications and solicitation opportunities. Why should one company, simply because it is able to identify 80% of its shares from 13F filings and another 10% from NOBO disclosure, have a substantial advantage in terms of conducting effective and broad-based solicitation campaigns over a smaller company that has holders controlling 10% of its shares filing 13Fs and 35% of its shareholders disclosed as NOBOs? In addition, the lists of owners provided by brokerage firms and banks to Broadridge can at times enable too many parties, and hence some non-record date shares, to vote at a meeting, while at the same time shielding the identities of many beneficial owners. Is this really what the SEC and NYSE intend to have as the proxy voting system of the future?

Modernizing the Proxy Mailing and Tabulation Process

We hope that the SEC, as part of its current review of proxy plumbing issues, will examine the financial incentives underpinning a proxy voting system that has as its foundation extremely low response rates from retail shareowners. At minimum, we recommend that the SEC encourage the NYSE to mandate that brokerage firms allocate funds for investor education. After all, brokerage firms have invested little, if any, of the monies paid to them directly by corporations or on a firm-by-firm basis by Broadridge to help deal with brokerage industry issues that have led to declines in votes received by corporations from retail shareholders on instructional proposals.

As is well known, Broadridge has a virtual monopoly position with regard to the distribution of materials and the tabulation of votes from clients of brokerage firms and banks. We do not believe that corporations and retail shareowners are well served by a monopolistic system that uses what some contend is non-market rate pricing, and places unnecessary distance between the votes of shareholders and the corporations or dissidents who need or want those votes.

While rules governing annual meetings drive a substantial revenue stream toward brokerage firms and Broadridge, the corporations who pay NYSE-approved and other rates have neither control over the process nor any ability to change it. In our view, it is the corporate issuers and their shareholders who should be the primary beneficiaries of economies of scale realized through increased efficiencies and greater volumes of mail processed than in years past. If brokerage firms determine that it is in their interest to hire a third party to handle the mailing and processing of proxy materials, the resulting efficiencies should be translated into reduced costs to the corporations footing the bills. Issuers should also be able to choose other parties with possibly more cost-effective approaches to handling mailings to shareholders as well as proxy mailings and tabulations, if they exist.

It is our opinion that the SEC should consider the establishment of an alternate mailing methodology that will create an opportunity for parties other than Broadridge to mail proxy and other materials and tabulate the votes of street name holders, if a corporation deems such a step to be in their best interest. Companies paying the fees for services should be able to undertake N&A and other mailings directly to beneficial owners, and mail proxy materials using a customized proxy form. Even so, Broadridge would likely continue to service the significant majority of all mailing and tabulation projects. Broadridge could also offer mailing and tabulation services using an ABO system. The quality, service and price offered might then become the deciding factors in terms of which vendor a corporation selects to undertake projects under ABO. Needed changes to facilitate such a system might include having each broker assign voting rights through an omnibus proxy process to its clients in much the same way DTC assigns voting rights to its participants. Any new mailing process used by any party, including Broadridge, should be available to be audited by qualified third parties. Of course, there will be issues to work out, such as how electronic votes from institutions using the Broadridge, RiskMetrics, or other voting platforms will be dealt with, or what procedures need to be established to ensure the integrity of votes received directly by corporations or their agents (by mail, telephone, electronically, or voice votes). Such issues are currently being dealt with effectively through procedures established for registered owners.

In addition, the concept of an aggregator of shareholder information, which could make NOBO/OBO (or ABO) and record date information available to a variety of entities, including Broadridge, is one put forward by other commentators. We believe this idea merits very serious consideration by the SEC.

The current proxy mailing process is also facing scrutiny as the SEC considers new rules on proxy access. Numerous companies submitting responses to the SEC's Proposing Release on "Facilitating Shareholder Director Nominations" were critical of the proposed mandate for a universal proxy card that will include both management and shareholder nominees (and more nominees than open board seats). A number of companies urged the SEC to allow companies to have the flexibility to design "user friendly" proxy cards and notices, as well as include a single vote option for the company's nominees as a group – on what could otherwise be a very confusing (for retail shareowners) universal proxy card. Some also asked for greater freedom to include educational materials with "notice" mailings. In our view, the proxy mailing process under the proposed proxy access rules must be flexible enough to permit a "best practice" to emerge as the industry standard and not necessarily default to a model put forward by Broadridge or representatives of the brokerage industry.

Any new mailing/voting system approved by the SEC for use by corporations or their selected agents must preserve the right of a corporation to secure the uninstructed vote for auditors available under Amended Rule 452 to establish quorum at a shareholder meeting. The brokerage firms must also be required, when the issuer (under an ABO system) selects a vendor other than Broadridge to handle the mailing and tabulation of votes, to exercise their rights to vote uninstructed shares under Amended Rule 452 on all routine proposals in exactly the same manner as they handle the process when Broadridge uses the existing mailing/tabulation methodology. Any new system without these requirements will not be workable. In this regard, while there are some complicated issues that will need to be resolved, we are confident that workable solutions can be found.

As for market acceptance of the ABO concept, we strongly believe that a significantly greater number of companies will order ABO lists than have previously ordered NOBO lists. Corporations seeking to either secure additional votes to elect directors or generally increase the number of shares voting in director elections will ensure that this occurs. Furthermore, many more companies are likely to order ABO lists to actively solicit owners for director votes and in support of various proposals than will elect to use an alternate mailing approach under ABO.

In our view, the objective of reform should not be to impose a universal system, but rather to make available more choices, and more cost-effective solutions, to all companies. Indeed, we do not want new rules imposing a new mailing/voting system on companies that are content to continue using the current Broadridge-centered system. On a related note, we do not think the SEC should mandate use of a new mail/tabulation system under ABO, but might simply wish to consider whether to require its use in certain situations, including proxy fights, withhold campaigns, merger votes, or other special situations.

Audit Trail Under the ABO Process

There have been complaints about the inability to audit street name votes in close proposal votes, withhold vote campaigns, and proxy fights. It is interesting to note that the records of transfer agents and other parties receiving and recording votes of registered owners are fully auditable. Proxy solicitors also digitally record calls when securing telephone votes from shareholders and then send confirmation letters, creating both a fully auditable trail of each conversation they have and an opportunity for an owner to change a vote if they wish to do so. A clear audit trail is not generally available with regard to the VIFs received for street name accounts under the current system.

One of the key advantages of using the ABO methodology would be that for the first time there would be an audit trail available to verify votes cast by clients of banks and brokers in all elections in which a company chooses to take control of the mailing/tabulation process from Broadridge or the company selects Broadridge to handle its mailing/tabulation using the ABO approach. The value of this approach would be most evident in confirming votes in close elections, withhold campaigns, or proxy fights. The ABO methodology might add to the cost of tabulating results in certain situations, but the objective of verifiable results is surely worth the price.

Who Benefits from ABO?

With an ABO system in place, regulators would benefit from more transparency, greater disclosure, and increased participation in the voting process by retail shareowners, which would also improve the integrity of the proxy voting system. Corporations and other parties soliciting votes in a close election would benefit by ensuring that their messages reach "all" shareholders. Retail shareholders would benefit by having a greater say in corporate decision-making than is possible under the system that will come into effect on January 1, 2010. Voting results would also represent more closely than through the current system the will of "all" shareholders. Under ABO, noncontested solicitation campaigns would generally be more effective, completed faster, and involve fewer follow-up mailings. While The Altman Group and its competitors, as proxy solicitors, might arguably benefit from access to additional names identified under ABO, revenues from telephone solicitation fees associated with many assignments would actually decline. This is because a smaller number of larger holders could be contacted in order to reach client objectives. With proxy solicitors expected to benefit from increased demand for their services as a result of Amended Rule 452, adoption of ABO will help to hold down the costs to companies of solicitation efforts that were not necessary when brokers could vote uninstructed shares for directors.

Other Issues:

While the ABO proposal addresses one of the most critical problems that we see in terms of "proxy plumbing" issues, there are a range of other weaknesses in the mechanics of the proxy process that also need to be addressed. In the following analysis, our description of each issue is followed by a possible solution. We recognize that some of the issues are complex. What we present below are possible solutions, which should be viewed as starting points for further discussion. We remain open to considering alternative approaches to fixing each problem.

Overvoting

Overvoting usually results from the practice of share lending due to short sales or brokers who do not net out their long and short positions, which can sometimes lead to a broker having clients cast more votes than the firm has in its position at DTC. While the problem of overvoting is not as prevalent as it was just a few years ago, it still persists because some brokerage firms apparently prefer not to pre-reconcile voting rights with regard to annual meetings. As a result, there is still a serious question as to whether accurate voting lists are always being used.

Altman Solution: A complete list of owners (as available in an ABO system), segregated by share amounts associated with each firm, would enable companies to easily identify potential overvote situations, e.g., situations where brokers or banks identify more shares than DTC records indicate are eligible to vote. The issue of transparency and overvoting by brokers could be addressed via this simple change. Some in the financial community may feel pressured by the challenges and difficulties associated with pre-reconciling voting rights. If the lists they now produce are accurate, then no additional work would be required. However, if the lists are inaccurate, then obviously the reporting process needs to be improved. With an increasing number of votes each year ending up with very small margins of victory or defeat, this issue must be dealt with.

Shares on Loan / "Empty Voting"

Firms using borrowed shares, derivatives, and other transactions to influence the outcomes of votes--with minimal or even a negative economic interest, so-called "empty voting," is an issue raised by former SEC Commissioner Paul S. Atkins back in January

2007.[15] He did so following publication of an article on the problem by Professors Henry Hu (now Director of the Commission's new Division of Risk, Strategy, and Financial Innovation) and Bernard Black titled "The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership."[16] Despite the view of many on Wall Street that existing regulations and practices render concerns about "empty voting" of little or no consequence, it is clear to us, and in the record of submissions to the SEC by various companies that many corporations view this particular issue as one of significant concern. Since the issue of uninstructed broker voting without an "economic interest" in the company ("empty voting") played a role in the decision to Amend Rule 452, the SEC should now address the issue of "empty votes" by activist investors and others.

Changes in voting rights for institutions that have loaned out shares, and the often undisclosed changes in voting power for those who have borrowed shares or passed them along to new owners on the buy side of short sales, present a complex issue when it comes to promoting transparency with regard to voting rights. Corporations looking at 13F reports have no way of knowing how many shares reporting institutions can actually vote, net of any loaned or borrowed shares. Another issue is the lack of timely disclosures of substantial changes in voting rights in the period of time from the end of a calendar quarter through the record date for a vote. In addition, institutions have commented that if they were made aware of what issues were being considered at an annual meeting in advance of the record date they would have an opportunity to make a decision as to whether or not to lend shares, or recall shares already loaned out in order to reclaim their voting rights.

Altman Solutions. We have two distinctly different proposals.

First— Substantial differences in voting rights vs. disclosed ownership should, in itself, be subject to disclosure. Contingent upon a triggering event (e.g., a defined % change), the SEC should consider requiring 13(f) filing institutions to not only identify holdings, but also voting rights in their control as well as those passed to others through loans. Such disclosures should not necessarily be limited to the end of each quarter.

Second— The SEC should seek to establish a voluntary system that would enable corporations, on a pre-record date basis, to inform interested parties of the nature of the agenda items that will be considered at the annual meeting. For example, companies with routine agendas can so indicate. Because of market sensitive information or other issues requiring confidentiality, companies would not be required to participate in this system. A company could also identify that they will have a non-routine agenda, and even identify the type of agenda items to be considered if they choose to do so. Such a system, which we first conceived of and discussed in July 2009 with Hye-Won Choi, in her capacity as the head of corporate governance at TIAACREF, would enable institutions to determine whether they wish to recall shares out on loan based on the agenda items to be considered.

Opaque Ownership

The use of financial derivatives to obscure a shareowner's actual ownership position (and/or nondisclosed voting rights) from an issuer poses significant challenges for companies. The requirement to disclose artificial ownership or voting positions is still murky and not specifically covered by Commission disclosure rules requiring transparency of ownership positions, even in those cases where an entity would otherwise be required to file under 13(d),13(f) or 13(g).

Altman Solution: The SEC should require all beneficial owners who have disposed of voting rights in excess of a pre-determined percentage, and within a time frame surrounding the record date of a particular company's meeting, to identify any situation where they have voting rights for fewer shares than are being disclosed in their 13F or other filings. Likewise, all parties who have increased their voting rights substantially should also be required to file in a timely manner - so that previously undisclosed voting blocks will become information accessible to corporate issuers. A privacy argument has been used in the past by institutions that do not wish to have their ownership or derivative positions disclosed, fearing it might reveal trading strategies. While periodic public disclosures might be done within 13F filings (for example, adding a column disclosing total actual voting rights in a company's stock after accounting for loans or other items that result in a material change in net voting rights), event-driven reports could be structured as confidential disclosures made available solely to the issuer or its agent, and only for a narrow

15 http://www.sec.gov/news/speech/2007/spch012207psa.htm

16 Hu, Henry T.C. and Black, Bernard S., "The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership," Southern California Law Review, Vol. 79, pp. 811-908, 2006.

range of record dates, including those for the company's annual meeting, special meetings, an exchange offer, bankruptcy vote, etc.

More Timely Disclosures

Issuers are now required to disclose the record date for their annual or special meetings earlier than they need to, which, given advances in technology, trading strategies, and the use of derivatives and stock loans, may work to a company's detriment. In contrast, institutions are submitting typically "stale" information with regard to ownership and voting rights. Technology has advanced far enough to consider leveling the playing field in terms of timeliness of disclosures. While the number of days for companies to give advance notice of a record date for an annual meeting can be easily changed, the more challenging hurdle will be to have institutional investors file more timely 13(f) disclosures.

Altman Solution: The advance notice requirement of a record date for an annual meeting should be reduced to 10 business days. Rule 13(f) filings should be due within 15 days after the close of the quarter. Consider the following scenario. Institutions can delay filing their 13F form for up to 45 days after the end of a quarter (in this example, for a position held as of March 31). Now, if that same date (March 31) is also the record date for a company's annual meeting held before May 15 (the final date for required 13F submissions showing holdings at March 31), the company may not have an accurate accounting of its "street" held institutional shareholder base and lack visibility as to who has voting rights for the annual meeting. Such delay makes little sense when NOBO requests and company record date information are available on a several day turnaround basis from Broadridge. We also take note that a significant number of 13(f) reporting institutions (large and small) are not only able, but already have processes in place, to meet a quarter-end + 15 day filing schedule for their 13F forms. Moreover, many institutions subject to 13(f) filing requirements are also able to deliver quarterly statements to their clients within a few weeks after the end of each quarter.

Investor Education

Both the SEC, in its order approving Amended Rule 452, and the Proxy Working Group, in its report of June 5, 2006, have previously acknowledged the need for a substantial investor education effort on the proxy voting process and the impact of changes resulting from Amended Rule 452. However, no substantial education effort on this subject has ever been launched, let alone initiated in time to show significant progress in preparing individual shareowners for the transition in broker voting taking place on January 1. Perhaps the daunting nature of the task, or anticipated costs, have slowed progress. It is our view that the NYSE should never have issued the Proxy Working Group recommendation to amend Rule 452 without first outlining and then implementing an investor education process. The NYSE was aware, or all decision-makers should have been aware, that Amended Rule 452 was going to compound a long-term problem marked by low participation rates for retail shareowners with regard to instructional proposals.

Commissioner Elisse B. Walter recently commented that with regard to the implementation of Amended Rule 452: "We all need to make sure that shareholders understand these changes and what they mean for the upcoming proxy season. We at the SEC will be doing our part to educate investors, and I hope that all of you will do the same."[17] Since no education effort was started when the NYSE first asked for approval of Amended Rule 452, and here we are in late 2009 with no program in place, we offer below a possible starting point for what will have to be a long-term and sustained education program. It will take long-term and sustained efforts for investor education on proxy voting to have even a modest impact on retail shareholder participation in corporate elections. The scale of that task, as well as vote shortfalls, will only be partially ameliorated by a projected increase in the number of solicitation campaigns over coming years.

Indeed, telephone solicitation efforts, which inform shareowners that their votes are important and that their brokers are not permitted to vote for them, should be viewed as another element of investor education. As a result, we encourage the SEC to establish a process for monitoring both investor education efforts and progress in improving participation by retail shareowners in the proxy voting system. The SEC should also track the impact on retail voting of solicitation campaigns, and compare the dramatic differences in results between companies using mail only vs. a combined mail and telephone solicitation approach.

17 Commissioner Elisse B. Walter, "SEC Rulemaking – Advancing the Law to Protect Investors," Comments before the 48th Annual Corporate Counsel Institute (Northwestern University School of Law, Oct. 2, 2009).

Altman Solution: The NYSE should mandate that all member firms distribute educational information concerning "proxy voting" to all new clients from a pre-selected start date forward. The NYSE and NASDAQ OMX could also jointly prepare educational tutorials (print/videos/e-learning) on client voting that all brokers can refer clients to. Good educational information about voting is now available online from Broadridge.

As for existing retail shareowners, every member firm of the NYSE, as well as all other firms who clear through member firms, should be required to participate in an ongoing education effort that would require all firms to mail educational inserts concerning "voting" together with their statements to clients. These printed materials can be developed by individual firms for use with their clients, subject to an established procedure, or the firm can use materials prepared and printed by a joint NASDAQ/NYSE committee.

Since firms are already paying for postage and the envelope used to mail monthly statements, the only incremental cost might be a few pennies per customer per month, to aid the cause of investor education. Given the revenue received over the years by the brokerage firms through their proxy departments on the fees paid to them by Broadridge (for the right to mail materials to their customers and charge corporate issuers for those mailings), it seems appropriate that brokers should be willing to incur a modest cost per account – paid over a period of time - in order to fund a multi-year education effort. The internet and e-mail could also be used, e.g., in cases where a broker distributes monthly statements electronically, and to support the information needs of shareholders who prefer to obtain information online. Details on this suggestion can be easily worked out in a short period of time because all of the mechanics are already in place. Informational inserts could also be included in proxy packages distributed by Broadridge or another party managing a mailing under ABO. The NYSE, individual brokerage firms or corporations could easily prepare explanatory materials concerning the importance of voting. Corporations would pay for any inserts they produce, but not for those prepared by brokerage firms or for any other education efforts undertaken by the NYSE or brokerage firms.

