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Key Takeaways from the 2009 Proxy Season and Preparing for 2010 *A Primer for Public Company Directors*

With executive compensation and governance issues continuing as daily news headlines, legislators, members of the administration and the Securities and Exchange Commission (SEC) have made a variety of far-ranging proposals to change the current compensation and governance requirements for U.S. public companies. Even without federal mandates, populist sentiment and proposals from shareholder groups have placed increased pressure on public company boards, particularly compensation committees and nominating/corporate governance committees. In many ways similar to the environment in 2002 when Sarbanes-Oxley was enacted, in view of the recent financial crisis, there is a rush to “re-regulate” U.S. public companies, with many groups seeking to take a role in this process.

In just the last 90 days, input on various corporate governance issues has come from Senator Charles Schumer through the proposed Shareholder Bill of Rights Act of 2009, Representative Gary Peters through the proposed Shareholder Empowerment Act of 2009, statements of Mary Schapiro, Chairman of the SEC, rule proposals set forth by the SEC, statements of Treasury Secretary Timothy Geithner, and the Department of the Treasury proposals for Financial Regulatory Reform, and it is unlikely to stop there. As we evaluate these proposals for major changes in corporate governance, it is important to consider in this context another force that exerts substantial influence on U.S. public companies—the proposals made by shareholders at annual meetings in accordance with SEC regulations.

This client alert evaluates the results of five key types of shareholder proposals that were presented at 2009 annual meetings, based on data as of June 15, 2009 published by RiskMetrics Group.¹ For each type of proposal, we review the results of the voting so far, including how the voting has changed compared with voting in 2008. We also



consider the “takeaways” for each subject, and consider what may lie ahead, including how these types of shareholder proposals relate to proposed legislative or regulatory measures. Finally, we suggest some actions that boards may wish to consider relating to these matters to better position their companies going forward.

Key Shareholder Proposals from 2009 Annual Meetings

The following are five key shareholder proposals from the 2009 proxy season that affect corporate governance:

- an advisory vote on compensation, also called “say on pay;”
- majority voting for directors;
- requiring an independent board chairman;
- right of shareholders to call a special meeting; and
- repeal of classified boards.

We note that in the 2009 proxy season, RiskMetrics generally recommended a vote in favor of each of these types of shareholder proposals.

Advisory Vote on Compensation/“Say on Pay”

Background. “Say on pay” proposals generally allow shareholders of public companies to participate in a non-binding, advisory vote on whether they support the compensation of the company’s top executives as described in the proxy statement. Based generally on changes that were codified into law in the United Kingdom in the early part of this decade, shareholder proposals calling for companies to institute say on pay advisory votes began to appear in the U.S. in late 2005. Several companies have already voluntarily added a say on pay proposal to the proxy ballot in response to these shareholder proposals. Moreover, beginning in mid-February 2009, as a result of the American Recovery and Reinvestment Act of 2009 and the Emergency Economic Stabilization Act of 2008, participants in the Troubled Asset Relief Program (TARP) have been required to include a management-instituted say on pay advisory vote on compensation as part of their proxy statement. On July 1, 2009, the SEC approved proposed rules to clarify and implement the requirement for companies that have obligations outstanding under TARP to include say on pay votes at their annual meetings.²

A review of the numbers. Of 81 say on pay shareholder proposals considered at 2009 annual meetings or expected to come to vote in 2009, 52 vote results are available. The average support is 46.7%, with at least 18 of the 52 proposals achieving majority support. In 2008, a total of 75 say on pay shareholder proposals came



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to vote, with an average support of 41.5% and 11 achieving majority support. Accordingly, over the last year there has been an increase in both the number of proposals and average support for these proposals. We note that these numbers reflect only the shareholder proposals for say on pay, and not the advisory votes put to shareholders under TARP and by other public companies.

Key takeaways. With average support nearing majority level and over one-third of the shareholder proposals being approved, shareholders are increasingly supporting the adoption of say on pay proposals. Of all the governance reforms currently proposed, say on pay is the one that appears to have the most support across all constituencies. TARP recipients are already required to include a say on pay vote as part of their proxy statements for their annual meetings. The Schumer bill, the Peters bill and the Treasury recommendations all contemplate requiring a non-binding annual advisory vote on compensation for all public companies listed on a national exchange.

