

Hot Topics for Your 2010 Annual Shareholder Meeting



As we begin to wind down 2009, many public companies are already laying the groundwork for shareholder meetings in 2010. That groundwork is justified by what many are predicting to be an unusual year for public-company shareholder meetings—in both proxy statement disclosure and the conduct of the meetings. Here is a brief overview of four hot topics that will affect public-company annual shareholder meetings held in 2010, including a few tips on how public companies can prepare themselves.

Revitalization of Certain Shareholder Proposals

By all accounts, activist shareholders and proxy advisory firms will increase activity in 2010 as compared to 2009. One spur to this activity will undoubtedly be the Staff Legal Bulletin No. 14E issued on October 27, 2009, which provides guidance on the SEC staff's position regarding the application of Rule 14a-8 under the Securities Exchange Act of 1934, as amended. Rule 14a-8 addresses when a company must include a shareholder's proposal in its proxy statement for an annual or special meeting of shareholders. Under Rule 14a-8(i)(7), a company is permitted to exclude the proposal if the "proposal deals with a matter relating to the company's ordinary business operations."

Through the October staff legal bulletin, the staff essentially reversed its analysis of the excludability of proposals relating to certain kinds of risk and succession planning. In previous legal bulletins, the staff had expressed the view that companies could properly exclude as "ordinary business operations" proposals relating to (a) a company's internal assessment of the risks and liabilities that it faces as a result of its operations (such as health, safety, environmental, or financial risks) or (b) a company's CEO succession plan or succession planning process.

In the October bulletin, the staff expresses the view that proposals relating to an internal assessment of the risks of a company's operations will now be reviewed by examining the underlying subject matter of the risk evaluation to determine if it relates to the company's ordinary business. "In those

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cases in which a proposal's underlying subject matter transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote, the proposal generally would not be excludable under Rule 14a-8(i)(7) as long as a sufficient nexus exists between the nature of the proposal and the company." Given the fact that this is a reversal of a prior staff position and that it is being hailed by activist shareholders as a victory, companies should expect to see additional proposals relating, at least nominally, to risk management, as well as resubmission of proposals that had been rejected under the previous staff legal bulletin.

The October bulletin also cleared the way for one particular type of risk management proposal. Noting the "widespread recognition that the board's role in the oversight of a company's management of risk is a significant policy matter regarding the governance of the corporation," the staff stated that "a proposal that focuses on the board's role in the oversight of a company's risk management may transcend the day-to-day business matters of a company and raise policy issues so significant that it would be appropriate for a shareholder vote." With half of the argument in favor of inclusion mapped out for shareholders submitting these types of proposals, companies should be prepared for proposals addressing the board's role in risk management.

For companies that did not receive shareholder proposals on these topics—either because the October bulletin was issued after the date by which shareholders must submit proposals or just out of sheer luck—one prophylactic measure may be the disclosure in the Compensation Discussion and Analysis (CD&A) and corporate governance sections of the 2010 proxy statement. In this way, the October bulletin becomes one of the better arguments for early adoption of the proposed disclosure requirements of Release No. 33-9052, discussed below in hot topics 2 and 3.

Disclosure About Risk Assessments in Compensation

On July 10, 2009, the SEC issued Release 33-9052, entitled "Proxy Disclosure and Solicitation Enhancements." The comment period was open through September 15, 2009. Through this release, the SEC proposed amendments to rules relating to compensation and corporate governance disclosure applicable to proxy and information statements, annual reports, and registration statements. If the amendments proposed in this release are adopted, the SEC anticipates that they will be effective for the 2010 proxy season.

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Like the October staff legal bulletin discussed above, risk management is one of the hot-button issues addressed in this release, within the contexts of both compensation and corporate governance. One of the other interesting specifics of this release is the proposed CD&A disclosure requiring that a company “discuss and analyze its broader compensation policies and overall 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.”

For many companies, this disclosure requirement has a familiar ring to it. As early as October 2008, when John White, director of the SEC’s Division of Corporation Finance, gave a speech entitled “Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009,” the SEC has reiterated its commitment to “principles-based” disclosure in CD&A, with specific reference to risk in executive compensation. In his speech, Mr. White stated:

Would it be prudent for compensation committees, when establishing targets and creating incentives, not only to discuss how hard or how easy it is to meet the incentives, but also to consider the particular risks an executive might be incentivized to take to meet the target—with risk, in this case, being viewed in the context of the enterprise as a whole?... [T]o the extent that such considerations are or become a material part of a company’s compensation policies or decisions, a company would be required to discuss them as part of its CD&A. So please consider this carefully as you prepare your next CD&A.