After years of discussion and no action by either the SEC or NYSE on a major education effort,

Amended Rule 452 creates a new urgency for the NYSE to adopt, or the SEC to mandate the implementation of, an effective initial effort on this issue. We believe that such an effort can be undertaken inexpensively. The basic proposal outlined above could be implemented by the spring 2010 proxy season, particularly so if it is given a priority comparable to the Commission's apparent willingness to address problems with N&A on an expedited basis (including directing the Office of Investor Education and Advocacy to develop a program designed to educate and inform shareholders about the notice and access model).[18]

Any additional proposals adopted must be broad-based and designed to engage shareholders' interest. No doubt the NYSE, SEC, and others will wish to add other dimensions to the approach recommended here. We would wholeheartedly support such initiatives.

Conclusion:

Some of the issues that we have raised concerning the mechanics of the proxy voting system may appear on the surface to be difficult to resolve, but are open to practical solutions. In our view, it is most important to focus regulatory reviews and potential action on improving access to shareholder names through the adoption of ABO, which will help to increase participation rates of retail shareowners at all meetings where direct mail or telephone solicitation efforts are used. It is also vital to focus on increased accuracy of vote tabulations, which can be accomplished through the availability of an audit trail for the solicitation of street name holders conducted using the ABO approach. The ABO approach is a practical, inexpensive, and achievable solution. In addition, we look forward to exploring any solution that will ensure the integrity, fairness, and openness of proxy voting, as well as helping companies and other parties who are soliciting votes to identify and communicate with all shareowners who possess actual voting rights. Implementing any or all of the proposals outlined herein will go a long way toward meeting those objectives.

18 Securities and Exchange Commission, "Amendments to Rules Requiring Internet Availability Release Nos. 33-9073; 34-60825; IC-28946; File No. S7-22-09]. October 14, 2009.

Momentous Changes Ahead for U.S. Corporate Governance

Carol Bowie, RiskMetrics Governance Institute,
Ted Allen, Risk&Governance Weekly Editor

The last year has seen a number of developments that are likely to affect corporate governance more dramatically than any since Sarbanes Oxley legislation in 2002, and perhaps since introduction of comprehensive securities laws in the 1930's. The triumvirate of the Securities and Exchange Commission (SEC), the U.S. Congress, and the Obama administration's Treasury Department has introduced an array of proposals related to board directors, executive pay, and proxy voting. While not all of these may ultimately be adopted, it's clear that they will continue to push the pendulum of influence in shareholders' direction, with the expectation that informed and empowered investors will provide market-based regulation of corporate governance practices that help create and preserve value.

The commentary below represents the views of RiskMetrics Group, not necessarily of our clients, on the recent key developments and proposals under consideration.

SEC Actions: Enhancing Disclosure and Shareholder Influence

Broker Voting

Under the new leadership of Mary Schapiro, the SEC has accelerated activity that had stalled under its prior chairman. On July 1, for example, the SEC gave final approval to a New York Stock Exchange rule change to bar brokers from casting uninstructed client shares in uncontested director elections starting in 2010. The 3-2 partisan vote mirrored the divide on this issue between investor advocates, who welcomed the action, and many in the business community who assert that it will diminish the influence of retail shareholders, increase the number of directors who lose their seats each year, and impose additional costs on issuers.

RiskMetrics shares the SEC's view that uninstructed broker voting can have a "distortive" effect on director elections, and on "vote no" campaigns in particular. Most investors believe that votes should be cast by those who have an economic stake in companies. Director accountability is a hallmark of corporate governance, and the assurance that director elections will reflect only the sentiments of investors whose interests are focused on that accountability will help to ensure it.

Elimination of broker voting will benefit investors by increasing the power of their votes. Broadridge Investor Services estimates that broker votes accounted for 19 percent of votes cast, on average, at U.S. companies during the 2009 season, so it is clear that the change could significantly increase the number of directors who fail to receive majority support. With more than two-thirds of S&P 500 companies having adopted a majority voting bylaw or a director resignation policy, more boards will have to decide whether to accept director resignations over governance issues.

RiskMetrics also supports the SEC's commitment to address other proxy voting issues – the "plumbing" problems of vote transmission that have long plagued the process both domestically and internationally, and the SEC's promised effort to promote informed voting by retail investors, so that all shareholders participate in this vital responsibility of ownership.

Proxy Access

By a similar divided vote on May 20, the SEC proposed yet another proxy access rule, which the commission originally slated to have in place before the 2010 proxy season. In contrast to a majority election standard -- which enables shareholders to preclude unacceptable nominees from taking or continuing in office -- proxy access would provide a complementary tool for investors to impact the quality of boards and, importantly, to further the aim of ensuring that directors are accountable.

The proposed Rule 14a-11 would impose a sliding ownership threshold based on market capitalization (or net assets in the case of investment companies) that reflects existing SEC classifications for companies. For "large accelerated filers," or those with more than $700 million in worldwide market value, the minimum ownership percentage would be 1 percent of the voting securities. At "accelerated filers" (firms with a worldwide market value between $75 million and $700 million), the threshold would be 3 percent. At "non-accelerated filers" (companies with less than $75 million in market value), the threshold would be 5 percent. Investors would be allowed to aggregate their holdings to meet these ownership requirements.

The draft rule requires a one-year minimum ownership period, which is less than the two-year requirement backed by the Council of Institutional Investors and found in some corporate bylaws. The draft rule would permit investors to nominate candidates for up to 25 percent of the board. In the event that nominees from multiple investor groups exceeded this cap, the first filer would have priority. The filing deadlines would be the same as for shareholder proposals, unless a company has set a different deadline in an advance notice bylaw.

The SEC also seeks to amend Rule 14a-8(i)(8), to permit investors to resume filing access bylaw proposals at companies, provided that the resolutions don't conflict with the proposed Rule 14a-11.

As outlined in our August 14 comment letter regarding the SEC's proxy access proposal, RiskMetrics believes that it generally provides reasonable parameters in giving substantial, long-term shareholders the ability to put forth a limited number of director nominees without the cost and burden of a proxy contest. Along with others, we recommended that the Commission consider several modifications to the proposed rule; for example, to give priority to the shareholder or group owning the largest stake, rather than the first to submit a nominee, in the event that more shareholder nominated candidates are proposed than the imposed maximum would permit for an election. We expect an SEC-sanctioned proxy access process to contain safeguards to prevent abuses by special-interest groups and to ensure that shareholders have sufficient information on which to base voting decisions. Institutional investors approach corporate governance in a thoughtful manner, with the overriding aim of building value for their portfolio companies, and they are likely to use a proxy access mechanism judiciously.

The SEC recently signaled that it requires more time to craft a final rule, which would not be issued in time to impact proxy season 2010. We expect to see later that year, however.

New Disclosure Requirements

On July 1, the SEC unanimously voted to propose new rules that call for more information on the risks related to compensation programs, other services performed by pay consultants, director qualifications, and board leadership structures. These proposals also include a new mandate that companies disclose proxy vote results in an 8-K filing within four business days of an annual meeting, instead of up to several months later in a quarterly filing.

The key proxy rules, which may ultimately be supplemented or superseded by legislation, call for disclosure on:

- *The relationship of a company's overall compensation policies to risk.* SEC officials said companies would only be required to address "material" risks.
- *The qualifications of director nominees and how their skills would help them to serve on the board and perform their specific committee assignments.* In addition, companies would have to provide details on outside directorships held during the past five years, instead of only current board memberships, as well as involvement in legal proceedings over the prior 10 years instead of five.
- *Board leadership structure.* Companies would have to explain why they decided to appoint a non-executive chairman or chose to combine the roles of board chair and CEO.
- *Potential conflicts of interests of compensation consultants.* Companies would have to provide details on other services performed by pay advisers and the fees paid for that work.

In addition to providing fuller information to shareholders, these requirements will ensure that management and directors consider each of these issues and provide a rationale for their actions. The financial crisis not only demonstrated the critical importance of robust risk management systems, but also underscored the vulnerability of a corporation's long-term health when incentive structures and programs are overly driven by short-term performance results. At the same time, disclosure of specific director qualifications is long overdue, as shareholders have often had little understanding of why certain directors serve on specific committees or, in some cases, on the board at all.

Board leadership structures have also been an important topic in the aftermath of the economic meltdown. The view that independent leadership is an essential component of good governance continues to gain currency, and compelling issuers to explain the rationale for their chosen leadership structure will help ensure that the preference is justified and not simply a matter of custom. Finally, the influence of compensation consultants on executive pay practices cannot be understated. While it is unlikely that most consultants would compromise the integrity of their advice in order to gain other services, investors deserve to have a complete picture of a consultant's revenue so that they can make informed decisions regarding potential conflicts of interest.

The SEC initiatives additionally revise the disclosure of equity compensation on the Summary Compensation Tables in corporate proxies. Going forward, companies will report the aggregate grant date fair value (per FAS 123R) of equity granted during the previous fiscal year, instead of the current accounting value of previous grants. This change will give shareholders a more meaningful picture of executives' annual pay in determining whether it is warranted by company performance.

On September 10, RiskMetrics submitted an extensive comment letter in response to the draft rule, expressing support for the spirit and objectives of the SEC's latest effort to provide meaningful transparency on key governance issues to shareowners, and suggesting additional areas where executive pay disclosures could be improved.

The commission also issued draft rules that address the annual advisory vote on pay that is currently required of all firms participating in the Troubled Asset Relief Program (TARP). The comment periods have now closed for both proposed rules, and SEC officials hope to have final rules in place before the 2010 proxy season.

Legislative Proposals: Potentially Far-reaching Corporate Governance Regulation

Legislative activity continues to unfold. In the past few months, Senator Charles Schumer of New York and Rep. Gary Peters of Michigan, both Democrats, have separately introduced wide-ranging governance reform bills. On July 16, the U.S. Treasury Department delivered draft legislation to Congress that would require all public companies to hold an annual advisory vote on compensation and to offer separate votes on "golden parachute" payments when shareholders vote on mergers or other transactions.

The Treasury also called for Congress to take steps to ensure the independence of compensation committees and their process for evaluating and approving executive pay. If enacted, this bill would implement three requirements to that end. First, it requires members of the compensation committee to meet new standards for independence, just as Sarbanes-Oxley did for audit committee members. Second, to ensure that committees are receiving objective advice, any compensation consultants and legal counsel the committee hires would have to be independent from company management. Finally, the legislation also requires that compensation committees be given the authority and funding to hire such independent compensation consultants, as well as outside counsel and other advisers, who can help ensure that the committee negotiates pay packages in the best interests of shareholders. At the same time, if the committee decides not to use its own compensation consultant, it would have to explain that decision to shareholders.

Rep. Barney Frank (D-Mass.) who chairs the House of Representatives' Financial Services Committee, acted quickly on the Treasury's draft legislation. H.R. 3269 was approved by the House and would mandate annual advisory votes on compensation as well as separate advisory votes by shareholders to approve change-in-control related payments to executives. It's less clear when the Senate will act on the bill, but Senator Christopher Dodd (D-Conn.), who chairs the Senate Banking Committee, was the main proponent of requiring TARP participant financial firms to hold advisory compensation votes this year, and he has also indicated support for broadening the mandate.

Dubbed the “Shareholder Bill of Rights Act of 2009” (Senate Bill 1074), Schumer’s legislation would also require issuers to hold an advisory “say on pay” vote at every shareholder meeting where executive compensation disclosure is required, as well as a separate vote on golden parachute arrangements to accompany votes on mergers, acquisitions, or sales of substantially all of an issuer’s assets.

Schumer’s bill also directs the SEC to establish rules to allow investors to nominate directors to appear on issuer proxy statements. While that was overtaken by the SEC’s recent proxy access proposal, if this bill or a similar one is adopted, the language could help the SEC fend off a legal challenge from access opponents who assert that the agency lacks the authority to adopt such a rule.

If Schumer’s legislation does become law, most if not all companies would also be required to appoint independent board chairs, eliminate staggered board terms, establish new risk committees comprised of independent directors, and adopt a majority vote standard in uncontested director elections. The bill directs the SEC to act within a year to require the national exchanges to make these four mandates part of their listing standards. The legislation authorizes the SEC to exempt companies based on size, market capitalization, public float, or the number of shareholders of record, however.

While Peters’ bill, “The Shareholder Empowerment Act of 2009,” has many similarities with Schumer’s, the Michigan lawmaker also seeks to prohibit compensation committee advisors from performing other work for management, as included in the more recent Treasury proposed legislation.

Seeking to “curb excessive risk-taking,” Peters’ legislation also would require companies to inform shareholders about the performance targets used to determine bonuses and other incentives. And, his bill would require companies to adopt “claw-back” policies and prohibit severance payments to executives who are terminated for “poor” performance, similar to requirements currently affecting financial firms that have received assistance under the Troubled Assets Relief Program (TARP).

The prospects for the various bills are uncertain, though they are likely to be aggregated into one set of proposals in final legislation sent for President Obama’s signature. The latest proposals, with administration backing, initially appeared to be on a fast track; but while Democrats control the White House and both chambers of Congress, they do have other priorities (health care reform, climate change, and financial industry regulatory reform), which may leave less time for wide-reaching controversial governance legislation this year. In the meantime, as described above, recent disclosure related proposals from the SEC could be seen as paving the way for stronger regulation or potentially pre-empting it. RiskMetrics has advocated support for several reforms included in the various proposals but, like many investors, generally prefers market, rather than legislative, regulation of governance practices.

Say on Pay

This issue deserves special mention, since multiple bills all would enact advisory votes on pay, and the Obama administration has expressed strong support for requiring it. The SEC is preparing rules for TARP companies that currently must include these votes on their annual meeting ballots. While investors are not unanimous in backing the “say on pay” initiative in the U.S., they have demonstrated substantial and growing support for the concept -- average support from votes cast on say-on-pay shareholder proposals this year is nearly 47 percent, up from about 41 percent in 2008. What’s more, according to RiskMetrics’ records, shareholders gave majority support to the proposal at 22 companies this year, compared with 11 last year.

Annual advisory votes would give shareholders an opportunity to communicate collectively their views about companies’ executive pay practices. Rather than the “blunt instrument” of votes against compensation committee members that is investors’ primary recourse in most cases today, advisory votes can provide a meaningful way to alert directors of concerns about top managers’ compensation. As important, regular advisory votes will promote both candor and engagement on key pay issues before the annual meeting, thus providing a more effective market mechanism to encourage reasonable, performance-based pay programs that create and sustain shareholder value.

For 2008, RiskMetrics developed a set of global principles as the framework for all advisory vote evaluations, and also implemented a specific policy for "say on pay" at U.S. issuers, which at that time numbered less than 10. The mandate for all TARP participants to provide advisory votes in 2009 led to more than 300 such evaluations this year. The U.S. analyses focus on areas such as pay-for-performance and peer group benchmarking evaluations; examination of problematic pay practices such as excessive perquisites and severance arrangements; and board communication and responsiveness. Our approach is detailed in the RiskMetrics voting policy at http://www.riskmetrics.com/policy). As "say on pay" becomes a standard ballot item, either through voluntary or mandated adoption, our primary goal will continue to be to assist investors in evaluating whether executive pay decisions are aligned with shareholders' interests.

Moving Forward

Regardless of the outcome of pending initiatives, it is clear that the governance landscape is shifting. Both corporations and investors are still reeling from the near collapse of the global financial system and its aftermath, and shareholders want assurance that their interests will be protected when this crisis passes. While some worry that director election changes and annual compensation votes will lead to a more contentious environment, the need for increased accountability is paramount. At the same time, key market players will continue to benefit from exposure to multiple perspectives and opinions. To help foster that, RiskMetrics has also created a new platform, the Governance Exchange (www.governanceexchange.com), to provide shareholders, board directors, and corporate managers opportunities for secure online dialogue around critical issues in governance and sustainability, along with timely research and web casts. As the developments discussed above take hold, the Governance Exchange and similar platforms will encourage constructive engagement around the ongoing challenges that face both the owners and managers of today's corporations.

The Future of Corporate Governance

Richard Ferlauto, Director, Corporate Governance and Pension Investment
American Federation of State, County and Municipal Employees

With action likely by the Securities and Exchange Commission and the Congress on proxy access, "say on pay", and enhanced risk disclosure many fundamental shareowner rights, for years in dispute, will have been achieved. With codification of these rights, the time has passed for a check-the-box approach to corporate governance. So going forward the discussion of shareowner rights ought to evolve into serious consideration of the responsibilities of both directors and shareowners embracing an approach to governance based upon the principles of transparency, accountability and responsibility. Shareowners and directors have a shared responsibility for corporate governance—if governance is to create true long term value. It is not just about directors any longer; investors and the agents of beneficial owners, such as mutual funds, need to come under equal scrutiny.

In this environment, we also need to reinvigorate regulators to structure new rules of disclosure and communications, while to insuring that investors are protected. No matter how effectively a new a corporate governance regime might empower investors, governance alone cannot replace a strong regulatory framework. Enhanced disclosure, better enforcement, higher fiduciary standards and improved investor remedies will be required to rebuild faith in a system that has been badly shaken by the financial meltdown and the Madoff scandals.

For directors:

The director is center stage with proxy access looming for director nominations and "say on pay" about to stare down the necks of compensation committee members. So how do directors stack up when it comes to shareowner interests for transparency, accountability and responsibility? Are directors ready, able and willing to step up to the plate? According to the recent opinion poll of investors by ShareOwners.org, 91% of investors think that corporate directors are primarily responsible for the financial melt down and our current economic crisis. That is a huge and damning number-- which hopefully will get directors to take notice and change their act.

Directors should ask themselves whether or not they can succinctly articulate a three to five year strategic vision for their company; never mind that true long run planning requires an even longer time frame. Certainly, directors now can appreciate the importance of their responsibilities regarding oversight of enterprise risk and must insure that risk exposure is clearly disclosed to owners and other stakeholders. A prerequisite to "long-termism" is a board focused on strategic planning, alignment of corporate resources with incentives for plan implementation, and comprehensive risk assessment.

Directors and boards need to take seriously their obligation to shareowners to evaluate their own performance by having systems in place to regularly review their efforts and collect feedback from their investors. These procedures might include peer-to-peer director evaluations managed by third party professionals, public disclosure of the qualifications of director nominees including publication of their governance philosophy and view of the firm. And nominating systems should be put in place that bring new blood onto the board, including ways to shake-up stagnant boards that tend to be asleep when it comes to dealing with a big challenge. This may mean using new methods for expanding the pool of board nominees such as proxy access as well as mechanisms for retiring directors who are dead wood. Even more important, directors should understand the benefits of frequent contact with shareowners and look for new tools for directly communicating with shareholders.

