NEW YORK
1285 Avenue of the Americas
New York, NY 10019-6064
+1 212 373 3000

WASHINGTON, D.C.
2001 K Street NW
Washington, DC 20006-1047
+1 202 223 7300

LONDON
Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44 20 7367 1600

TOKYO
Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81 3 3597 8101

BEIJING
Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86 10 5828 6300

HONG KONG
12th Fl., Hong Kong Club Building
3A Chater Road
Central Hong Kong
+852 2536 9933

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The Shareholder Bill of Rights Act of 2009

On May 19th, Senators Charles Schumer of New York and Maria Cantwell of Washington introduced the Shareholder Bill of Rights Act of 2009 (S. 1074), which, if adopted in its current form, would encompass the most fundamental restructuring of U.S. corporate governance in recent years. While states as diverse as North Dakota and Delaware have already taken steps to incorporate, or to allow companies to incorporate, certain of the changes espoused by the bill, this legislation would leapfrog those efforts by federalizing key aspects of corporate governance that up until now have stood firmly under state purview. The bill would add a new Section 14A to the Securities Exchange Act of 1934 to the effect described below.

- *Corporate governance provisions.* The bill would require the SEC to publish a rule, not later than one year after the law's enactment, that directs the national securities exchanges and associations to prohibit the listing of any company that does not comply with the following requirements, subject to a cure period and the ability for the SEC to exempt certain issuers from some or all of these requirements based on size, market capitalization, public float, number of shareholders or other criteria.
  - *Independent chairman.* The bill would require companies to have an independent chairman of the board. While the bill states that such independence shall be defined by the rules of the exchange on which each company is listed or otherwise by the SEC, the bill requires in addition that such independent chair shall not have previously served as an executive officer of the company. This requirement is more onerous than the three-year independence look-backs that are currently in effect under the NYSE and Nasdaq rules of corporate governance. Further, we note that "executive officers" as currently defined by the Exchange Act and national securities exchanges extends beyond "named executive officers" and generally includes the president, any vice president in charge of a principal business unit, division or function, any other officer who performs a policy making function or any other person who performs similar policy making functions.
  - *Elimination of classified boards.* The bill would eliminate classified boards and require companies to elect all directors annually.
  - *Majority voting.* The bill would mandate that directors be elected by a majority of votes cast in uncontested elections. In contested elections, defined as elections where the number of nominees exceeds the number of directors to be elected, directors would continue to be elected by a plurality of the shares represented at a meeting and entitled to vote. Directors who do not receive the

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requisite majority of votes cast would be required to tender their resignations, which resignations must be accepted by the board.

- *Risk committees.* The bill would require companies to establish an independent risk committee responsible for establishing and evaluating risk management practices. The SEC would be required to issue rules regarding this requirement within one year after the enactment of the law, and companies would have one year to comply with this requirement after the publication of such rules.

- *Say-on-pay and golden parachutes.* The bill would require companies to have a nonbinding, advisory shareholder vote on the "compensation of executives" whenever any proxy statement for a shareholder meeting is required by the SEC's proxy rules to include compensation disclosure (starting with meetings occurring one year after the law's enactment). The bill would also require any person soliciting proxies in connection with a business combination transaction to disclose in its solicitation materials any agreements or understandings that such person has with any principal executive officers of the target or the acquiror concerning any type of compensation (present, deferred or contingent) that are related to the business combination and to require a separate shareholder vote to approve such agreements, unless already approved as part of a broader say-on-pay vote.

  While the bill specifies that these votes would not be binding on, overrule a decision by or create, change or add to the fiduciary duties of the company's board of directors, the current corporate governance environment may result in these votes having a significant effect on future actions of the company. If a board were not to act to address a negative shareholder vote on compensation matters, further negative shareholder reaction would likely be swift. Moreover, many proxy advisory firms may look unfavorably on a board that does not act to address issues presented by a negative say-on-pay vote. For example, RiskMetrics, one of the most influential proxy advisory firms, recommends withholding votes or voting against a board that fails to act on a shareholder proposal that received approval by a majority of shares cast for the previous two consecutive meetings.

- *Proxy access*. The bill mandates that the SEC establish rules relating to the use of company proxy materials by shareholders who have beneficially owned not less than 1% of the voting securities of a company, directly or indirectly, for two or more years, for the purpose of making shareholder nominations to the board. The SEC has, in fact, already voted to issue a proposal that would establish such a proxy access regime for U.S. companies only, including (i) the creation of a new proxy rule that would affirmatively allow shareholder nominations in company proxy materials subject to certain conditions (including a three-tiered share ownership requirement based on the size of the issuer and a less stringent one-year holding period) and (ii) the narrowing of Rule 14a-8(i)(8)'s election exclusion to allow shareholder proposals relating to a shareholder nomination process or related disclosure. For our memorandum on the SEC proposals, see http://www.paulweiss.com/resources/pubs/detail.aspx?publication=2331.

  The bill further clarifies that the SEC has full authority to determine the use of company proxy statements for the nomination and election of directors by shareholders, which would put an end to the debate as to the validity of any proxy access regime adopted by the SEC.

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The say-on-pay, golden parachute and proxy access provisions of the bill would not apply to non-U.S. issuers as they are generally exempted by SEC rule from compliance with U.S. proxy requirements. Whether the corporate governance provisions will apply to non-U.S. issuers is less clear. There is precedent for Congress to mandate such requirements even for non-U.S. companies, for example, the audit committee requirements under Rule 10A-3 of the Exchange Act and related listing standards mandated by the Sarbanes-Oxley Act of 2002. However, unlike the Sarbanes-Oxley Act, the Shareholder Bill of Rights Act gives the SEC broad exemptive authority with respect to these corporate governance provisions, which it may use to exempt non-U.S. issuers in conformity with the national securities exchanges' historical practice of accommodating home country practices on corporate governance issues.

Having just been introduced, the bill must still pass both houses of Congress before being sent to the President for his consideration. Notwithstanding the sweeping nature of this bill, it included little detail on how many of the provisions would operate, and the true scope of its provisions will not be known until subsequent rulemaking by the SEC and stock exchanges is completed. Further, while many prominent politicians are on the record for supporting various portions for this bill (for instance, President Obama and Representative Barney Frank are known supporters of say-on-pay), whether there is sufficient support for the federalization of these fundamental aspects of the governance structure of companies is not yet known. In any event, as became evident with the accounting and other failings of corporate America in the early 2000s that led to the enactment of the Sarbanes-Oxley Act of 2002, we could be in for a similar interesting ride with the Shareholder Bill of Rights Act of 2009. For a copy of the bill, see http://thomas.loc.gov/cgi-bin/query/z?c111:S.1074:.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning the issues addressed in this memorandum may be directed to Mark S. Bergman (+44 20 7367 1601), Raphael M. Russo (212-373-3309), Lawrence I. Witdorchic (212-373-3237) or Frances F. Mi (212-373-3185).