Mr. White was undoubtedly referencing Instruction 3 to Item 402(b) of Regulation S-K, which requires discussion in the CD&A of the material principles underlying a company’s executive compensation policies, or decisions or important factors relevant to an analysis of those policies or decisions. Because this requirement transcends any particular subject matter or factor, it applies to risk as a principle in executive compensation decisions—notwithstanding that there is, as of yet, no specific disclosure requirement on this topic. Therefore, to avoid both SEC comments and shareholder proposals alike (see hot topic number 1), companies should look to improve their CD&A through explanation of the role that risk has in executive compensation decisions.

What’s So Great About Your Nominees?

One of the other areas of enhanced disclosure of Release No. 33-9052 relates to the biographies

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of director nominees. The amendments would require disclosure of the specific experience, qualifications, or skills that qualify a particular nominee to serve as a director and committee member. The release gives examples of the types of information that may be disclosed in response to this new requirement: information about a director's or nominee's risk assessment skills, any specific past experience that would be useful to the company, information about a director's or nominee's particular area of expertise, and why his or her service as a director would benefit the company at the time.

The SEC proposed these amendments primarily for the benefit of investors, with the hope that companies would "provide investors with more meaningful disclosure to help them in their voting decisions by better enabling them to determine whether and why a director or nominee is a good fit for a particular company." Issuers would be well advised, however, to take advantage of this opportunity to highlight the qualifications of their board members in light of the repeal of broker discretionary voting in the election of directors. (For more on why this will be important in 2010, see hot topic number 4.) Whether a company uses some form of majority voting or plurality voting, all companies would benefit by taking more active steps to familiarize their voters with the nominees and encourage participation among the formidable voting block of "street name" holders.

The Governance Quandary of Rule 452

On July 1, 2009, the SEC approved amendments to NYSE Rule 452 that governs the matters on which brokers may vote in their discretion in the absence of instructions from the street-name holder. These amendments eliminate the ability of brokers to vote in their discretion in the election of directors, even if the election is uncontested. The amendments to Rule 452 are effective for shareholder meetings held on or after January 1, 2010. The repeal of discretionary voting for the election of directors has been a major source of hand-wringing for 2010 shareholder meetings, with many companies reading tea leaves to determine how this might affect their meetings.

The legal impact on the outcome of the election of directors will largely be driven by whether a company has adopted some form of majority voting or whether directors are elected by a plurality.

The majority of S&P 500 companies have already adopted some form of majority voting, whether through actual charter or bylaw amendments or policies that require directors to tender their resignations if they fail to receive more "for" than "withhold" votes. These companies are now

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planning their response to various “what if” voting scenarios for the 2010 shareholder meeting, as well as shareholder outreach to gain support for company nominees.

For the S&P 500 companies that have not adopted some form of majority voting, and most public companies outside the S&P 500, the movement toward any form of majority voting has slowed due to the high level of uncertainty regarding the impact of these regulatory changes. Unfortunately, avoiding the majority voting movement does not insulate plurality voting companies from impact of the amendments to Rule 452.

The plurality system is one in which the nominees receiving the highest number of affirmative votes are elected, regardless of the number of votes against or withheld. In an uncontested election, where the number of seats available is the same as the number of nominees, all the nominees would be elected regardless of the number of votes against any of them.

The impact of the amended Rule 452 is that the number of votes in favor of each nominee will be much smaller because of the elimination of the broker vote traditionally cast for the election of a nominee. There may be a significantly higher proportion of withheld votes than in prior years, or the number of withheld votes may even exceed the number of votes for a nominee. Therefore, a nominee may be elected even if the apparent sentiment of the shareholders is against the nominee. This creates a corporate governance conundrum for plurality voting companies.

Some companies with a plurality voting requirement have adopted policies requiring that nominees tender their resignation if the number of votes withheld exceeds the number of votes for those nominees, which results in a de facto majority voting standard. Other plurality companies, like their majority voting counterparts, are exploring shareholder outreach programs, planning additional solicitation efforts, carefully analyzing their shareholder base to determine voting alliances, and preparing their response to the voting tallies—whatever they may be. ■

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