Executive pay is immediately on the table because of the public outrage from Americans not immune from economic distress in the way that corporate chieftains are insulated by their compensation schemes. For years excessive executive pay has been a red flag for investors-- often indicating weak boards, faulty use of incentives and the failure of succession planning. These board failures will not be overcome by legislation (even though "say on pay" legislation will become law because boards failed to voluntarily embrace reforms when given the opportunity). Directors on their own must reconsider current pay models, based peer benchmarking for executive recruitment and retention, driven by the compensation consultant industry. Peer group benchmarking is a limited approach that has little connection to creating wealth for shareholders. Compensation committee directors ought to be focused on pay that is related to long-term success, complexity of executive task and the efficient allocation of the human resource budget.

For Shareowners:

Shareowner and board communications are paramount, challenging institutional shareowners to responsibility execute their obligation to monitor and oversee the well functioning of the board. Now that they will have the power to replace them, shareowners must communicate the new rules of the game to the directors. These rules must be deemed fair and appropriate to be legitimate. Institutional investors, whether asset owners or asset managers, need to be transparent in their decision-making, dedicate the needed resources for board oversight and have access to expertise to make informed decisions.

Tops on the agenda, financial intermediaries for many retail investors— mutual funds and ETFs need to fairly reflect the interests of their beneficial owners and not their own internal and perhaps conflicting interests, such as pressure to grow their 401k asset management business. The voices of the individual/retail shareholder-- with limited opportunities to engage with securities regulators, corporate directors and the makers of financial intermediaries-- need to be heard with more frequency. Reaching out to the retail investor increases in importance with the collapse of 401(k)-type plans, which hold the long term retirement assets of many families.

ShareOwners.org, a new nonprofit and nonpartisan organization dedicated to shareholder education has been launched to give such a voice to investors. Shareowners.org recently completed a major new survey of 1,256 U.S. investors conducted by Opinion Research Corporation (ORC), which found that more than three out of four American investors (79 percent) want to “see strong action taken to correct the problems that exist today” in the financial markets, including over a third (34 percent) who are “angry” about the debacle on Wall Street and the related failure of regulatory oversight.

The survey also reveals that three out of five investors (58 percent) are “less confident in the fairness of the financial markets” today than they were one year ago and that more than half of American investors (52 percent) say “more information and online education about your rights and duties as a shareholder” would make them more confident about the fairness of the financial markets.

The SEC has taken steps in this direction by creating an Investors Advisory Committee, which could provide venue at the Commission, that reaches out to the average retail investor through increased educational programming, new technologies and an emphasis on plain English communication and transparent procedures for access to the Commission. It is important to remember that these retail investors also are often plan beneficiaries of large institutional investors such as pension funds, who have aligned interests.

For Regulators

Responding to the needs of long-term investors requires further regulatory action to rebuild confidence in the market. A good place to start would be through beefing up the Securities and Exchange Commission (SEC) through increased staffing of Corporate Finance to insure that companies are fully compliant with their disclosures and the Enforcement Division to see they have the feet on the ground to stamp about fraud. Disclosure requirement need to be enforced so that documents are accessible to investors by stressing plain English language requirements. And, some important disclosures including the CD&A and MD&A need to be rethought so they become value information sources for investors and not simply compliance documents. The Commission will have the opportunity to think through technological modernization that could help it streamline its operations, communicate more effectively with shareholders and track disclosure information most cost effectively. By creating a modern frame work for disclosure the SEC can create a positive frame work for shareowner and corporate communications.

The next step for corporate governance requires boards, investors and regulators to have a much more expansive vision of their roles and take mutual responsibility for creating long term value. To accomplish this change, we will new to map out new directions for engagement and communications where traditional corporate governance stereotypes should no longer hold sway.

A Delaware Lawyer's Perspective on the Brave New World of Proxy Access, Say on Pay, De-Staggered Boards (etc.)

John F. Grossbauer[1]

As this note is being written, we are in the middle of another round of crisis-inspired reform proposals originating in Washington, DC. The last crisis brought us the Sarbanes-Oxley Act and related changes to listing standards designed to make public company boards of directors more independent and better monitors of financial reporting. These mandates resulted in a changed dynamic in many boardrooms, with truly independent directors taking a more active role in relation to the monitoring of companies' financial reporting and, in my experience, being much more receptive to thoughtful criticism of management and to offers to purchase control at full and fair prices.

The response to the current crisis is still being written, but it does appear that the focus of the changes this time is on the relationship between stockholders and directors rather than the focus on board process that SOX reflected. Thus, we have proposals to enhance stockholder voice in a number of ways, including through proxy access, say-on-pay, elimination of broker discretionary voting, and other changes reflected in the proposed Schumer-Cantwell "Shareholder Bill of Rights" legislation in the U.S. Senate and the "Shareholder Empowerment Act of 2009" introduced in the House of Representatives. While it is unclear whether and in what form any or all of these changes will be enacted, it is apparent that the relationship between shareholders and boards will continue to evolve. The response of public companies and their directors to these developments will be of interest to many from many perspectives, with State law, and in particular the common law of fiduciary duties, continuing to play an important role in shaping this response.

At the outset, I would like to take issue with at least one of the premises underlying the new wave of reform. That is the assumption that, as stated in the Schumer-Cantwell bill, "a key contributing factor to [the 'failure of corporate governance'] was the lack of accountability of boards to their ultimate owners, the shareholders." In my opinion, while some boards clearly were not appropriately responsive to shareholders' concerns, if boards in general can be accused of any governance "failures," those failures originated in being too responsive to the wishes of shareholders. In many cases, the over-leveraging and what in hindsight may have been excessive risk-taking in which certain companies engaged was done in direct response to shareholder pressure to deliver ever-increasing earnings and an ever-increasing stock price or to create a more "efficient" capital structure that would generate cash with which to fund special dividends or share buybacks. To be sure, many compensation schemes worked to ensure that management's incentives were aligned with these short-term pressures, and reform of compensation programs is undoubtedly appropriate. However, in thinking about which of the current menu of reforms may be the most effective in preventing the next crisis, it is important to consider whether some of the supposed cures for the problems created by this type of "short-termism" would actually promote more "short-termism" by making changes in board control easier to achieve. The proposed elimination of staggered boards and the continuing pressure to limit or eliminate many other defensive measures (such as poison pills, advance notice bylaws and

[1] Partner, Potter Anderson & Corroon LLP. The views expressed in this article are those of the author alone, and do not necessarily reflect the view of Potter Anderson or its clients.

supermajority vote requirements) may, in fact, increase pressure on managements and boards to continue to maintain or increase earnings even at the expense of less risky strategies that might produce less short-term gains but position the company for a more prosperous future over the longer term. With this bias in mind, I will discuss the types of responses Delaware corporations may be considering if all or some of these changes are in fact adopted.

One exercise in which all public companies will need to engage is a thorough review of their organizational documents. In particular, Delaware corporations should review carefully each of their bylaws relating to stockholder meetings and voting to ensure they appropriately address the issues raised by the proposed reforms and to anticipate ongoing or increasing shareholder activism.[2] Advance notice bylaws are an obvious area for review. In particular, if Rule 14a-11 is ultimately adopted, companies will need to consider whether to defer to the timing and informational requirements of the SEC rules, or whether to deviate from those requirements. It may be prudent to expressly address these issues in bylaws even if (perhaps especially if) a company decides to defer to the requirements of any new rules, in order to avoid any confusion over the application of advance notice bylaws to nominations made pursuant to proxy access. This is especially important if the relevant bylaw provides that it is the "exclusive" method by which stockholders may nominate candidates for election as directors. Such bylaws also quite often provide (particularly after last year's CNET decision in the Delaware Court of Chancery) for a time period for notice shorter than the period likely to apply to any federal proxy access rule that is ultimately adopted. Also, to the extent companies will be permitted to impose additional disclosure requirements on stockholders utilizing proxy access and on their nominees, it will be necessary to determine whether the specific requirements of a particular company's bylaws are permitted by the new SEC rules or would be deemed to unduly interfere with a new proxy access regime. In particular, companies will need to carefully consider requirements for updating disclosures, requiring written acknowledgements of fiduciary duties by nominees and requiring nominees to complete D & O Questionnaires to determine whether those provisions are consistent with the final rules and, even if permitted by those rules, whether those bylaw requirements would be deemed by institutional investors and their advisors to be "too burdensome."

In addition, in anticipation of the potential for increased proxy contest activity (regardless whether proxy access is ultimately adopted), companies should discuss with their advisors whether it is appropriate to amend their bylaws to permit the use of separate record dates for notice and voting as permitted by revised Section 213 (a) of the Delaware General Corporation Law, which became effective on August 1, 2009. Another possible area in which bylaw change might be appropriate is the adoption of bylaws prescribing qualifications for nominees for election as directors. Delaware law expressly permits such bylaws, which can assist the board in ensuring a proper mix of talents and abilities on particular boards, but great care must be taken in crafting such bylaws to avoid unintended consequences.

With the demise of broker discretionary voting, companies should revisit the bylaw standards for the taking of action at shareholder meetings. Companies may wish to consider the pros and cons of adopting a "votes cast" standard applicable to all matters, and not just for director elections governed by majority voting. In doing so, it is important to note that such a standard will apply to proposals both favored and opposed by management, and that it may be appropriate to provide for a separate voting standard for bylaw amendments, to ensure that any changes to a company's bylaws are supported by a clear majority of shares. Separation of notice and voting records dates could make sense in this context as well.

If Schumer-Cantwell or similar legislation is adopted, an entire additional set of changes will be neces-

2 I would not, however, advocate that companies proactively adopt proxy access bylaws unless and until the SEC adopts a revised Rule 14a-8(i)(8), an action the Council of the Corporation Law Section of the Delaware State Bar Association has advocated. At that point, companies will need to consider the likelihood of their receiving a proxy access bylaw proposal and of such a proposal being approved by stockholders to determine whether adoption of such a bylaw by board action is appropriate.

sary. First, in order to eliminate a staggered board, most companies will need to amend their certificates of incorporation, and many such amendments will require a supermajority vote that may be difficult to achieve. Second, the bylaws and related corporate governance guidelines may require amendment to implement the separation of the roles of chairman and CEO. Governance guidelines or bylaw amendments also may be required to implement the proposed requirement that boards accept resignations tendered by directors who fail to receive a majority vote for reelection. In this regard, there is some doubt whether such a provision would be enforceable under Delaware law without the inclusion of a "fiduciary out" to permit the board to refuse the resignation if the company's best interests so require. Finally, a risk committee charter would need to be formulated, and a risk committee appointed.

While these types of detail-oriented issues are important, more important are the "big picture" issues that boards are facing. Chief among these is the need for directors to engage in more frequent and effective communication with stockholders. In particular, if stockholders believe their concerns are being heard and seriously considered with an open mind, the likelihood of stockholders making use (or at least successful use) of their new powers may be lessened. Articulating a clear strategy with a path to long-term value creation will aid boards and management teams in building support for their "value proposition." Companies also may want to think about methods by which they can encourage long-term shareholders to take the long view when evaluating director candidates and shareholder proposals. Directors also will need to consider the likely increased time commitments that these new rules will require in deciding whether to serve on multiple boards of directors.

For the time being at least, I think Delaware is unlikely to provide any legislative response to these proposals in addition to that reflected in the 2009 amendments to the DGCL. However, over the longer term, courts and legislators at both the State and federal level should consider additional measures by which to encourage long-term thinking among shareholders. In particular, while much time and effort has been spent in defining and increasing shareholder rights, little attention has been paid to whether these increased rights should carry with them increased responsibilities, or whether all shareholders should be treated equally in all cases regardless whether they are net long or net short in a security and regardless whether they have owned their shares for 10 days or 10 years. For example, it may be appropriate to reconsider measures like time-phased voting and dual-class structures. While such provisions are permissible under Delaware law, they are currently not permitted by stock exchange rules (with very limited exceptions) and such provisions likely would be viewed as unacceptable by many institutional shareholders. However, I believe there is a need for creative thinking to put into place governance structures that would provide economic incentives for stockholders to continue to hold their shares over the long term and to cast their votes with the long term in mind, and all options that will further this objective should be considered.

The last crisis gave us SOX and the related changes in listing requirements that represented the first real substantive federal requirements for the design of corporate governance regimes in state-chartered companies. Although there was some concern that these changes were the first of many that would render State law (and, in particular, Delaware law) irrelevant, that has proven not to be the case thus far. Similar concerns are being raised today. These concerns are real, and should be considered when deciding whether to implement the proposed changes discussed above. The balance of State substantive law, federal disclosure rules and exchange listing requirements has produced tremendous value for the United States and the rest of the world over the long term. We should take great care in altering that balance by imposing too many "one size fits all" federal solutions.

Proactive Communications in a Shifting Landscape: Navigating the Changes in Corporate Governance and Shareholder Activism

By Jeremy Jacobs, Managing Director, Joele Frank, Managing Partner,
Joele Frank, Wilkinson Brimmer Katcher

Skepticism of boards and managements, erosion of traditional corporate defenses and economic turmoil have lowered the bar for dissident shareholders to gain board seats and made investor and public relations more vital than ever before. This year is already one of the most active proxy seasons in recent years. Year to date, there have been 124 proxy contests, compared to 125 for the entirety of last year.[1]

Skepticism of boards and managements, erosion of traditional corporate defenses and economic turmoil have lowered the bar for dissident shareholders to gain board seats and made investor and public relations more vital than ever before. This year is already one of the most active proxy seasons in recent years. Year to date, there have been 124 proxy contests, compared to 125 for the entirety of last year .

Dissidents are frequently able to get nominees on a target's board once they've commenced, or merely threatened, a proxy contest. Two factors contributing to this are that influential proxy advisory firms generally support minority slates and that, in this challenging economic environment, settlements are increasingly being used to avoid the costs and distraction associated with a fight.

By taking action now – before any approach – to assess vulnerabilities, sharpen messages and accelerate communication with key constituencies, companies can better position themselves to avoid an attack or defend against one should it occur.

Establish and Leverage a Core Team

Dissidents are more sophisticated than ever before. They can accumulate large positions under the radar using tactics such as swap agreements. They understand the need to appeal to the masses, presenting themselves as advocates for fellow shareholders and waving the flag of corporate governance. And they are frequently as well advised – if not more so – than the corporate targets they attack.

With the assistance of bankers, dissidents are issuing white papers to help make their case. Executive recruiters are helping dissidents identify and convince high caliber executives to serve on their slates. Attorneys are examining corporate bylaws and working with proxy solicitors to optimize the timing of an attack. IR/PR firms are developing messages and executing press strategies to publicize and persuade.

Once an attack begins – either behind the scenes via letters and calls or publicly through the filing of a Schedule 13D – companies will waste valuable time if they must first identify a team and get them up to speed. It is essential to establish and leverage a core team that includes members of management, lawyers, bankers, proxy solicitors and IR/PR advisors beforehand. Indeed in many cases, a good "SWAT Team" can help companies ask themselves the tough questions and develop strategies to address the challenges so as to avoid a fight in the first place.

Assess and Address Vulnerabilities

Working with their advisors, companies should regularly evaluate their own vulnerabilities, including weaknesses in their executive leadership, governance policies, strategy, capital allocation and operations. If a company does not identify its challenges and a plan to address them, sooner or later a dissident will. And given the changes in corporate governance "best practices," proxy voting rules and shareholder access, dissidents do not need to launch a proxy contest to spotlight problems and push for change.

Over the past years, there has been a decline in staggered boards. In fact, in 2008, only 34.4% of the companies on the S&P 500 had classified boards, down significantly from 60.4% in 19991. This development, combined with the large number of companies that have adopted majority voting provisions and the elimination of the broker non-votes in uncontested elections, has made companies far more vulnerable to

1 Source: SharkRepellent.net

withhold campaigns and election outcomes that are embarrassing or worse. This highlights the need for proactive investor relations even in the absence of organized activism.

Even companies that have chosen to maintain traditional defenses, such as staggered boards, are vulnerable since they must overcome the general presumption that such policies are "anti-shareholder." A company must be able to demonstrate why its situation merits maintaining these defenses when so many other companies have eliminated them. Companies and their directors need to be well informed about the potential fallout from defending a rights plan or a classified board over shareholder objections and need to be thick-skinned about the criticism they will likely receive.

Some companies have argued that they deserve a pass on governance issues or other areas of criticism, such as executive compensation, given their strong operating performance. However, "strong" performers are also open to criticism if they don't measure up to their peers in corporate governance. Indeed, leading proxy voting advisory firms such as RiskMetrics Group, Glass Lewis & Co., Proxy Governance and Egan-Jones Proxy Services consider relative performance when issuing their voting recommendations. Key metrics often include one, three and five year stock performances, return on investment (ROI), executive compensation comparisons and governance policies. Since these advisory firms often influence a significant portion of a vote, it is critical that companies not only track their performance, but also understand that their peers' performance can increase or decrease their own vulnerabilities.

Stay Close to Shareholders. IR is the Early Warning System

We advocate maintaining an open dialogue with all shareholders and tracking ownership trends. Understanding who your shareholders are and their expectations is critical. This can include temperature-taking calls around corporate events, such as earnings and analyst presentations, as well as informal conversations. While a stock watch firm can be helpful in identifying buyers and sellers within a shareholder base, activist interest can also be flagged by monitoring conference call/webcast participants, requests for one-on-one meetings, and who is downloading earnings call transcripts.

Although companies frequently devote a majority of their IR efforts towards institutional shareholders, the elimination of broker discretionary votes makes close engagement with retail shareholders important as well. Thus, companies need to understand the composition of their shareholder base so that they can appropriately target their outreach.

Companies should also keep the lines of communication open with potential activists as they may have legitimate concerns that can be addressed. The recent proxy contest between Target Corporation and activist investor Pershing Square Capital Management provides an instructive example. Pershing proposed that Target seek alternatives for its credit card receivables and that it spin off its real estate holdings. Target listened carefully to Pershing's proposals, reviewed alternatives for the credit card business and conducted an analysis of its capital structure. Ultimately, the company did sell part of the credit card receivables and rejected the Pershing real estate plan. The board and management's high level of engagement with Pershing and openness to its ideas helped Target and its board gain credibility with shareholders and ultimately win a contested election.