The good news for public companies is that the management-instituted say on pay votes that have been included in 2009 proxy statements have received favorable votes from shareholders. The *Wall Street Journal* reported that at 15 large companies with 2009 say on pay proposals, support ranged from 63.5% of votes cast at Motorola, Inc. to nearly 98% at Goldman Sachs Group, Inc.³ It is particularly noteworthy that, to date, say on pay proposals have been approved by shareholders for all TARP recipients, even in the few instances where RiskMetrics Group recommended a vote against the proposal. In addition, in the United Kingdom, where say on pay has been required since 2002, there have been only a handful of companies that have not received majority support for the proposal. In these instances, the adverse votes have come at companies where there have been long-standing shareholder concerns about overall company performance as well as governance issues.

What may be coming in 2010. All public companies, not just TARP recipients, should be working on the assumption that say on pay will be required to be included in the proxy statement in the near future. It is possible that legislation to extend the say on pay vote beyond TARP companies may pass later this year, with say on pay required for 2010 annual meetings. What is not so clear, however, is the form of the proposal that may be required, how often a vote will be required, whether the proposal will be limited to companies listed on a national exchange or expanded to all public companies, and whether there will be a phase-in based on the size of the public company. Most anticipate that say on pay will be a non-binding annual advisory vote. The Schumer bill, Peters bill and Treasury recommendations all contemplate an annual non-binding shareholder vote on executive pay as a whole. The proposed SEC rule applicable to TARP recipients does not mandate specific language or any form of resolutions, but does require that the vote must be to approve the compensation of executives, as disclosed pursuant to the SEC compensation rules, including the compensation discussion and analysis, the compensation tables and any related material. At least one influential institutional shareholder group, the United Brotherhood of Carpenters and Joiners, calls for a triennial executive pay vote that is broader in scope, seeking to allow shareholders to vote separately on three components of compensation (annual incentive plan, long-term incentive plan and post-employment benefits). In any event, the SEC will likely be asked to craft the final requirements.



Majority Voting for Directors

Background. As a general matter, “majority voting” proposals seek to provide that, in uncontested elections, director candidates must be elected by a majority of votes cast, rather than by the traditional plurality. Proponents argue that majority voting creates greater accountability on the part of directors. These proposals typically include provisions that require any director not receiving a majority of the votes cast to offer his or her resignation to the board. Many states have adopted amendments to their corporate codes to facilitate majority voting for the election of directors for companies that choose to “opt in” to this requirement.

A review of the numbers. Of 54 majority voting proposals presented to shareholders or expected to come to vote in 2009, 16 vote results are available. The average support is 51.3%. In 2008, a total of 28 proposals came to vote, with an average support of 51.2%. Accordingly, the record shows an increase in the number of proposals, but no measurable increase in average support (which is already at the majority level).

Key takeaways. Support continues at the same level, just over 51% in 2008 and 2009. The Schumer bill and the Peters bill would require public companies listed on a national exchange to implement majority voting in uncontested director elections. Based on data provided by RiskMetrics Group, over 75% of companies in the S&P 500 have already adopted some sort of majority voting standard or policy in uncontested elections, which suggests that the legislation may not be necessary. That percentage, however, falls to under 50% when considering the S&P 1,500 and to under 25% when considering the S&P SmallCap.

What may be coming in 2010. While both the Schumer bill and the Peters bill include majority voting as one of their provisions, and majority voting has (just barely) the support of a majority of shareholders where it has been on the ballot, it is not clear that majority voting has the same populist support as say on pay. We do expect that companies will continue to see majority voting shareholder proposals in 2010 and beyond.

Another key issue with regard to majority voting is the impact of the elimination of broker discretionary voting in director elections. On July 1, 2009, the SEC commissioners approved an NYSE proposal to eliminate a broker’s ability to vote its customers’ unvoted shares with respect to any election of directors, whether in an uncontested or a contested election. The NYSE proposal will apply to shareholder meetings held on or after January 1, 2010. Not being able to count on the broker discretionary votes in director elections across the retail shareholder base is expected to make it more difficult to achieve a majority vote for directors in many cases.