Sharpen Messages in Advance of a Proxy Contest and Consider the Need to Ramp-Up IR / PR Efforts

While dissidents have historically used corporate governance reform and quick-hit financial engineering as their platforms, dissidents today are attacking strategic execution. During the economic downturn, many public companies have faced increased pressure to "do something" to improve results and shareholder returns, while corporate boards find themselves vulnerable to attack for failing to anticipate and protect against unprecedented market volatility. Impelled by plunging share prices and a series of scandals and perceived failures of corporate governance, shareholders are nowmore receptive to dissident arguments and more willing to blame managements and boards. Even retail shareholders, long seen as generally supportive of management, are more inclined to support activists than ever before. Dissidents often receive support despite having no suggestions as to how to improve the business and/or nonexistent track records on the "What's the Harm?" principle.

Before dissidents go public, companies should look for communications opportunities to reinforce their strategic execution and plan for continued value creation (because the middle of a proxy contest is often too late for that). In addition to reviewing companies plans in one-on-one shareholder meetings, companies should consider issuing a regular stream of press releases that link to their business plan by updating stakeholders on, for example, integration achievements, new partners or customers, and results (quantitative or qualitative) from new business initiatives. By ensuring that investors and analysts understand their position, companies can avoid allowing a dissident to gain traction with the shareholder base.

Identify Supportive Third Parties

Should a dissident begin a public campaign against a company, third party commentators, such as industry and financial analysts, as well as major customers and business partners, will be important sources to validate its key messages. Companies should maintain a list of appropriate third parties and ensure that they are kept apprised of the company's strategy and key messages.

Looking again at the example of Target, the company was particularly effective in this regard, identifying and leveraging influential third parties, such as industry and corporate governance experts, and pursuing carefully selected opportunities to present its case and challenge Pershing Square's portrayals.

Refresh Media Relationships

Developing executive relationships with key reporters prior to an attack is important. Tactics could include one-on-one interviews, backgrounders, editorial board briefings/meetings and inviting select reporters for a site-visit or presentation sit-in.

Reporters are naturally inclined to focus on the sensational or negative, and in the current environment, business media coverage increasingly takes an investigative approach that assumes the worst. Should a proxy contest ensue, having media that are familiar with the company – on both a personal and strategic level – will help increase the likelihood that the company's perspective is reflected in stories. We also recommend identifying company spokespeople and conducting media training as appropriate so that spokespeople can react quickly and are able to effectively articulate the company's key messages.

Putting It All Together: NRG/Exelon

NRG's 10-month takeover battle represents an instructive example of how a company can successfully defend against attacks using these tools. Exelon launched an exchange offer for NRG in October 2008 at the nadir of the recession and of NRG's stock price. NRG believed Exelon's offer reflected a depressed valuation and that the only remedy was a market recovery and the execution of strategic initiatives. NRG knew that it had a timeline of seven to 10 months (until the next annual meeting at which Exelon could attempt to replace the NRG Board) to prove that it was worth more than Exelon had offered. Consequently, the management and advisor teams prepared for a marathon campaign, not a sprint, and quickly made this clear to the media.

Settling in for the long haul, NRG and its representatives developed relationships with a core set of reporters and investors and reinforced NRG's initiatives, past and future, to increase cash flow, capitalize on new technologies and position itself at the forefront of what it termed the coming "nuclear renaissance." The company repeatedly demonstrated in presentations to investors, interviews and background conversations how much Exelon's valuation of NRG failed to recognize its contribution to a combined company. As the markets began to stabilize, NRG completed an accretive acquisition that was well received by investors. At the same time, it highlighted the success of its hedging program in comparison to Exelon's, which had contributed to poor quarterly results.

As NRG aggressively and effectively communicated with investors and the media, Exelon began to fumble and failed to capitalize on its early momentum. NRG successfully convinced investors and all four leading proxy advisory firms that Exelon's offer undervalued the company and its future prospects — that even a nominally large premium was inadequate and opportunistic given the current severity of economic dislocation. Exelon's offer was ultimately withdrawn. NRG's story demonstrates that effective communications can work to counter the challenges facing public companies in this less supportive environment.

A Common Sense Approach

The guidelines outlined above may seem like common sense – and they are. But they are also difficult to execute well. Constantly assessing a company through shareholders' eyes and asking tough questions can help a company prepare for unwanted scenarios like an activist campaign or a hostile takeover bid, or even avoid those scenarios entirely. What this means in practice is that companies must accelerate their investor and public relations, take proactive steps to communicate with key constituencies, shore up support and monitor activity all the time. In the current environment, consistent, active investor and public relations remain the best offense and defense.

Shareholder Proxy Access and the Balance of Power in Corporate Governance

Roy J. Katzovicz, Chief Legal Officer,
Pershing Square Capital Management, L.P.

Our experience with concentrated, long-term investments in large, public companies has taught us that the overwhelming majority of corporate directors are smart, diligent, and capable business people trying the best they can to faithfully discharge their fiduciary duties. They do not, however, always get it right.

Something is broken in corporate America. Particularly over the last decade, prudent risk management took a back seat to the quest for short term profits. Now we are all suffering the consequences. There is, however, reason for optimism. A number of tectonic trends in corporate governance appear to be converging, and a subtle rebalancing of power between management, their boards of directors and shareholders appears likely. We think that is a good thing.

Engaged shareholders with meaningful stakes in the companies in which they invest have the potential to regulate corporate conduct through private and market behavior. The existing tools of shareholder engagement, however, have not proven to be sufficient or optimally suited for that task. We believe that the SEC's proposal to require public companies to include shareholder nominees in corporate proxy materials goes a long way toward better equipping shareholders to be more effective monitors of corporate behavior and, as a result, another force for good corporate governance.

We applaud this initiative and view it as a market-based solution in that the government is now trying to empower market actors to manage risk rather than trying to achieve the same goal through direct government intervention into the day-to-day affairs of corporations.

Corporate Governance Failures and the Government's Response

In the wake of unprecedented economic turbulence, the government at various levels has undertaken an examination of our existing regulatory and corporate governance regimes. Stated more simply (if not less charitably) some are out to find one or more protagonists on whom to lay blame. Corporate boards of directors are receiving their fair share.

With the publication of recent shareholder proxy access proposals, our lawmakers and regulators are betting that stronger shareholder voices in the governance of U.S. businesses will reduce risk in our system, limit future wealth destruction, and trigger competition for the best candidates to rise to the role of director and help govern our businesses. Even if the absence of shareholder access to corporate proxy statements was not the primary cause of the recent economic crisis, the hope is that it may play a large role in the solution.

Some critics have faulted the SEC's approach as the federal government's intrusion on traditional state regulation of corporate governance. State-level advocates have voiced a preference for a more incremental approach that would allow incumbent managers, boards and shareholders of individual companies to decide whether shareholder proxy access is desirable and, if so, the details of any conditions that should be included in the company's bylaws.

Generally, we believe that the shareholder franchise mechanics for U.S. corporations practically impede shareholders' ability to nominate and elect directors of their choosing. A solution that relies on a company-by-company approach is likely to suffer from the same inertia that has frustrated direct shareholder representation in the past. While some may fault the SEC's proposal as too blunt of a tool because it applies to all corporations, we have no such objection. The fundamental policy aim of the proposal is to facilitate greater participation in corporate governance by shareholder representatives system-wide. It is a systemic solution for a systemic problem and is, therefore, appropriately broad in scope.

Furthermore, the federal government's proposed policy change should not be viewed as rash or punitive. Instead, it should be viewed as a forward-looking attempt to fashion appropriate incentives for those people who are in the best position to avoid the repetition of past mistakes and maximize future value of U.S. corporations taken as a whole. It should be judged on its ability to achieve this goal and as part of the larger mix of regulatory reforms.

Why It Might Work

Shareholders are the participants in corporate America who only get what is left over after customers are served, employees, lenders, vendors, and taxes are paid. Accordingly, shareholders are the corporate constituency that is among the most sensitive to risky and bad business decisions by managers and boards. As a class, shareholders have unique economic incentives to monitor the activities of the firms in which they invest to ensure the success of those firms' businesses over the long run. In its current state, however, corporate democracy is democratic in name only. Shareholder expression through nominating and voting for directors has failed to live up to its potential as a positive feedback mechanism.

If shareholders had a more meaningful opportunity to elect directors of their own choosing, it would be easier for them to hold individual incumbent directors accountable. This in turn would give incumbent directors even greater incentive to more actively engage management teams and avoid mistakes in the future. As self-interested participants who would just as soon not waste time and money unnecessarily meddling in the affairs of firms, we believe that shareholders will generally only exercise their new-found powers at moments where intervention is likely to create or protect more shareholder value.

In any event, by injecting a greater element of competition at the board of directors-level, the mere possibility of the exercise of this power by shareholders should cause directors to be more effective in their roles in hopes of maintaining their positions.

The SEC's proposal would (1) lower the direct costs of nominating and campaigning in favor of alternative director candidates, (2) reduce the procedural complexities of nominating those candidates, (3) minimize the uncertain and often large litigation costs incurred in the context of contested elections by fostering an administrative dispute resolution process, and (4) as a consequence of the previous three elements, give shareholders a stronger hand in direct negotiations with managers and boards of companies who would just as soon avoid potentially embarrassing or disruptive campaigns.

For those who view active monitoring and engagement by shareholders as an effective tool in building long-term value, these are meaningful and helpful changes.

Why It Won't Go Wrong

Critics of shareholder proxy access proposals question whether shareholders can be trusted to faithfully fulfill the hoped-for aims of the proposed policy change. These critics are wary of relying on the alignment of each shareholder's economic incentives with the long-term success of a corporate enterprise. Unsurprisingly, critics target two types of shareholder groups that are already active in the arena of corporate governance: (1) activist hedge funds and (2) governance-focused pension funds.

Activist Hedge Funds

Hedge funds are typically painted with a broad brush and are generally criticized for having short-term trading strategies that, while economically rational from the hedge funds' perspectives, may not serve to build the long-term value of corporate enterprises in every situation. We do not dispute that this criticism may have merit for some subset of funds, but to say that it applies to all or even most funds without regard to their diverse strategies and areas of specialization goes too far. By branding all funds as "short-termists", critics have blamed these private investment pools for the prevailing myopic focus of U.S. public companies on near-term stock performance at the expense of the long-term health of corporate enterprises.

These criticisms of hedge funds are dubious. Activist hedge funds seeking short-term performance in the form of leveraged recapitalizations, corporate self-tenders or forced sales of companies were not the cause or even a major contributing factor of the financial crisis. Any such suggestion is as suspect as blaming short sellers for the consequences of the demise of the shadow banking system. The facts bear out otherwise.

The short-term focus on stock price of many public company managers and boards long pre-dates the recent growth of hedge funds in public markets. Indeed we see great danger in misattributing this problem to shareholders rather than the managers and boards with responsibility for directing the day-to-day affairs of their firms. This argument deflects scrutiny of the disturbing and perverse incentives inherent in certain executive compensation programs that pay out short-term bonuses for short-term performance. And, we are alarmed by the lack of introspection on this point by outside professional advisors who enable such behavior (many of whom now object to the SEC's shareholder proxy access proposal).

Almost by definition, hedge funds that seek and achieve direct representation on the boards of their portfolio companies cannot be short-term traders. The SEC proposal includes a one year holding period for any shareholder who desires proxy access for its nominee. Moreover, the time and commitment it takes to wage a proxy contest is substantial. And, if a hedge fund gains a seat for one of its executives or affiliates, they and it will be subject to (1) the public company's internal policies that limit trading by directors and their affiliates to certain open window periods, (2) the transparency imposed by prompt disclosure rules when directors or their affiliates sell shares, and (3) the short-swing profit disgorgement requirements imposed by our securities laws on insiders such as directors. Collectively, those requirements provide effective impediments to short-term trading. It is, therefore, counterintuitive to attack an entire class of market participants as short-termists when their participation on boards of directors yields the opposite result.

Moreover, across the U.S. our state fiduciary laws protect minority shareholders from self-dealing or disloyalty on the part of corporate directors no matter who their sponsors are. The long history of private enforcement in this area alone should protect against the outside risk that hedge fund-nominated directors would act to the detriment of shareholders taken as a whole in order to confer some private benefit on those who nominated them to their posts.

Pension Funds

Governance-focused public and union pension funds are often criticized by opponents to shareholder proxy access as political animals focused on aggrandizing the politicians at their helms or – worse – as shills for the labor movement in search of leverage to extend the benefits of union members at the expense of the shareholders they purport to represent. More than any other actors, over the past decade pension funds have led the fight for better corporate governance practices.

While there are pension funds that openly view their efforts as part of a broader strategy that takes on issues beyond shareholder value, they tend to be the exception rather than the rule. In our experience, the larger, returns-focused institutions have successfully led campaigns for governance improvements. Often indexed in their holdings, these fund managers view broad-based incremental improvement to governance as long-term value enhancing across all equities. Critics would generally be hard pressed to find fault in the agendas and intentions of these funds as they are very much driven by shareholder value considerations.

To those who have voiced particular skepticism regarding the role of union pension funds as governance advocates, we would point out that unions have long been in the business of providing benefits to constituents beyond their membership. Over time, for example, the mere threat of unionization has likely resulted in higher wages and better terms and conditions of employment for non-unionized workers. Notwithstanding the motivations of active public and union pension funds, all shareholders have benefited from many corporate governance reforms pressed by these advocates.

Whether in the area of majority voting for directors, increasing transparency of executive pay, limiting the use of poison pills, eliminating discretionary broker non-votes, increasing the independence of key board committees or battling against staggered boards, pension funds' corporate governance efforts have largely been pro-shareholder and positive for the system.

For so long as these governance-focused pension funds continue to concentrate on those areas that increase shareholder value, they will continue to receive support from a substantial portion of the shareholder community.

Ultimate Protection: The Shareholder Franchise

Even if the critics are right about some of their concerns, fear and rejection of shareholder proxy access would be an overreaction. The proposal simply lowers costs for shareholders to engage in already permitted behavior. Can it really be that an incremental reduction in proxy campaign costs will usher in the collapse of U.S. corporations? That seems implausible.

In America, our business leaders rarely shy away from competition – where we find it we tend to take comfort that we've achieved the most reliable results. In our own experience, we have found eager participants in industry leading executives who are typically (though not always) unaffiliated with our investment funds but yet willing and eager to serve on alternative slates. If the fear is that, as a class, American business people who are focused on building long-term value will no longer be eager to serve as directors of public companies because of this modest increase in competition, our experience suggest that this outcome is unlikely.

Moreover, there is at least one major attribute to current shareholder proxy access proposals that should provide significant and sufficient protection against the hijacking of corporate boards by special interest groups. Current proposals only give sponsors the ability to put alternative director nominees on a ballot. They do not secure the alternative candidates' election. Proponents of shareholder nominees have to convince other shareholders to support them. We can assure you from personal experience that this is no easy feat.

The mechanisms of the shareholder franchise are sufficiently daunting that the introduction of shareholder proxy access on its own is unlikely to herald a revolution in shareholder representation on boards.

Many common protections of political democracy are absent from corporate democracy. These include two or more candidates for every open seat, secret and universal ballots that allow voters to vote from among all available candidates, the absence of record dates for eligible voters and campaign spending limits. In particular, the absence of universal ballots, on which shareholders can vote from among all nominees regardless of who proposed them, is glaring and clearly anti-choice. There is no positive case for effectively requiring shareholders to vote for slates rather than being able to choose from among the best individuals nominated by all parties.

Beyond the absence of these protections in the corporate context, in our own experience we have found that institutional investors who value their access to management often fear that access will dry up if they support dissidents. They are, therefore, unlikely to support even a minority of alternative independent directors.

One of the greatest threats to the efficacy of shareholder proxy access is the absence of institutional shareholder voting policies or procedures to address minority, non-control proxy contests where independent alternative candidates are nominated. In addition, we are aware of institutional shareholders whose pro-management biases are so strongly ingrained that, absent only the most extraordinary circumstances, they do not even possess the power or authority to support alternative candidates.

To the extent that shareholder proxy access prompts the institutional shareholder community to reassess these policies and to adopt new policies that focus on attracting and electing the best directors possible, we believe that the initiative is worthwhile. Given that shareholder proxy access effectively requires a universal ballot and therefore lends itself to a director-by-director analysis, we believe that its enactment will cause institutional holders to begin this process. This is at least a step toward standardizing universal ballots in all contested elections.

Our hope is that, outside the control context, selection of the best nominees in a contest will be based more on character, competency, and relevancy of their experience rather than the identity of the person nominating the candidate.

Areas of Concern

Current shareholder proxy access proposals set ownership thresholds as low as 1% of a company's outstanding stock and as such there is a risk that the threshold is too low and may encourage wasteful proxy contests. Because of the significant campaign costs other than the printing and distribution of proxy statements and ballots (like the associated opportunity cost of time and direct legal, travel and solicitation expenses), we are hopeful that this risk remains unrealized. If not, the system will need to be reexamined.

The SEC's proposal and request for comment has a number of specific provisions that merit reconsideration. Generally, the system should provide incentives to the largest shareholders to take the most active roles given that they are disproportionately impacted by virtue of their relatively outsized stock ownership. Accordingly, we are apprehensive of a "first-to-file" system where the first shareholder (rather than the largest shareholder or group of shareholders) has priority access to the proxy statement.

As part of the SEC's current proposal (and contrary to its approach in 2003 on the same issue), it chose not to provide any relief from Section 16 of the Exchange Act of 1934 to groups of shareholders who collectively seek shareholder proxy access. Generally, Section 16 triggers disgorgement of profits by holders of 10% or more of a company's stock for purchases and sales within a 6-month period. If the whole point of shareholder proxy access is to encourage shareholder engagement, the introduction of an element that chills shareholder collective action seems counterproductive. This is particularly the case in situations where the policy reasons that underlie Section 16 (namely apprehension of inside access by individual large holders by virtue of the size of their stakes) are not apparent in this context.

In its proposal, the SEC requested comment on whether nominees proposed by shareholders seeking proxy access should be required to be independent of the shareholders that nominate them. In our view, such a requirement would greatly dampen the benefit of direct shareholder involvement in corporate governance and create yet another artificial separation between stock ownership and governance. While it may be the case that a wholly independent candidate is the best person for the job in any given circumstance, we see no reason why this should be imposed as a matter of law. So long as full and fair disclosure of affiliations and business relationships remains the standard in proxy disclosures, this is a variable that should be left up to the contestants.

Separately (and importantly), we urge the SEC to extend the right to a universal ballot outside the limited context of shareholder proxy access. Non-control, minority slate contests happen. There is no reason to prejudice shareholders' right to choose among all the candidates just because the sponsoring shareholders choose to finance the campaign without taking advantage of shareholder proxy access. The inability to choose from among the individuals nominated from all parties shields individual directors from accountability and robs shareholders of the opportunity to choose the best person for the job. Those who claim this is not the case because of impractical and often theoretical alternative voting mechanics are disingenuous (at best). The appeal of allowing shareholders to easily choose directors from amongst all nominees is obvious.

Conclusion

While the fear of overreaction is oftentimes well placed after extraordinary market events, we do not believe that the long-discussed concept of shareholder proxy access falls into that category. We support shareholder proxy access and believe that it can have a meaningful, albeit only incremental, impact of enhancing corporate democracy. By lowering costs and giving shareholders an enhanced ability to monitor their portfolio companies, shareholder proxy access attempts to use market forces to improve corporations. At a time of extraordinary governmental intervention into private enterprise, we would urge critics to give this market-based policy a chance.

The System Isn't Broken: A Legislative Parade of Horribles

Martin Lipton, David A. Katz and Laura A. McIntosh*

In the first eleven months of 2009, regulators and lawmakers have proposed a dizzying array of reforms that, if implemented, would exacerbate short-termism, undercut directorial discretion, further empower institutional investors and shareholder activists, and impose unnecessary and potentially costly burdens on public companies. Few of the proposed reforms are truly new, and nearly all are ill-conceived. They appear to proceed in part from a misguided impulse on the part of regulators and lawmakers to be seen as "doing something" about the current recessionary environment—though hardly any of the proposed reforms have even a remote connection to the origins of the credit crisis that precipitated the economic downturn—and in part from an opportunistic desire to use the financial crisis as an excuse to enact an activist "wish list" of reforms. Politicians and regulators are using the financial crisis and current economic environment to promote an agenda that could significantly change the landscape of corporate America.

Members of Congress, the Department of the Treasury and the Securities and Exchange Commission (SEC) all are currently engaged in putting forth corporate governance initiatives. The proposed reforms include shareholder proxy access rules, corporate governance proxy disclosure requirements, executive compensation proxy disclosure requirements, requirements as to the structure, composition and election of the board of directors, executive compensation clawbacks, say-on-pay referendums, independence requirements for compensation committees and their outside consultants, supermajority shareholder approval of "excessive" pay, and mandatory majority voting. Pending federal legislation includes the Shareholder Bill of Rights Act of 2009 (Bill of Rights Act),[1] sponsored by Senators Charles Schumer and Maria Cantwell, the Shareholder Empowerment Act of 2009 (Empowerment Act),[2] sponsored by a group of Representatives, the Excessive Pay Shareholder Approval Act (Excessive Pay Approval Act),[3] sponsored by Senator Richard Durbin, the Treasury's Investor Protection Act of 2009 (Investor Protection Act), the Corporate and Financial Institution Compensation Fairness Act of 2009 (Compensation Fairness Act),[4] sponsored by Representative Barney Frank and the Restoring American Financial Stability Act of 2009 (Financial Stability Act),[5] a draft of which was introduced by Senator Christopher Dodd.

Amidst this veritable avalanche of reform, the SEC has already approved the New York Stock Exchange's (NYSE) proposal to eliminate broker

* Martin Lipton and David A. Katz are partners at Wachtell, Lipton, Rosen & Katz in New York City. Laura A. McIntosh is a consulting attorney for the firm.

1 Shareholder Bill of Rights Act of 2009 (S. 1074).

2 Shareholder Empowerment Act of 2009 (H.R. 2861).

3 Excessive Pay Shareholder Approval Act (S. 1006).

4 Investor Protection Act of 2009; see also U.S. Department of the Treasury Fact Sheet: Administration's Regulatory Reform Agenda Moves Forward: New Independence for Compensation Committees, TG-218 (July 16, 2009); U.S. Department of the Treasury Fact Sheet: Administration's Regulatory Reform Agenda Moves Forward: Say-On-Pay, TG-219 (July 16, 2009). The Investor Protection Act addresses say-on-pay and compensation committee independence; the Compensation Fairness Act (as initially proposed on July 21, 2009), which was passed by the House Financial Services Committee on July 28 and by the House on July 31, includes those provisions and goes further to prohibit excessively risky compensation practices at financial institutions. Corporate and Financial Institution Compensation Fairness Act of 2009 (H.R. 3269) (as passed on July 31, 2009). The Investor Protection Act, with amendments, was approved by the House Financial Services Committee on November 4, 2009.

5 Restoring American Financial Stability Act of 2009 (Nov. 10, 2009 Discussion Draft introduced by Sen. Dodd). The discussion draft of the Financial Stability Act is 1136 pages, of which approximately 19 pages relate to corporate governance matters. The discussion draft takes a different approach on many of the corporate governance matters by using the SEC's power to approve the listing standards of national stock exchanges as opposed to simply preempting state law.

discretionary voting in uncontested elections beginning next year.[6] The elimination of broker discretionary voting is likely to have far-reaching impacts, although the effects will be felt differently by public companies depending on their relative size and their specific shareholder profile.

The key features of the proposed regulatory and legislative initiatives are discussed below. If these proposals are adopted substantially as proposed, they are likely to have a lasting impact and further impede the ability of American public companies to compete in the global marketplace.

Shareholder Proxy Access

The latest chapter in the continuing saga of proxy access began in June 2009 as the SEC released proposed proxy access rules for the third time this decade.[7] The first proposal, in 2003, was the subject of fierce debate—the SEC received a record number of comment letters on the proposal—and was shelved in 2004.[8] The prevailing sentiment at that time was that the issue of proxy access was highly complex and carried many hidden consequences. For a time, it appeared that the issue had been largely superseded by the widespread adoption of a majority voting standard for the election of directors. In 2007, in response to a court ruling that unsettled the SEC's long-held position that shareholder proposals on proxy access could be excluded from the proxy statement,[9] the SEC took the unusual step of issuing two conflicting alternative proposals on shareholder access, each approved by 3-2 votes of the SEC Commissioners.[10] Later that year, the SEC voted to continue its policy of permitting companies to exclude shareholder proposals relating to board nominations or director elections from the company proxy statement. Now comes the latest installment, and, under the new leadership of SEC Chairman Mary Schapiro, the SEC seems poised to take definitive action even over the strong objections of two Commissioners.[11] The SEC comment period ended August 17, 2009, and the SEC, which originally had announced its intention to adopt final rules by November 2009 to be in place for the 2010 proxy season, has deferred any action on the proxy access proposal until early 2010 as recently indicated by SEC Chairman Schapiro:

> I am committed to bringing final rules to the full Commission for consideration early in 2010. We recognize that this timing means that any new rules will not be in effect for the 2010 proxy season, but we think it's far more important that we adopt the right rules — rules that make sense and are workable — than it is for us to act rashly.[12]

As part of its proposal, the SEC raised more than 500 questions that it asked be addressed in the comment process. In response, the SEC received more than 500 letters from a variety of sources: private investors, shareholder activists, corporate raiders, public companies, chief executive officers, law firms, law school and business school professors, individual directors, entire boards of directors and other interested parties. [13]

This most recent proposal from the SEC, like the previous iterations, requires issuers to include in their proxy materials director nominees proposed by shareholders who satisfy ownership and other requirements. Any shareholder or group of shareholders that has held at least one percent of the stock of a public company (with larger thresholds for Small-Cap companies) for at least a year would be entitled to have their proposed nominees for up to 25 percent of the entire board included in the company's proxy statement and on its proxy card, on a first-come, first-served basis. Under this proposed rule, exclusion of proposals related to elections and

6 SEC Release No. 34-60215; File No. SR-NYSE-2006-92 (July 1, 2009). See also David A. Katz and Laura A. McIntosh, "Corporate Governance Update: SEC Revisits Shareholder Access to Director Nominations," NYLJ, Aug. 30, 2007; David A. Katz and Laura A. McIntosh, "Corporate Governance Update: Proxy Access—Not Then, Not Now," NYLJ, Sept. 28, 2006.

7 SEC Release Nos. 33-9046; 34-60089; IC-28765; File No. S7-10-09 (June 10, 2009).

8 *SEC Release No. IC-26206 (Oct. 14, 2003).*

9 AFSCME v. AIG, 462 F.3d 121 (2d Cir. 2006).

10 SEC Release No. 34-56160 (Aug. 3, 2007) and SEC Release No. 34-56161 (Aug. 3, 2007).

11 Separately, proxy access is an element of the proposed Bill of Rights Act. The Financial Stability Act gives the SEC authority to adopt, and then directs that the SEC adopt, proxy access rules within 180 days of the proposed bill's enactment. On November 4, 2009, the House Financial Services Committee approved an amendment to the Investor Protection Act offered by Representatives Maxine Waters and Gary Peters that would give the SEC specific legal authority to implement proxy access rules. The Committee then approved the Investor Protection Act, as amended, by a 41 to 28 vote. See Jessica Dye, "House Panel Tweaks, Clears Investor Protection Bill," Law360 (Nov. 4, 2009).

12 Chairman Mary Schapiro, Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009).

13 These letters can be found at http://sec.gov/comments/s7-10-09/s71009.shtml.

nominations would be permitted only in very narrowly defined circumstances.

The SEC's proposed approach is both unwise and unnecessary. The one percent threshold is extremely low[14] and will further empower activists to manipulate the corporate process in pursuit of their own agenda. The first-come, first-served procedure proposed by the SEC will give shareholders a perverse incentive to rush to nominate directors to ensure their place in line. Moreover, the SEC proposed rule does not require a nominating shareholder to hold, or even to state a commitment to hold, stock in the company for any period of time if it succeeds in electing a nominee to the board. It would be detrimental to provide increased rights to shareholders who are free to seek short-term gain through the manipulation of board composition (and perhaps corresponding movements in stock price) without requiring such shareholders to continue to have an economic stake in the company. If the point of requiring a nominating shareholder to hold a substantial number of shares is to be sure that the shareholder has real "skin in the game," that shareholder ought to be obliged to maintain its "skin" for some period should its nominee be elected.

Overall, the proposal raises issues of enormous complexity, as the SEC evidently recognized in the large number of questions on which it sought comment. As has been true from the beginning of the proxy access debate, opening shareholder access is a step that could have the negative effects of causing corporate disruption and waste, deterring qualified candidates from standing for election and undermining the effectiveness of board processes. Shareholders have always had the ability to nominate directors for election and have had great success in placing directors on many boards.[15] It is highly debatable whether such nominations need to be facilitated further by providing shareholders with access to the company's own proxy statement, especially at a time when shareholders increasingly follow regimented, one-size-fits-all voting recommendations from proxy advisory firms. While it is difficult to predict, many observers believe that adoption of anything like the SEC proposed proxy access regime would result in a very significant increase in shareholder nominations and proxy contests. Some leading mutual funds supposedly are considering whether to form a clearinghouse of potential board candidates to be available for shareholder nominations at companies that are targeted for proxy access and are even reconsidering long-standing polices against offering their own employees or consultants as candidates.[16]

Delaware has demonstrated that there is a sensible alternative to the federalization of an important area of state corporate law. In April 2009, Delaware enacted legislation enabling the adoption—via board action or shareholder initiative—by Delaware companies of bylaws permitting shareholder access to company proxy materials.[17] Delaware's private-ordering approach, which can be effected by carefully drafted company bylaws, enables companies and their shareholders to tailor proxy access to their own specific circumstances and keeps the issue of proxy access in the proper realm of state law. Federalizing proxy access on a one-size-fits-all basis was a terrible idea in 2003 and again in 2007. It is no better now. The financial crisis does not provide any rationale for the federal government to overrule state corporate law statutes and private ordering that it has not even given a chance to be applied in practice.

In addition, the role of the board of directors is an element that appears to be absent from the debate about shareholder access to the company's proxy materials; the SEC should not be mandating a process that could lead to dysfunctional boards of directors of public companies at little or no cost to the proponents. SEC Commissioner Troy Paredes recognized the importance of collegial decision-making in a recent speech to independent directors:

> What makes for an effective board of directors?
>
> Boards of directors are expected to improve decision making by spurring deliberation. In acting as a body, the promise is that boards will draw on

14 RiskMetrics Group, a public company formerly known as Institutional Shareholder Services or ISS, generally has a four percent threshold for shareholder nominations to be included in the proxy statement: "Our bylaws set forth the provisions by which we will include in our proxy materials the name of a person nominated by one of our shareholders, or group of our shareholders, who meets specified requirements for election as a director. Generally, a nominating shareholder must have owned at least 4% of our outstanding common stock continuously for at least 2 years and must provide notice to us in accordance with our bylaws." See RiskMetrics Group Proxy Statement dated Apr. 29, 2009 at 6, available at http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NDI2NXxDaGlsZElEPS0xfFR5cGU9Mw==&t=1.

15 *See, e.g.,* Business Roundtable, Written Testimony for the Record of John Castellani, President, Before the Senate Banking Subcommittee on Securities, Insurance and Investment; Protecting Shareholders and Restoring Public Confidence by Improving Corporate Governance (July 29, 2009) at 14–20 (discussing shareholders' various abilities to make their views known to the companies they invest in—from direct communication to the board to shareholder proposals to withhold vote campaigns to proxy contests).

16 *See* Stephen Davis and Jon Lukomnik, "Take Heed: Investors Empowered on Proxy Access," Compliance Week (July 14, 2009).

17 Delaware Gen. Corp. L. § 112 (effective Aug. 1, 2009).

the distinct perspectives, experiences, sensibilities, and expertise that different directors offer. The expectation is that as the group works through a range of ideas and arguments, the ultimate decision will be better as a result of the directors' collective efforts.

The active engagement of directors is a lynchpin of meaningful deliberation. Decision making should improve when directors—whether interacting with each other or with management—engage in open and frank discussions, even if it means being critical. When assessing some course of action, directors should ask probing questions and follow-ups of each other and of management; should challenge key assumptions; should offer competing analyses; and should develop competing options to ensure that alternatives are considered and not cast aside too readily. Put differently, directors should be willing to dissent, and disagreement from others should not be discouraged or suppressed. When it leads people to engage rigorously, disagreement helps ensure that the unknown is identified, that information is uncovered, and that challenges and opportunities are assessed in a more balanced way. Indeed, a board may want to consider designating one or two directors whose express charge is to be skeptical and to press when needed.

However, there is a word of caution. Disagreement and spirited deliberation should not give way to hostility. Distrust and disharmony can threaten an enterprise; boards need collegiality and cooperation. Dissent will be most constructive, then, when conflicting viewpoints and pointed resistance do not trigger defensiveness, but instead are encouraged as catalyzing better decisions.[18]

Executive Compensation

Proposed legislation concerning executive compensation addresses both disclosure requirements and specific corporate practices. The Empowerment Act would require all publicly-traded companies to disclose specific performance targets used to determine senior executive officers' eligibility for bonus, equity and incentive compensation. Furthermore, the Empowerment Act would require all publicly-traded companies to develop and disclose a policy for reviewing any unearned bonus, incentive or equity payments that were awarded to executive officers owing to fraud, financial statements that require restatement or some other cause. This mandatory "clawback" obligation would require recovery or cancellation of such unearned payments to the extent feasible or practical. The Financial Stability Act would require, in the event of accounting restatements due to material noncompliance with financial reporting requirements, recovery of amounts in excess of what would have been paid under the restated financial statements from any current or former executive who received incentive compensation (including stock options) during the three-year period preceding the date that restatement is required. In contrast, the clawback provision of the Sarbanes-Oxley Act of 2002 covers only the chief executive officer and chief financial officer, applies only if the noncompliance results from misconduct, and relates to compensation events during the year following the misstatement. In an unprecedented approach, the SEC is currently pursuing two cases against CEOs—using Section 304 of the Sarbanes-Oxley Act of 2002[19] —for clawbacks of incentive payments. The SEC has not alleged that either CEO personally engaged in misconduct, but simply that the incentive payments and bonuses were earned based on misstated financial results. In one case the SEC filed a complaint against the CEO[20] and in the other case the SEC staff issued a "Wells" notice indicating its preliminary recommendation that the SEC commence an action against the executive.[21]

The Investor Protection Act, delivered to Congress by the Department of the Treasury, would mandate non-binding, advisory say-on-pay votes on executive compensation packages for each annual meeting and for "golden parachute" arrangements for executives in the context of a change-in-control transaction. The Investor Protection Act also would require disclosure of such arrangements, the conditions upon which they may become payable and the aggregate amount of all such compensation. The Bill of Rights Act, sponsored by Senators Schumer and Cantwell, and the Financial Stability Act, introduced by Senator Dodd, would mandate would mandate separate annual non-binding shareholder votes to

18 SEC Commissioner Troy A. Paredes, Remarks at Independent Directors Council's 2009 Investment Company Directors Conference (Nov. 13, 2009).

19 15 USC § 7243 (Forfeiture of certain bonuses and profits).

20 *See* SEC v. Jenkins, Case No. 2:09-cv-01510-JWS (D. Ariz., filed July 22, 2009).

21 *See* Item 8.01 of Form 8-K for Beazer Homes USA Inc. filed Nov. 16, 2009 ("the Staff of the . . . Commission issued a Wells notice to the Company's Chief Executive Officer, Ian J. McCarthy, indicating that they have preliminarily determined to recommend that the Commission bring a civil action against him to collect certain incentive compensation and other amounts allegedly due under Section 304(a) of the Sarbanes-Oxley Act of 2002 . In their Wells notice, the Staff did not allege any lack of due care by Mr. McCarthy in connection with the Company's financial statements or other disclosures.").

approve the compensation of named executive officers. The Bill of Rights Act would require shareholder approval of "golden parachute" arrangements in the context of a change-in-control transaction at any shareholder meeting concerning an acquisition, merger or similar transaction. The Financial Stability Act would direct the SEC to adopt rules requiring shareholder approval of "golden parachute" arrangements in the context of a change-in-control transaction for any principal executive officer, to the extent not previously approved by shareholders.

The Excessive Pay Approval Act would require an annual supermajority shareholder vote to approve "excessive compensation" of any employee of a public company. "Excessive compensation" is defined as compensation (broadly defined to include fringe benefits, bonuses and any other form of remuneration) to an employee of a public company in any year exceeding an amount equal to 100 times the average compensation for services performed by all employees of that company during such year. The proxy statement seeking the supermajority shareholder approval would need to disclose the compensation paid to the lowest paid employee, the highest paid employee, the average compensation paid to all employees, the number of employees who are paid more than 100 times the average compensation for all employees and the aggregate compensation paid to employees who are paid more than 100 times the average compensation.