Requiring an Independent Board Chairman

Background. Proposals on this topic typically require that the chairman of the board be an independent director who is not a member of the management team. While, in some countries, boards are often led by independent chairs, the combined CEO/chairman remains the prevailing model in the U.S. We note that in 2002, the NYSE considered requiring its listed companies to have an independent board chair, but instead



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enacted requirements for an independent director to take certain limited roles on the board (often called the “presiding” or “lead” director).

A review of the numbers. Of 33 proposals for independent board chairs considered at 2009 annual meetings or expected to come to vote in 2009, 20 vote results are available. The average support is 38.8%. In 2008, a total of 28 proposals came to vote, with an average support of 29.3%. This increase of almost 10% from 2008 is the largest increase in support for any of the governance shareholder proposals, though the average level of support remains low compared with other governance proposals.

Key takeaways. There are shareholder groups and other organizations advocating for a mandated split in the CEO/chairman roles, and this approach often receives media attention in the wake of corporate failures. Nevertheless, with only 33 proposals and average support of less than 40%, this proposal does not appear to be gaining the momentum that has been seen with respect to say on pay. The proposal is, however, more likely to achieve majority support in certain industries, such as financial institutions, due to the well-publicized recent corporate failures. For example, a 2009 shareholder proposal at Bank of America managed 50.3% support, and as a result the board appointed an independent chair.

The Schumer bill and the Peters bill would require public companies listed on a national exchange to have an independent chairman. In addition, Mary Schapiro, Chairman of the SEC, has stated that the SEC is actively considering a package of new disclosure rules requiring additional information about director nominees, including experience and qualifications, as well as an explanation as to why a board has chosen its particular leadership structure. On July 1, 2009 the SEC commissioners approved proposed new disclosure rules designed to enhance the information included in proxy statements, including information about the qualifications of directors, executive officers and nominees and a company’s leadership structure, among other items.

One approach with respect to an independent board chair that has been put forward is an “opt out” model.⁴ Under this model, companies would voluntarily adopt bylaw or charter amendments establishing independent chairmanship as the default model of board leadership. If directors choose to take a different course, either by combining the two posts or naming a non-independent chair, they would be required to explain to shareholders why they believe doing so represents a superior approach to optimizing long-term shareholder value and, if required by the amended charter, seek shareholder approval to vary from the independent chairman model.

What may be coming in 2010. While both the Schumer bill and the Peters bill would mandate independent board chairs for listed companies, requiring an independent chair represents a fundamental change in the governance model for U.S. public companies, and it is unclear whether there is broad support for this approach among legislators, regulators and shareholder groups. We doubt there is sufficient support at this point from the various constituents to require such a sweeping change for all public companies. Additionally, in recent years, many boards with a combined CEO/chairman have implemented effective leadership



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structures for their independent directors (including the appointment of a lead director), suggesting that the one-size-fits-all approach of an independent chair may not be appropriate. In any event, the SEC's proposed rules requiring proxy disclosure about the leadership structure of the board, and why the board believes the structure it has chosen is best for the company and its shareholders, are expected to be adopted in time to require such disclosures in the 2010 proxy statement. We expect that companies will continue to see shareholder proposals requesting an independent board chairman in 2010 and beyond, especially in industries where there is a particular investor concern about independent oversight of company management.

Shareholders' Right to Call a Special Meeting

Background. While the rules vary from state to state, the governing documents of many U.S. public companies have historically provided that only the board of directors may call a special meeting of the shareholders, with shareholders not having the power to call these meetings. In other cases, a relatively high designated percentage of shareholders is required to call a special meeting of the shareholders. Ensuring that only the board or a high percentage of shareholders may call special meetings of shareholders has been a standard element of many companies' anti-takeover defenses. Shareholder proposals in this area have been on the ballot for many years. The proposal typically asks that a company provide shareholders the right to call a special meeting, and sets the percentage necessary to request such a meeting at a 25% threshold or less.