The Compensation Fairness Act, passed by the House of Representatives on July 31 and containing the most extreme compensation-related legislative proposal of all, would—in addition to requiring non-binding shareholder votes on executive compensation and "golden parachute" arrangements— authorize federal regulators to prohibit any compensation or incentive pay that regulators determine encourages "inappropriate risks." This would apply to broadly defined "financial institutions" (a term which could include any financial institution with more than one billion dollars in assets that "the appropriate federal regulators" determine should be covered). Under the bill as passed by the House, all "financial institutions" would be required to disclose compensation structures that include any incentive-based elements; federal regulators would review incentive compensation structures at all covered financial institutions and make determinations as to whether the compensation promoted undue risk. As noted by the U.S. Chamber of Commerce in a letter to the Chairman and Ranking Member of the House Committee on Financial Services, the Compensation Fairness Act would "constitute an unprecedented governmental intrusion into matters that have historically been addressed by private actors."[22]

The Compensation Fairness Act also includes non-binding annual shareholder votes on compensation for top executives at all public companies as well as on golden parachutes.[23] In addition, the version adopted by the House of Representatives included an amendment to the Compensation Fairness Act, proposed by Representative Mary Jo Kilroy, requiring that institutional investors with greater than $100 million in assets annually report publicly how they voted on say-on-pay and golden parachute votes.[24]

Further, the Investor Protection Act would require all public company compensation committee members and their advisors to be independent (using new, stricter independence standards than those currently in place at the NYSE) and, if a compensation committee did not hire an independent compensation consultant, the Investor Protection Act would require disclosure as to why the committee determined not to do so.[25] The Financial Stability Act would require compensation committee members to satisfy independence standards to be established by the applicable stock exchange. The Financial Stability Act would also require compensation consultants, legal counsel and other advisers to the compensation committee to be "independent," based on rules to be promulgated by the SEC. Moreover, the Financial Stability Act would authorize compensation committees to retain independent advisors and would require compensation committees to oversee the advisers they retain.

Executive pay has long been a touchstone for debate and an easy target for populist-minded reformers. Disclosure and communication are key elements in the process of harmonizing company goals and shareholder interests.

22 U.S. Chamber of Commerce, "Letter on H.R. 3269, the 'Corporate and Financial Institution Compensation Fairness Act of 2009'" (July 27, 2009). The Chamber also noted that "In many firms, because incentive compensation plans range from the CEO to the receptionist, these provisions would place the federal government in the position of regulating compensation for all, or a vast majority of, employees in a company. This would be particularly intrusive when coupled with the provisions of H.R. 3126 which would allow the proposed Consumer Financial Protection Agency to regulate the compensation of employees who interact with consumers, regardless of industry, such as real estate agents, or even cashiers who accept credit cards."

23 The Chamber of Commerce commented that "The "Say on Pay" provisions can be improved by making the votes triennial and providing for a 5 year opt-out if approved by a super-majority of shareholders." Id.

24 Amendment to H.R. 3269 Offered by Ms. Kilroy. See also Proxy Voting Transparency Act of 2009 (H.R. 3351). Currently, hedge funds and public pension funds do not have to report the results of their proxy votes, though mutual funds do. See also Alicia Caramenico and Ted Allen, "House Committee Approves 'Say on Pay' Bill," RiskMetrics Group Risk & Governance Blog, July 29, 2009.

25 The Compensation Fairness Act also requires that all compensation committee members be independent directors and that all compensation consultants be independent, the latter under new independence criteria established by the SEC.

Say-on-pay legislation may have superficial appeal to certain groups, but there is no reason to believe that it would increase communication between companies and their shareholders. There is not even a shareholder consensus in favor of say-on-pay proposals.[26] It is clear that say-on-pay would increase the ability of RiskMetrics and other proxy advisory firms to substitute their judgment for that of the board of directors in establishing compensation. Some chief executive officers have raised concerns that say-on-pay could lead to further government intervention and shareholder micromanagement with the result that talented executives could leave public companies for privately-held firms. Other chief executive officers have expressed concerns that institutional shareholders or hedge funds could use a say-on-pay policy to attempt to coerce management into making certain short-term decisions that would not be in the company's best long-term interests.

The fact is that the directors, and not the shareholders, are charged with the responsibility of determining executive compensation. Indeed, despite the furor that has raged in activist circles for years over executive compensation, directors should be confident in following normal procedures, with the advice of an independent consultant and the company's legal counsel, as they make decisions on executive pay—decisions that must take into account complex concerns of not only aligning incentives and risks but also of retention. Case law is clear that courts will protect decisions on executive pay made by directors on an informed basis, in good faith, and without a taint of self-interest. In the current environment, directors would be well-advised to structure compensation that links pay with the long-term performance of the company and to avoid compensation that might encourage undue risk.It is properly the province of the directors to determine executive compensation, and it would be a mistake for shareholders to attempt to usurp or undermine the proper functioning of the board in this critical area.

Broker Discretionary Voting

In July, the SEC approved the NYSE's proposal to eliminate broker discretionary voting in uncontested elections.[29] As a result, effective in the 2010 proxy season, brokers will not be able to vote on behalf of clients who fail to provide voting instructions in uncontested director elections at NYSE-listed companies. This is a significant change, as broker votes accounted for approximately 19.1 percent of votes cast during the 2009 proxy season. In addition to increasing the proxy solicitation expenses for annual meetings, the rule change is expected to have the even more deleterious effects of significantly empowering activist and institutional shareholders, marginalizing retail shareholders, and precipitating more frequent board changes.[30] According to SEC Chairman Schapiro: "The rule change . . . is designed to help assure that voting rights for matters as critical as the election of directors are exercised by those with an economic interest in the company, rather than by brokers. I believe this will improve corporate governance and enhance accountability."[31]

The impact of the elimination of broker discretionary voting in uncontested elections is likely to depend primarily on two factors: the relative size of the public company and its shareholder composition. To generalize, public companies can be divided into four groups: Large- or "Mega"-Cap companies, Mid-Cap companies, Small-Cap companies and Controlled companies; each of these types of companies will fare differently with the elimination of broker discretionary voting. Each of these types of companies may face quorum issues in situations where the quorum is not established through routine proposals like the ratification of auditors, although this is most likely to be a problem for Mid-Cap and Small-Cap companies, since generally they have higher percentages of retail shareholders.

Controlled companies generally should not be affected by the elimination of broker discretionary voting, even in situations where the controlling shareholders do not have an absolute majority of the outstanding shares, since the voting outcome is likely to arrive at the same result whether or not the brokers can vote. Moreover, controlled companies are the least likely to be targeted by hedge funds and other activists.

Large- or "Mega"-Cap companies are likely to see the next smallest impact with the elimination of broker

26 For a discussion on say-on-pay proposals during the 2009 proxy season, see David A. Katz and Laura A. McIntosh, "Corporate Governance Update: 2009 Proxy Season Review and a Look Ahead to 2010," NYLJ, Oct. 29, 2009; see also RiskMetrics Group Postseason Report, Oct. 2009, at 24-25.

27 *See* Del Jones, "CEOs openly oppose push for say-on-pay by shareholders," USA Today, July 15, 2009 ("For example, certain investors could threaten to vote "no" on the CEO's pay to coerce the CEO into making decisions for short-term gain, such as delaying capital investment or taking on unnecessary debt. Such tactics could temporarily boost the stock price to the detriment of the company's long-term health").

28 *See* Martin Lipton and Jeremy L. Goldstein, "Executive Pay and Directors' Duties," July 20, 2009.

29 Separately, the Empowerment Act also includes a prohibition on broker discretionary voting for all publicly-traded companies.

30 For an in-depth discussion of the issues raised by this rule, see David A. Katz and Laura A. McIntosh, "Corporate Governance Update: Activist Shareholders Would Gain Power from Proposed Rule Change," NYLJ, Mar. 27, 2009.

31 Chairman Mary Schapiro, Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009). Chairman Schapiro recognized that "the implementation of the revised rule heightens concerns about shareholder participation and education, which need to be addressed", indicating that the SEC "staff is working hard on these education efforts . . . ." *Id.*

discretionary voting, as they tend to have the highest percentage of institutional ownership (estimated to be in the neighborhood of 75 percent[32]). However, since institutional investors tend to provide direction on how to vote their shares, they are likely to have even greater power at the ballot box, since a lower percentage of the outstanding shares will be voted. This is likely to increase institutions' and activists' ability to run successful withhold vote campaigns.

Mid-Cap companies tend to have a lower percentage of institutional ownership and therefore are likely to face a more substantial impact from the elimination of broker discretionary voting. Assuming institutional ownership in the range of 30 to 35 percent, Mid-Cap companies, in certain circumstances, are likely to be unduly influenced by proxy advisory firms such as RiskMetrics. For example, in such a company, if RiskMetrics recommended to its institutional clients that they withhold votes in a director election, prior to the elimination of broker discretionary voting, there would be a significant likelihood that as a result of broker discretionary voting, the withhold vote campaign would fail. However, with the elimination of broker discretionary voting, under those same circumstances, the institutional shareholders, who generally follow the recommendations of the proxy advisory firms in uncontested elections, would prevail in a withhold vote campaign. As more and more companies adopt a majority voting standard for the election of directors (which may become mandatory[33]), withhold vote campaigns will be increasingly meaningful, as they will give shareholders the ability to block directors from being elected and potentially force the resignation of incumbent directors.[34] For the company to prevail in such circumstances, it would need to hire a proxy solicitor and expend significant resources and funds in an effort to communicate with the underlying shareholders and to attempt to get them to vote.

Small-Cap companies are likely to fare the worst as a result of the elimination of broker discretionary voting, since they tend to have the largest percentage of retail shareholders.[35] Therefore, these companies, who are likely to be the least able to spend additional funds in any economic environment, will face the greatest need to do so. Unless the Small-Cap companies can get their retail shareholders to vote their shares (which will take a concerted effort by these companies and their proxy solicitors), they are unlikely to achieve satisfactory vote levels. Moreover, since public companies need to publicly disclose their voting results, these companies are likely to be viewed as very attractive targets by hedge funds and other activist investors; for a relatively small investment, these activists will be able to exert great influence at a shareholder meeting, in many cases dictating the outcome.[36]

Board Requirements

Nowhere is the usurpation of board discretion more egregious than in the numerous proposed reforms directed at the composition and structure of the board of directors. The Bill of Rights Act and the Empowerment Act would require all publicly-traded companies to split the role of board chairman and chief executive officer.[37] The chairmanship would be required to be held by an "independent" director. The proposed legislation offers varying definitions of "independence" and could result in a more stringent definition than the one currently used by the NYSE.[38] The Financial Stability Act has a

33 The Bill of Rights Act and the Empowerment Act would require all publicly-traded companies to elect directors under a majority-voting standard.

34 *See* David A. Katz and Laura A. McIntosh, "Director Elections and Majority Voting," NYLJ, Dec. 29, 2005.

35 The SEC clearly recognizes the significance of this issue. In a recent speech, Chairman Schapiro stated: "Retail investors have a history of low participation rates, but notice and access distribution of proxy materials may contribute to a further reduction in participation rates. This poses a special challenge for companies with broad retail investor bases. That is why some have proposed client-directed voting—where brokers would be allowed to solicit voting instructions from their shareholder clients in advance of the company proxy materials." Chairman Mary Schapiro, Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009).

36 In both the United States and Europe, the median market capitalization of a target company has fallen from $275 million in 2008 to $75 million in 2009, while proxy fights have increased this year by 27%. See Sam Jones and Lina Saigol, "Activist Investors Eye Smaller Prey," FT.com, July 23, 2009.

37 Separation of the roles of chairman and CEO has received high-profile support this year in the form of a report from the Millstein Center for Corporate Governance and Performance at the Yale School of Management. Together with the Chairmen's Forum, a group of nonexecutive chairmen convened by the Millstein Center, the Millstein Center issued a policy briefing arguing for voluntary adoption of the independent chair model. The paper contemplates possible exchange listing standards to compel compliance if the model is not widely adopted by public companies. See The Millstein Center for Corporate Governance and Performance, Policy Briefing No. 4, "Chairing the Board: The Case for Independent Leadership in Corporate North America," Mar. 30, 2009.

38 One example is the potential independence of former executives of an issuer. The Bill of Rights Act would exclude any former executive officer of the issuer from being an independent director, while the Empowerment Act excludes anyone who has been an executive of the issuer in the preceding five years and the NYSE excludes anyone who has been an executive officer within the preceding three years. See Shareholder Bill of Rights Act of 2009 (S. 1074), Sec. 5(e)(2); Shareholder Empowerment Act of 2009 (H.R. 2861), Sec. 2(d)(2); NYSE Listed Company Manual Sec. 303A.02(a) and (b). With respect to other categorical bars to independence, the Bill of Rights Act defers to the rules of the exchange on which an issuer is listed, while the Empowerment Act spells out specific criteria that, in many cases, are more stringent than those of the NYSE.

weaker requirement than the Bill of Rights Act, only requiring companies to disclose in their annual meeting proxy statements why they have chosen either to separate or not to separate the positions of the board chairman and the chief executive officer.

Director independence became a touchstone of corporate governance via regulatory and legislative reforms in the wake of the Enron, WorldCom and Adelphia scandals. Standards of independence now are firmly ingrained in corporate culture and, disturbingly, due to the efforts of activist shareholders and proxy advisory firms, are periodically being further increased. Though many independent directors do bring needed objectivity and outside expertise to board deliberations, there can be a downside to "excessive" independence. As Judge Frank Easterbrook recently noted, "Independent directors tend to be ignorant directors. Independence means that they don't know what's going on, except what managers tell them."[39] Moreover, another influential jurist, Delaware Vice Chancellor Leo Strine, has noted:

> Increasingly, boards are comprised of one person who knows everything about the company and who has an intense interest in its future—the CEO—and nine or ten other people selected precisely because they have no possible interest in or connection to the company that might cause them to be perceived as conflicted—or that might cause them to have any genuine concern for the corporation's future.[40]

The Bill of Rights Act also would require each public company board to establish a risk committee, comprised entirely of independent directors, which would be responsible for establishment and evaluation of risk management practices. The Financial Stability Act would only require risk committees for large financial institutions.

In perhaps its most far-reaching feature, the Bill of Rights Act would require boards of directors of publicly-traded companies to be declassified. As a result, all public company directors would be subject to annual election; staggered boards, which have been an available option since the dawn of the corporate form, would become illegal as a matter of federal law. Under the Financial Stability Act, staggered boards would be prohibited unless adopted or ratified by the shareholders of the company. This proposed legislation ignores the dramatic changes in the prevalence of staggered boards that has taken place over the last nine years by private ordering without any federal intervention; for example, the percentage of S&P 500 companies with staggered boards has declined from 61 percent in 1999 to 34 percent at the end of 2008.[41] The elimination of staggered boards would increase the vulnerability of public companies to unsolicited takeovers and would further encroach on territory properly governed by state corporate laws.

Moreover, the Bill of Rights Act and the Empowerment Act would require all publicly-traded companies to elect directors under a majority-voting standard. The proposed standard would apply only to uncontested elections and would require that the number of shares voted "for" a director's election exceed 50 percent of the votes cast with respect to that director's election. Incumbent directors who are not reelected by a majority vote would be required to tender their resignation to the board of directors (with the Bill of Rights Act mandating that the board accept such resignations). Similarly, the Financial Stability Act would mandate a majority voting standard in uncontested elections of directors and would require that any director who does not receive a majority vote submit a resignation to the board of directors, but would allow the board to accept the resignation or vote unanimously to reject it, in which case the company must disclose the reasons for the rejection and why the rejection was in the best interests of the company and its shareholders.

Governance Disclosure

In early July, the SEC proposed a package of new proxy disclosures, generally to be effective for the 2010 proxy season, concerning a wide variety of corporate governance and compensation issues.[42] Among other things, the proposed rules would require a description of, and justification for, a company's leadership structure, including whether and why a company has chosen to combine or separate the positions of chief executive officer and chairman of the board, and whether and why a company has a lead independent director. The proposed rules also would require a description in proxy statements of the board's role in risk management as well as a discussion in the Compensation Discussion & Analysis section addressing the relationship between a company's overall employee compensation policies and risk management practices and/or risk-taking incentives (to the extent material). Required information

39 Frank H. Easterbrook, "The Race for the Bottom in Corporate Governance," 95 Va. L. Rev. 685, 693 (2009).

40 Leo Strine, "Toward Common Sense and Common Ground? Reflections On The Shared Interests Of Managers And Labor In A More Rational System Of Corporate Governance" (Keynote Address to The Journal of Corporation Law), Mar. 1, 2007, available at http://www.law.upenn.edu/academics/institutes/ile/CCPapers/040507/Strine%20Speech.pdf.

41 Classified Boards Year Over Year, www.SharkRepellent.net (from 302 at year-end 1999 to 172 at year-end 2008).

42 SEC Release Nos. 33-9052; 34-60280; IC-28817; File No. S7-13-09 (July 10, 2009).

about directors, board nominees and executives would be significantly expanded, with longer look-back periods for disclosures. The proposed rules also would require detailed disclosures regarding compensation consultants who advise on executive and director compensation and provide other services to a company, including potential conflicts of interest and, significantly, quantification of the fees paid for each type of service. These proposals, if implemented, would impose a significant burden on companies that, in our view, is not justified by any benefit.

These proposals would also impact shareholder meetings and proxy contests. One proposed change would require that companies disclose voting totals on Form 8-K within four business days after a shareholder meeting, other than contested director elections, where disclosure would be required within four business days after preliminary voting results are determined.[43] Another proposed change would allow a person soliciting in support of nominees who, if elected, would constitute a minority of the board to seek authority to vote for another soliciting person's nominees in addition to or instead of the incumbent board's nominees to round out its short slate.[44] A third proposed change would allow a third party to send out unmarked copies of management's proxy card while communicating the third party's own views as to how the proxy should be voted, without the third party independently having to file proxy materials.[45] These last two proposed changes would further increase the likelihood of proxy contests and withhold vote campaigns, providing additional tools for activists to use in pursuit of their short-term focused agendas.

The Financial Stability Act would mandate annual proxy disclosure indicating whether the compensation committee has retained a compensation consultant and whether the work of the compensation committee has raised any conflicts of interest, demonstrating the relationship between executive compensation and financial performance, and comparing, in graphic form, the amount of executive compensation to the company's financial performance or investor return over a five-year period (or other period determined by the SEC). The Financial Stability Act would also require proxy disclosure as to whether company employees (not just executive officers) may engage in hedging transactions with respect to company securities awarded to the employee as compensation.

Proxy Mechanics

The SEC recognizes that it is necessary to review "proxy plumbing" and Chairman Schapiro has directed the SEC "staff to conduct a comprehensive review of the mechanics by which proxies are voted and the way in which information to shareholders is conveyed."[46] The SEC staff is reviewing "the entire process through which proxies are distributed and votes are tabulated."[47] This includes a review of the current system that allows beneficial owners to prevent the disclosure of their names and addresses to the companies in which they hold securities. Moreover, the SEC is reviewing the role of proxy advisory firms in the current proxy voting process.

Part of the difficulty is that the current proxy voting system is out of date and requires significant retooling. However, the SEC is advocating vast changes, proposing regulation on matters such as proxy access, without first fixing the underlying system that gives institutional and activist shareholders a built-in advantage over retail shareholders. The "proxy plumbing" should be fixed before these changes are implemented, so that the playing field for public companies is fair and transparent for all constituencies.

43 Under current rules, voting results of any matter that was submitted to a vote of shareholders during the fiscal quarter must be reported in the Form 10-Q or Form 10-K covering such fiscal quarter. Under California law, California corporations and many foreign corporations are required to disclose voting results upon the written request of a shareholder within 60 says of the shareholder meeting. *See* Cal. Corp Code Sections 1509, 1510(a).

44 The proposed rule change is consistent with the no-action relief granted by the SEC staff in March 2009 in the context of a proxy contest regarding the solicitation of proxies to vote in the election of directors where two dissidents had submitted separate "short slates" of director nominees for election at the same annual meeting. See Application of Rule 14a-4(d)(4) to Solicitation for Proposed Minority Slate of Icahn (Mar. 30, 2009), and Application of Rule 14a-4(d)(4) to Solicitation for Proposed Minority Slate of Eastbourne Capital, L.L.C. (Mar. 30, 2009). The no-action letters permit a soliciting shareholder to "round out" its short slate of directors with the nominees of other dissident shareholders rather than, as had historically been the case, only with nominees of the incumbent board.

45 If adopted, this proposed rule would overturn the Second Circuit's decision in MONY Group, Inc. v. Highfields Capital Management, 368 F.2d 138 (2d Cir. 2004), where the court found that a dissident shareholder could not send out copies of management's proxy card to shareholders and simultaneously rely on the exemption from filing proxy materials.

46 Chairman Mary Schapiro, Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009).

47 *Id.*

Conclusion

Many of these reform proposals represent misguided attempts to assert federal control over areas that have traditionally, and successfully, been governed by state law.[48] The benefits of the state law model have been demonstrated time and again by states' useful regulatory innovations, timely responsive actions and individualized regimes that help companies to maximize efficiency and minimize unnecessary burdens. Especially with respect to the details of corporate governance (such as whether a company splits the roles of chief executive officer and board chairman), a one-size-fits-all, top-down approach would have the effect of forcing conformity where it does not belong and serves no useful purpose. State lawmakers and companies are addressing many of the topics covered in the proposals and they are doing so in thoughtful, individualized ways that permit flexibility and promote productivity. Federal lawmakers should not commandeer this healthy and constructive process.

These proposals would have the effect of increasing unhealthy pressure on companies to focus on short-term stock price results.[49] Hedge funds and professional institutional investment managers control more than 75 percent of the shares of most major companies; in recent years, we have seen how these shareholders have demanded that companies produce unsustainable quarterly earnings results at the expense of long-term stability and growth.[50] President Obama in February decried the "reckless culture and quarter-by-quarter mentality that in turn have wrought havoc in our financial system."[51] As one commentator succinctly put it, these large and active shareholders are not investors, they are traders. Share turnover numbers are revealing: annual turnover on the NYSE in recent years has been greater than 120 percent, mutual fund turnover has been as high as 110 percent, and pension fund turnover has been more than 90 percent; by comparison, historical rates averaged in the 10-20 percent range before 1980.[52]

As Vice Chancellor Strine stated in a 2007 speech:

> As much as corporate law scholars fetishize the agency costs that flow from the separation of ownership and control in operating companies, they have been amazingly quiet about the "separation of ownership from ownership." What I mean by that is that the equity of public corporations is often owned, not by the end-user investors, but by another form of agency, a mutual fund or other institutional investor. It is these intermediaries who vote corporate stock and apply pressure to public company operating boards. . . . Most corporate law scholars have not burdened their minds with the fact that undifferentiated empowerment of these so-called stockholders may disproportionately strengthen the hand of activist institutions who have short-term or non-financial objecti[ve]s that are at odds with the interests of individual index fund investors. That proxy fights and derivative suits against money management boards are virtually unheard of under the "Business Trust" statutes that are prevalent in the governance of mutual funds is accepted by corporate law scholars with equanimity. But these same scholars claim the much greater number of such fights and suits against the board of operating companies is grossly insufficient and a justification for reforms in the corporation law governing operating corporations.[53]

Inexplicably, it is these very traders that these reform proposals would empower, further promoting the influence of those shareholders who seek short-term profits at the expense of long-term investment; the result is a recipe not for recovery but for relapse.

48 For a thorough discussion of this issue and other related points, see Martin Lipton, Jay W. Lorsch and Theodore N. Mirvis, "A Crisis Is a Terrible Thing To Waste: The Proposed 'Shareholder Bill of Rights Act of 2009' Is a Serious Mistake," May 12, 2009.

49 *See id.* and Lawrence Mitchell, "Protect Industry from Predatory Speculators," FT.com, July 8, 2009.

50 *See* Lipton, Lorsch and Mirvis, *supra.*

51 President Barack Obama, Speech on Executive Compensation, Feb. 4, 2009.

52 *See* Mitchell, *supra.*

53 Strine, *supra.*

Keep Calm and Carry On: U.S. Corporate Governance Reform Needs a Push, Not a Push Back

By Anne Simpson, Senior Portfolio Manager, Global Equities., Ms. Simpson manages the corporate governance program for CalPERS

In the wake of the financial crisis, the US reform agenda is full and it is fraught. Whilst the raft of new legislative and regulatory proposals looks impressive, plans to strengthen shareholder rights are still in need of attention.

The current crop of bills in Congress has been drafted to tackle a wide array of flaws in the capital markets: conflicted credit rating agencies, the incomplete jigsaw of banking and insurance regulation, weak investor protection, patchy registration of hedge fund and other advisers, and opaque trading in derivatives among them.

The SEC is also engaged in a formidable array of reforms, on proxy disclosure and solicitation, short selling, flash trading, and placement agents, to name just a few. These swiftly follow on the heels of important moves to abolish non-instructional broker voting for directors, and plans to withdraw embedded ratings requirements from regulations.

These Herculean reform efforts are intended to burnish the tarnished reputation of the world's largest capital market. The global impact of the financial crisis exposed regulatory weaknesses, fiscal mismanagement and venal behavior in boardrooms. As to the latter, it also revealed that in the world's largest capital market there was precious little that the owners could do to remove and replace those in corporate boardrooms responsible by accident or design for helping to bring the system to the brink of the abyss. As we teetered on that brink, there was bold talk of empowering the owners.

But on a crowded political stage, shareholders are in danger of being overlooked. The year began with proclamations and good intentions, but as legislation and regulation work their way through Congress and the regulatory rule-making process, less has been heard about giving the owners the rights which would allow them to hold corporate boards accountable. Chief among these rights are majority voting for directors, the ability to approve compensation policy via a non-binding vote of the stockholders (for companies beyond those in receipt of tax payer funds via TARP) and the governance gold standard of proxy access.

As for that gold standard, the SEC is contemplating its next move following the receipt of some 500 plus comment letters on new proposed rules which would allow shareowners to put forward their own candidates for election to corporate boards in the United States.

Currently, management candidates can be placed on the ballot issued by the company, but not shareholder candidates. Proposals by shareowners to put forward candidates for the board, regardless of merit or need, can be simply excluded. The alternative route with a recalcitrant board is to mount a proxy context, which in CalPERS' experience costs in millions, not thousands, of dollars, making it a prohibitively expensive route to improvement.

The SEC is consulting on rules which look modest by international standards. Shareowners with at least a one year holding period, and a stake of between 1% and 5% of the equity, depending upon company size, could be allowed to put their candidates up for consideration via the proxy and have them considered by all shareholders in their voting decisions. These proposals could be for no more than 25% of the board, to ensure there is no attempt to obtain control of the company and thereby undermine takeover provisions.

What seems to many investors to be a fairly common sense provision, has met resistance from the corporate community, and not for the first time. Earlier efforts to open up the ballot to the owners foundered under the weight of corporate opposition, tepid support from a divided SEC, and baffling rules which confused even supporters of the idea.

This time the SEC has put forward relatively straightforward proposals, which avoid arcane triggering events. However, their suggestions have not met with enthusiasm from the corporate community.

A browse through the comment letters on the SEC website provides insight into the extensive range of concerns and poses some questions as to their origin. One commentator, an office manager in the family chiropractic surgery wrote "The SEC is now considering changing the rules for proxy access. As my eyes roll in their sockets, I am thinking 'oh brother'". It is not clear how the proxy access rule would affect such a small family enterprise, and the writer does not explain.

Another wrote that "unfortunately nearly a year after I opened my dog bakery, I was forced to shut the doors because of slow sales". No doubt the economic downtown, exacerbated by the financial crisis played its part, but the writer cautions that her real concern is with proxy access, advising the SEC "I encourage you to keep the shareholder proxy access the way it is. By doing so you will be protecting the rights of small business owners."

Large multinational corporations have flagged their concern that the change to boardroom dynamics that proxy access would introduce. An oil major commented "We believe the strength of the current corporate governance structure of the US corporation lies in the consensus driven leadership and oversight resulting from the free and open exchange of knowledge and perspective by a free and open exchange of knowledge and perspective by a board of directors working in a collegial manner for the good of the stock holders." The stockholders would not disagree. The question is what can they do when the collegial board is presiding over financial decline, and is not responsive to calls for improvement? Then the introduction of a catalyst into the boardroom could well be revitalizing. It may even be welcomed by those directors looking for a new source of ideas and independence in the boardroom.

Another concern is entirely jurisdictional. That the SEC is reaching into the provenance of state law. However, the SEC has clear responsibility for the proxy, and it is this which is the focus of the reform. In simple terms, their rule allows company owners to use the proxy not just for proposals on policy, but arguably for the most important proposal they can make: improving board quality.

When boards fail, owners need to be able to step up to the plate and propose alternatives. It is not enough to 'just vote no' when you are presented with a failing board. You also need to be able to propose a way forwards. Otherwise, shareowners can be seen as those who knock down, but don't know how to build up. As fiduciaries, institutional investors like CalPERS know well that boards need talent, competence, independence and integrity to steer the company to success. We also know that companies need different combinations of talent at different times in their development. We also know that boards can become settled, descend into comfortable 'group think', lose the will to challenge wayward executives, or just say no when poorly considered proposals are on the table. Compensation is often an example of boards that have lost the ability to challenge.

With the advent of majority voting, of course, shareowners could simply wait for the next AGM, and hope that they can just vote no, and then hope that the incumbent board has a Damascean conversion, and decides to replace itself with those bringing new ideas, experience, and even a new style to the table. That is what proxy access is all about. It's about bringing new talent to the table. Perhaps it is better seen as the route to reform when the normal channels have failed, when discussion with and suggestions to the board have failed, but change is still sorely needed.

There are those who believe that activist investors will propose special interest candidates without the experience or skills needed, who will not be team players, or who will not focus upon their responsibilities to the company and all its shareholders rather than solely the shareholders who put the nominee forwards. In short, they fear the cure would be worse than the complaint.

That is a rather fanciful proposition. Any candidate put forward by one or several shareowners would simply go on the proxy. Then the broad community of shareowners will have the opportunity to vote. No activist can impose a board candidate by fiat, unless the moderate majority decides to abandon common sense. That seems unlikely.

The important point to make is that proxy access, majority voting and say on pay are simply means to ensure accountability. They are provided to fix a problem, not to cause one. When companies fail, there can be many reasons, but one of them is an inept board. It may well be that majority voting will empower equity to speak, and cause those presiding over failure to depart. But sometimes it is not that simple and directors need to be replaced, not just removed. This is why proxy access is important.

Corporate governance failures have exacerbated the severity and depth of the financial crisis, and this in turn has led to an economic downturn affecting millions in this country and around the world. There is a need for regulatory improvement and better co-ordination, but this should not distract our attention from ensuring that the relationship between companies and their owners is strengthened and given new respect and attention. That requires at the least, that boards be held accountable to their owners.

Developments in Proxy Contests and Corporate Governance

by Steve Wolosky and Adam W. Finerman,
Olshan Grundman Frome Rosenzweig & Wolosky LLP

While activist investors have made meaningful inroads in recent years in successfully obtaining independent board representation for directors focused on enhancing shareholder value, it has come sometimes at a high cost. Many efforts have been thwarted, not because representation is unwanted, but because of the significant legal, proxy solicitation, printing and mailing expenses which a shareholder must bear even to add one shareholder representative. Perhaps meaningful change is on the way. Recently, many significant changes regarding proxy contests and corporate governance reforms have been proposed. The proposed changes include amendments to the U.S. Securities and Exchange Commission ("SEC") rules which, among other things, would provide shareholders better access to company proxy materials, increase disclosure requirements regarding compensation policies, executive compensation, director qualifications, board leadership policies and structure and clarify rules relating to proxy contest involving director short slates. Concurrently, Senator Charles E. Schumer has proposed the Shareholder Bill of Rights Act of 2009 legislation which if adopted would also provide for shareholder access and additional corporate governance modifications.

Many of these proposed changes have been discussed and considered for years, some are newer. However, we believe they may get a more receptive view in light of the recent economic downturn and the new Obama administration. In addition, on July 1, 2009 the SEC approved the amendment to the New York Stock Exchange (the "NYSE") Rule 452 eliminating the ability of brokers to vote in elections of directors commencing for annual meetings held on or after January 1, 2010 without shareholder instruction.

Board and management practices at public companies have historically in many instances been that of collegiality, frequently with chief executive officers having a large say in selecting directors, who effectively serve as their "boss." Non-productive or "absentee" board members are rarely asked to leave or not stand for re-election, particularly if they are supporters of management and the status quo. In the past several years, of course, boards have come under increased scrutiny, and to some extent have improved their procedures, but we believe in a significant number of public companies, if not the majority, the age old practices of entrenchment, personal relationships, independence in name only but not in practice and a failure to truly represent the shareholder continues and is alive and well. Accordingly, when a dissident identifies a company that he or she believes could have significantly increased value for shareholders with a different direction or strategy, the dissident must choose between attempting to work with a frequently hostile and unresponsive board and management, many times more interested in maintaining the status quo (which frequently includes significant salaries and perks), or commencing a costly and time consuming proxy fight, knowing that the company will have available all of its considerable resources to fight, and the dissident must finance its fight personally. We believe that there are many worthwhile and potentially value enhancing fights which are abandoned because the dissident believes a full scale fight against the company would be too costly to justify.

The recent economic downturn illustrates that the boards and management of many public companies have not engaged in best business practices and certainly have totally ignored significant risks to their businesses (e.g. Lehman Brothers, Wachovia, etc). While management has walked away with multi-million dollar pay packages, the shareholders, the true owners of the company, have been made to bear the cost of these poor decisions. Therefore, the key question is whether these changes, as proposed, go far enough in empowering shareholders, promoting shareholder democracy and improving corporate governance so as to provide the proper regulatory framework in which shareholders can hold boards and management accountable.

SEC Rules: Shareholder Access

The SEC proposed a series of rule amendments that would enhance the ability of shareholders to nominate and solicit proxies for the election of their director nominees. Foremost, the proposed rules would require most publicly traded companies to include in their proxy materials a limited number of shareholder nominees under certain circumstances. In order to be eligible to have their nominees included in a company's proxy materials shareholders would have to meet both ownership and holding period thresholds with respect to the company's securities. The company would only be required to include shareholder nominees representing up to a maximum of twenty-five percent of the board of directors. In the event a company were to receive shareholder nominations of more candidates than it was required to include in its proxy materials, the company would be required to include only the candidate(s) that were first nominated.

The proposed SEC rule changes have the potential to benefit those shareholders wishing to gain minority representation. Electoral challenges to incumbent directors are in many instances limited due to the fact that challengers must bear the considerable cost of soliciting their own proxies, which in relation to the shareholder's investment in the company, can be cost prohibitive. Granting shareholders access to company proxy materials clearly would provide the ability for a shareholder to potentially participate in a cost-effective manner, enabling more shareholders to have the potential to obtain board representation, and in our view would promote dialogue with the company since a company would know that shareholders will have a choice. Limiting proxy access to only the management endorsed nominees serves no reason other than to entrench the existing management and curtail the free choice of the shareholders of the company.

Of course, as with everything, the specific implementation of these proposed rules, and the details of their implementation, are crucial in making sure that they in fact accomplish what they are intended to, which is to increase shareholder access, and not merely serve as window dressing. The SEC rules must address the logistics of the inclusion of shareholder nominees in company proxy materials, such as where the shareholder nominees will be listed on the proxy card (so they will not be hidden at the bottom away from the management endorsed nominees) and the extent to which shareholders will be permitted to include a statement in support of their nominees in a company's proxy material and the company will be permitted to include a statement in opposition to such nominees. Additionally, the rules should address the ability of the shareholders whose nominees are included in a company's proxy materials to simultaneously solicit directly for their own nominees and the ability to elect additional nominees proposed by other shareholders outside of the process of these rules. Unless there are sufficiently defined regulations regarding the logistics of the inclusion of shareholder nominees in company proxy materials such shareholder access will not truly enhance the ability of shareholders to achieve real minority representation on boards. The experience of proposals included in company proxy materials pursuant to Rule 14a-8 has demonstrated that, while inclusion of such shareholder proposals may look good on the surface, without separate solicitation by the proposing shareholders such proposals have a limited chance of success.

Another issue to be considered is the "first in time" provision. This requirement could create a race to nominate. The first in time rule would permit shareholders with relatively low ownership levels to have their nominees included in the company's proxy materials, while shareholders with significantly higher ownership levels could be excluded and left to solicit their own proxies. In fact, if the Board believed that a nomination was imminent, it could also provide information to a friendly shareholder and suggest that they submit a nomination acceptable to the company.