A review of the numbers. Of 62 proposals voted or expected to come to vote in 2009, 42 vote results are available. The average support is 52.3%. In 2008, a total of 23 proposals came to vote, with an average support of 46.6%. This shows an increase in support, such that these proposals are now likely to be approved, as well as a significant increase in the number of proposals.

Key takeaways. Shareholder proposals on this topic have been around for a number of years, whittling down the threshold percentage of shareholders required to call a special meeting. In 2009, most of the shareholder proposals, that would give shareholders the right to call a special meeting at the 10% level, came from a single well-known shareholder activist. There is not always agreement among the proxy advisory firms as to whether the proposal should receive their support, as there were a number of instances where RiskMetrics Group recommended a vote for a proposal asking for a 10% threshold while Glass, Lewis & Co. recommended a vote against the same proposal if the company already had in place a threshold of 25%. Still, this proposal was often passed by the shareholders when it was presented. We believe that these proposals have found favor with shareholders because of an increasing sentiment among shareholders in favor of shareholder democracy and participation in a company's affairs.

What may be coming in 2010. Neither the Schumer bill nor the Peters bill includes any provision providing shareholders with the right to call special meetings, and we do not expect to see legislation in this area in the near future. In 2009, the SEC rejected arguments put forward by companies in no-action letters that they had "substantially complied" with the proposal if the company already had in place bylaw provisions that included a 25% threshold for shareholders to be able to call a special meeting. Although companies were unhappy with



the SEC's position, commentators do not expect any near-term reversals of this position from the SEC in the current pro-shareholder environment. We expect similar proposals to continue in 2010 and beyond.

Repeal of Classified Boards

Background. With a classified board of directors, rather than electing all directors each year, the directors are placed into separate classes, with the shareholders typically electing one-third of the directors each year. This provides for continuity within the board, and is a traditional anti-takeover measure. In recent years, however, many public companies have eliminated the classification of their boards, so that all directors are elected annually.

A review of the numbers. Of 75 proposals to repeal board classification that were voted on or may come to a vote in 2009, 21 vote results are available. The average support is 62.4%. In 2008, a total of 78 proposals came to vote, with an average support of 65.1%. This shows a similar number of proposals, but a slight decrease in support, although it continues to have strong majority support as compared to other shareholder proposals.

Key takeaways. Although average support declined slightly, these proposals continue to garner over 60% shareholder support. The Schumer bill would require public companies listed on a national exchange to eliminate classified boards and require the annual election of directors. The repeal of classified boards has been a key shareholder proposal for many years, and we expect the pressure on public companies to eliminate classified boards to continue, especially for companies incorporated in states that would not require an amendment to the articles of incorporation to eliminate the classification of the board.

What may be coming in 2010. The use of classified boards by U.S. public companies has been decreasing steadily over the past 10 years. Even if the elimination of classified boards is not mandated by federal legislation, we expect that many boards will continue eliminating classification on their own. We expect companies to continue to face shareholder proposals for the repeal of classified boards.

And Still More to Come...

While this client alert has focused on five key shareholder proposals from the 2009 proxy season, there are other important types of proposals receiving increased support. Shareholder proposals on other executive compensation topics, including "golden parachute" payments, tax gross-ups, retention periods for stock awards and executive death benefits (also called "golden coffins"), had a smaller number of proposals on the ballot in 2009, but have in certain instances garnered significant support.

Beyond the use of shareholder proposals, the climate of populism and forces seeking to give shareholders an increased role in corporate governance is likely to significantly impact the relationships between U.S. public companies and their shareholders. For example, shareholder access to the proxy statement to nominate



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director candidates has been proposed by the SEC, and both the Schumer bill and Peters bill advocate for allowing shareholder nominees to appear in company proxy statements. Also, as discussed above, the SEC has made a proposal to change broker voting for director elections, which may also make it more difficult for directors nominated by the board to be elected in many cases.