The drive behind granting shareholder access to company proxy materials is the desire to level the playing field. Companies currently have a wealth of resources (they are spending shareholders' money) and unfair advantages in proxy contests, making it very difficult for shareholders to effect change. However, granting shareholders limited access to company proxy materials alone will not ensure a level playing field for all participants in a proxy contest. To in fact level the playing field in proxy contests and make it a truly democratic process, the SEC should allow shareholders to vote for all director nominees on proxy cards, rather than forcing shareholders to chose between competing proxy cards and limiting their ability to vote for only the nominees listed on such cards. Granting full access to proxy cards would perhaps be more useful than granting limited access to company proxy statements.

SEC Rules: Director and Nominee Experience and Qualifications

The SEC proposed amendments to Item 401 of Regulation S-K ("Item 401") to provide for increased disclosure regarding the experience and applicable qualifications of each director and director nominee to serve on the board and as a member of any committee on which they serve or are chosen to serve. The amendments would also expand the current requirement to disclose all present public company board memberships to disclosure of all directorships held at public companies during the past five years and would lengthen the required time period of disclosure of legal proceedings from five to ten years.

These amendments to Item 401 would improve the ability of shareholders to evaluate the suitability of current directors and nominees to serve as directors of the company. Increased disclosure regarding the relevant experience and qualifications of directors and nominees would enable shareholders to better assess their respective skills and particular areas of expertise and to determine if their membership on the board would be beneficial the company. Additionally, greater disclosure of the board membership history of directors and nominees would allow shareholders to judge the relevance of such experience, as well as illuminate relationships that may pose a conflict of interest. Finally, the involvement of directors and nominees in legal proceedings may reflect upon their fitness to serve the best interests of the company, providing shareholders with a greater pool of information would improve their ability to determine the character and competency of such individuals.

SEC Rules: General Compensation Policies and Executive Compensation

The SEC proposed an amendment to Item 402 of Regulation S-K ("Item 402") to require companies to expand their "Compensation Discussion and Analysis" to encompass their broader compensation policies and actual compensation practices for employees generally, including non-executive officers, if risks arising from those compensation policies or practices may have a material effect on the company. Appropriate elaborated disclosure would permit shareholders to assess the level of risk that employees may be encouraged to take to receive incentive compensation. Often incentive compensation arrangements are tied to short term goals, causing the interests of management and some employees to be misaligned with the long term well being of the company. Therefore transparency regarding compensation policies would provide shareholders with valuable information and enable them to make better educated voting decisions.

The proposed amendment of Item 402 would also revise the disclosure in the "Summary Compensation Table" and "Director Compensation Table" to include the aggregate grant date fair value of awards computed in accordance with generally accepted accounting principles. This information would assist shareholders in evaluating the decisions of the compensation committee.

SEC Rules: Board Leadership

The SEC proposed an amendment to Item 407 of Regulation S-K ("Item 407") to require a discussion of the company's leadership structure, including disclosure of whether the company has combined or separate principal executive officer and board chair positions, and the rationale for such. Furthermore, if the company has combined the principal executive officer and board chair positions the company must disclose whether the board has a lead independent director and the specific role the lead independent director plays in the leadership of the company. The discussion would also be required to include why the company has determined that its leadership structure is appropriate given the specific characteristics of the company, as well as the extent of the board's role in the risk management process and the effect this has on the leadership structure.

A discussion of a company's board leadership would provide substantive information regarding the company's corporate governance practices and provide shareholders with insight on how the board runs. Disclosure of the board's participation in the risk management process would also provide shareholders with information about the board's role in managing the material risks of the company.

SEC Rules: Rounding Out Short Slate Solicitations

The SEC has proposed to revise the proxy solicitation rules to clarify that a non-management soliciting person nominating a short slate of directors may supplement its short slate with nominees of other non-management soliciting persons in the same way that it can round out its short slate with management nominees. This amendment would be extremely beneficial in leveling the playing field in the election of directors. Currently, only management nominees may be used to fill out a non-management short slate, giving management nominees an advantage in that shareholders may vote for them on two or more proxy cards where non-management nominees can only be voted for on one proxy card.

Shareholder Bill of Rights Act of 2009

The legislation proposed by Sen. Schumer, the Shareholder Bill of Rights Act of 2009 (the "Bill"), also provides for shareholder access to company proxy materials, but goes further and includes significant corporate governance changes as well. These include a "Say-On-Pay" component that would grant shareholders a non-binding, advisory vote on executive compensation, separation of the roles of Chairperson and Chief Executive Officer, the annual election of directors and the requirement that directors be elected by a majority vote in uncontested elections. The key provisions of the Bill would generally improve corporate governance and shareholder participation:

- Granting shareholders a "Say-On Pay" is a positive development that will promote a check on undue management compensation and require that management answer to the shareholders and look to the economic health of the company, and not just to the lining their own pockets.

- Separation of the positions of Chairperson and Chief Executive Officer is another positive development that would improve corporate governance and likely increase independence in the boardroom. There has been a continuing trend, brought about by pressure from shareholders and proxy advisors, of companies separating these roles. In 2008 nearly forty percent of S&P 500 companies separated the roles of Chairperson and Chief Executive Officer. Further evidence of the good governance practice of separating these roles is the fact that, where the Chairperson and Chief Executive Officer roles are combined, the NYSE requires that the company must have a lead independent director.

- The declassification of boards, requiring the annual election of all directors, would also improve corporate governance as it would promote annual accountability of directors and discourage boards from acting counter to the desire of the shareholders for long periods of time. Nearly two-thirds of S&P 500 companies have annually elected boards and shareholder proposals requiring declassification of the board consistently receive support from proxy advisors and significant shareholder votes.

- The requirement that directors be elected by a majority vote in uncontested elections would also promote greater director accountability. Requiring that directors receive a majority of votes would ensure that the membership of the board accurately reflects the will of the shareholders. Over sixty percent of Fortune 500 companies have already instituted majority voting requirements. The one concern with this requirement is that in the Bill's current form the board would be required to accept the resignation of any director not elected by a majority in an uncontested election. While requiring directors to be elected by a majority vote in an uncontested election is generally beneficial in preventing holdover directors who are not the chosen representatives of the shareholders, mandatory acceptance of such resignations could lead to boards with too few members to function. Rather than being forced to accept the resignation of a director who does not receive a majority vote, boards should only be required to accept such resignation where the director fails to receive a majority vote for two consecutive years.

In response to the proposed changes by both the proposed SEC rules and the Bill, some argue that federal legislation is unnecessary to make the proposed changes, as such changes can be made by state law or at the individual company level through shareholder proposals. This view, however, penalizes shareholders in lagging companies which do not follow the general trends in corporate governance towards declassified boards and majority vote requirements. While this process takes shape some shareholders have greater rights while others do not. The benefit of federal legislation would be to universally grant certain important rights to all shareholders. The arguments against federal legislation also ignore the inherent advantage incumbent management has over shareholders desiring to initiate change in corporate governance.

NYSE Rule 452

Previously, the NYSE Rule 452 permitted brokers to vote in their discretion for "routine" matters when they did not receive voting instructions from the beneficial owners at least ten days before a scheduled shareholder meeting. The uncontested election of directors was deemed routine, therefore permitting brokers to vote in elections of directors without receiving voting instructions from the beneficial owners. The recent amendment to Rule 452, effective for shareholder meetings held on or after January 1, 2010, makes the uncontested election of directors a non-routine matter, requiring that brokers may only vote on such matter pursuant to instructions received from the beneficial owners. If the broker does not receive instructions from the beneficial owner with respect to the election of directors such shares will not be voted on that matter. This is a very positive development in making director elections truly democratic.

The policy of brokers voting for management endorsed nominees without receiving instructions from the beneficial owners was undemocratic and served to entrench management and to show illusory election results in "uncontested elections" where frequently management nominees appeared to have received over ninety percent of votes, when in fact many of those shareholders did not vote. In 2005 the NYSE created the Proxy Working Group to review the NYSE rules regarding proxy voting. In its report, the Proxy Working Group noted that the primary way director accountability is expressed is through the election process and recommended that the election of directors, even when uncontested, should not be viewed as a routine event in the life of a company. Additionally, the need to eliminate broker discretionary voting in the election of directors heightened with the rise of "just vote no" and "withhold" campaigns, which, without competing solicitations, did not meet the definition of a "contested" election. In such a case brokers were permitted to submit a routine vote, thus potentially skewing the results of such a campaign. The amendment of Rule 452 will ensure that the votes in the election contest more accurately reflect the will of the shareholders.

Conclusion

The overall impetus behind the proposed proxy contest and corporate governance changes is the greater engagement of shareholders in the administration of the company they own and greater accountability of boards and management to the shareholders on whose behalf they should be acting. We believe the amendment of NYSE Rule 452 is a very good first step. While some of the other proposed changes in their current form are not perfect, the momentum for change indicates the recognition of the need for better corporate governance and for boards of directors that are no longer closed clubs but rather accountable delegates representing the voices and concerns of the shareholders. We believe the proposed changes would benefit all shareholders by promoting board accountability, permitting limited or smaller scale fights and preventing incumbent boards from taking reelection for granted.

Ken Altman is the President and Founder of The Altman Group, winner of the last three TOPS Awards for Best Proxy Solicitation Firm.

With over 35 years of experience in proxy solicitation and shareholder communications, Ken is one of the most knowledgeable people in the U.S. in the proxy solicitation field. He began his career in the proxy industry in 1969, working part-time in the proxy department of a brokerage firm while in college. In early 1970, Ken joined D.F. King & Company, working there through the balance of his college years and while he completed his MBA. In 1976, Ken joined Hill & Knowlton, then the largest public relations firm in the world, to found and run their proxy business for 18 years. In 1991 Ken was appointed Chief Operating Officer of H&K's U.S. Company.

In 1995, Ken founded The Altman Group. In 2002, the firm expanded its operations and brought in a number of top proxy industry veterans. The firm has since added over 75 people to its staff, been retained by over 750 new clients, and opened a wholly-owned 250-seat call center in Lyndhurst, N..J. Unlike many proxy industry calls centers, the Altman call center is wholly-dedicated to proxy solicitation calls.

The Altman Group, which is widely recognized as one of the premier firms in corporate proxy solicitation, also has developed industry-leading expertise in corporate governance consulting, vote projection analyses, open and closed-end fund solicitations, and institutional shareholder identification.

Contact: kaltman@altmangroup.com

Charles Edward ("Ted") Allen III is Director of Publications at RiskMetrics Group, where he has overseen the company's newsletters on corporate governance and securities litigation since 2004. Prior to joining RiskMetrics, he worked as a legal news editor for Bloomberg News, *The Deal*, and *Legal Times*. He also was an associate at Proskauer Rose and received his law degree from Georgetown University.

Contact: Ted.Allen@riskmetrics.com

Carol Bowie leads the RiskMetrics Group Governance Institute team, which provides timely research around key issues in corporate governance. She previously headed the company's Governance Research Service unit and a similar team at the Investor Responsibility Research Center. Prior to that, Ms. Bowie was Director of Publications & Research for Executive Compensation Advisory Services and long-time managing editor of the *Executive Compensation Reports* newsletter, analyzing trends and developments in executive pay at public companies.

Contact: carol.bowie@riskmetrics.com

Richard Ferlauto is the director of Corporate Governance and Public Pension Programs for the American Federation of State, County and Municipal Employees (AFSCME) where he is responsible for representing public employee interests in public retirement and benefit systems. He was recently named by Directorship Magazine as one of the most influential corporate governance activists and has been featured in Institutional Investor magazine.

He is founder and Chairman of ShareOwners.org a nonprofit nonpartisan organizations that represents the interests of retail shareholders. He is a director of CERES, a leading investor and environmental organization.

On November 19th, the Securities and Exchange Commission announced the appointment of Richard Ferlauto as Deputy Director for Policy in the Office of Investor Education and Advocacy (OIEA). He will begin his new role with the SEC on January 1, 2010.

Contact: RFerlauto@afscme.org

Joele Frank, Managing Partner, has developed successful investor and public relations strategies and programs in more than 1,000 special situations, including NRG in its defense against Exelon, Target during its proxy contest with Pershing Square Capital Management and CSX in its defense against TCI. Ms. Frank has been included in *PR Week's* PR Power List for the last two years. She has also been named a member of *Inside PR's* Hall of Fame.

Contact: JFrank@joelefrank.com or 212-355-4449

Jeremy Jacobs, Managing Director, at JF,WBK, Jeremy Jacobs provides communications counsel to clients in special situations such as mergers and acquisitions, shareholder activism and proxy contests. Among the many companies he has advised during proxy contests are Coinstar, Luby's, KT&G, Inter-Tel and Six Flags. Mr. Jacobs has degrees in English Literature from Duke University and the University of Pittsburgh. He has co-authored several articles on communications in M&A and shareholder activism.

Contact: JJacobs@joelefrank.com or 212-355-4449

John F. Grossbauer is a partner in the Wilmington, Delaware firm of Potter Anderson & Corroon LLP. Mr. Grossbauer counsels public and private clients on all aspects of Delaware corporation law, advising on a wide variety of statutory and fiduciary duty law matters involving corporate governance, M&A and other matters. He has been involved in a number of proxy contests over the years for management and insurgents. Mr. Grossbauer is a member of the Council of the Corporation Law Section of the Delaware State Bar Association.

Contact: John F. Grossbauer, Partner, Potter Anderson & Corroon LLP
302-984-6131 Direct Dial; jgrossbauer@potteranderson.com

Roy J. Katzovicz is the Chief Legal Officer of Pershing Square Capital Management, L.P., a SEC-registered investment advisor to domestic and non-U.S. investment funds. As Chief Legal Officer of the firm, Mr. Katzovicz directs Pershing Square's efforts relating to corporate governance and securities market reform including OTC derivatives, shareholder proxy access and short selling rules. Prior to joining Pershing Square, he served as a corporate attorney at Wachtell, Lipton, Rosen & Katz.

Contact: Roy Katzovicz, Chief Legal Officer, Pershing Square Capital Management, L.P.
888 7th Avenue, 42nd Floor, New York, NY 10019
Email: rjk@persq.com
Office: (212) 813-3700

David A. Katz, a partner of Wachtell, Lipton, Rosen & Katz, an Adjunct Professor at New York University School of Law and Vanderbilt University School of Law and a Senior Professional Fellow at NYU Center for Law and Business, specializes in major domestic and international mergers, acquisitions, securities transactions, strategic defense assignments, hostile bids, proxy contests, and corporate restructurings, and counsels boards of directors on corporate governance and crisis management. He is a graduate of Brandeis University and New York University School of Law and co-authors the Corporate Governance column for the *New York Law Journal*.

Contact: 212-403-1309

Martin Lipton, a founding partner of Wachtell, Lipton, Rosen & Katz, specializes in advising major corporations on mergers and acquisitions and matters affecting corporate policy and strategy, and has written and lectured extensively on these subjects.

Contact: 212-403-1000

Laura A. McIntosh, a consulting attorney for Wachtell, Lipton, Rosen & Katz, received a B.A. *summa cum laude* from Yale University, an A.M. in English Literature from Stanford University, and a J.D. from Yale Law School, where she was editor-in-chief of *The Yale Law Journal*. Ms. McIntosh has worked on a wide range of corporate transactions; she has published numerous articles on law and governance, frequently lecturing on these topics and co-authors the Corporate Governance column for the *New York Law Journal*.

Contact: LAMcIntosh@consultant.wlrk.com

Anne Simpson, Senior Portfolio Manager, Global Equities, California Public Employees' Retirement System (CalPERS)

Anne heads the Corporate Governance program of the California Public Employees' Retirement System (CalPERS), the largest state public pension system in the United States with approximately $190 billion under management. The program includes CalPERS Focus List of shareholder engagement with companies, global proxy voting, legal and regulatory reform agenda and CalPERS actively managed corporate governance investment strategy, which currently constitutes a combination of external managers and internal management. Anne is a Senior Faculty Fellow at the Yale School of Management, and is a member of the World Economic Forum's Global Agenda Council on Corporate Governance. Anne also serves as a member of the Private Sector Advisory Group to the World Bank-OECD's Global Corporate Governance Forum. She was formerly the first Executive Director of the International Corporate Governance Network and prior to that was recruited to the World Bank to lead their corporate governance reform efforts in the wake of the Asia crisis. Anne was previously a co-founder and joint Managing Director of PIRC Ltd, investment advisers to global pension funds on corporate governance and corporate responsibility. Anne read Politics, Philosophy and Economics at St Hilda's College, Oxford and Development Economics as a Slater Fellow at Wellesley College, Massachusetts. She was elected a Fellow of the Royal Society of Commerce, Manufactures and the Arts in 1995. The Financial Times in 2007 cited her as "arguably the most influential shareholder activist" internationally.

Anne is the author of The Greening of Global Investment' published by the Economist, and with Jonathan Charkham, 'Fair Shares: the future of shareholder power and responsibility' published by Oxford University Press. She is an editorial board member of the Journal "Corporate Governance: An International Review".

Contact:

Steve Wolosky is a senior partner with Olshan Grundman Frome Rosenzweig & Wolosky LLP and is an experienced corporate and securities lawyer whose practice includes expertise in proxy contests and in mergers and acquisitions. Steve is one of the leading lawyers in the country advising hedge funds on equity investments in public companies, including "activist" situations seeking representation on Boards of Directors of public companies in the United States and worldwide.

Contact:

Adam W. Finerman is a partner with Olshan Grundman and is an experienced corporate and securities lawyer whose practice includes expertise in proxy contests and in mergers and acquisitions. Adam specializes in advising hedge funds on equity investments in public companies in connection with proxy contests, hostile takeover bids and defenses. He also has broad-based experience in corporate finance and mergers and acquisitions, and advises public companies on corporate governance and SEC reporting.

Contact:

The Altman Group

Winner Biennial TOPS Awards 2004, 2006, and 2008
- Highest Rated Proxy Solicitation Firm

New York
60 East 42nd Street
One Grand Central Place
New York, NY 10165
TEL: 212.681.9600
FAX: 212.681.1383

New Jersey
1200 Wall Street West
Lyndhurst, NJ 07071
TEL: 201.806.7300
FAX: 201.460.0050

Rio de Janeiro, Brazil
Praia de Botafogo 316/908
Rio de Janeiro - Brasil - 22250-040
TEL: 55.21.2237.8072

www.altmangroup.com

For further information please contact:

Ken Altman
President, The Altman Group
TEL: 212.681.9600
E-mail: kaltman@altmangroup.com