Actions that Boards Should Consider

In view of the shareholder proposals that were considered at 2009 annual meetings, and the pending legislative and regulatory measures that have been proposed in recent months and are expected in the near future, boards of U.S. public companies may wish to consider the following actions:

- ***Executive Compensation – A Primary Issue for 2010.*** The firestorm about executive compensation is likely to continue, and whether through say on pay or other measures, executive compensation will be an important topic for 2010 annual meetings. Directors should be reviewing the design of executive compensation packages and ensuring that they can explain, perhaps more succinctly than they have in the past, how they are measuring and rewarding performance. The drafting of the “compensation discussion and analysis” in the proxy statement will require further input from compensation committee members as it will become more important to describe in clear and concise language the nature of compensation programs and the reasons behind their structure.
- ***Corporate Governance Review.*** Shortly after the passage of Sarbanes-Oxley in 2002, most U.S. public companies undertook a comprehensive review of their corporate governance structures and documents to ensure that they complied with applicable requirements and reflected best practices. With the passage of time since that review, and the numerous cross-currents flowing in the corporate governance arena, many companies are finding it timely to review again their corporate governance structures and documents. As part of any such review, boards should consider the issue of board leadership. For example, for a company with a CEO/chairman, the board may wish to designate one of its independent directors as a lead director and give that lead director appropriate authority for “managing” the board and its meetings. In view of shareholder proposals relating to independent board chairs, and the recently proposed SEC proxy disclosure requirements to describe and explain board leadership structure, directors should consider how they will explain to shareholders why they believe the current approach is the optimal structure for board leadership.
- ***Review of Defensive Measures.*** Given the changes in the public markets over the last year, and changes in capitalization of many companies, many boards are finding it timely to review their defensive measures. This review must involve a delicate balance that ensures that the board has the tools necessary in the current economic environment to assure that any takeover proposal is in the best interests of the shareholders, but at the same time avoids allegations that the measures in some way entrench the board or management. Among the measures being actively reviewed by boards in the current economic environment are rights plans and advance notice bylaws. The pressures discussed



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above with respect to classified boards and the ability of shareholders to call special meetings play into this equation as well.

- ***Comment on Pending Proposals.*** The SEC’s proposal for shareholder access to the proxy statement to nominate directors for election was recently published, with the SEC seeking comments by August 17, 2009. On July 1, 2009, the SEC voted to propose rules relating to additional compensation disclosure requirements and board leadership structure, among other items, and to seek comments on these proposals. Boards should consider whether it would be prudent for their companies to comment on these proposals, either as individual companies or as members of larger groups.
- ***Monitor Legislative and Regulatory Developments.*** It will be particularly important for boards of directors, either as a group or through their nominating/corporate governance committees, to monitor legislative and regulatory developments over the next several months. In early 2009, as part of TARP and other financial institution legislation, we saw the adoption of measures that were applicable to contracts and arrangements that had previously been entered into, suggesting that boards may have little or no lead time to plan for new governance or disclosure requirements.



Currently, there are a variety of groups and forces seeking to reshape key aspects of the governance for U.S. public companies. A new mood of populism—which some have characterized as being “anti-corporate”—combined with important legislative and regulatory proposals will likely affect the relationship between corporations, their boards and their shareholders. It is instructive to review the results of shareholder proposals from 2009 annual meetings, not only to analyze how the mechanism of shareholder proposals may be used to effect change but also to understand how the subjects of these proposals may be part of broader corporate governance reforms.

¹ RiskMetrics Group Proxy Season Scorecard, as of June 15, 2009,
http://www.riskmetrics.com/knowledge/proxy_season_scorecard_2009

² Securities and Exchange Commission, Proposed Rule, “Shareholder Approval of Executive Compensation of TARP Recipients”, Release No. 34-60218, July 1, 2009, <http://www.sec.gov/rules/proposed/2009/34-60218.pdf>

³ A Quiet Response to “Say on Pay” Measure, *Wall Street Journal*, May 18, 2009,
<http://online.wsj.com/article/SB124241544874624773.html>

⁴ See, e.g., The Millstein Center for Corporate Governance and Performance, Policy Briefing No. 4, “Chairing the Board: The Case for Independent Leadership in North America,” 2009,
<http://millstein.som.yale.edu/2009%2003%2030%20Chairing%20The%20Board%20final.pdf>

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