

IRATE INVESTORS:

Prepare for Shareholders Looking for More Board Say



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By Amy I. Stickel

As the financial markets have crashed and the economy has been thrown into upheaval, many investors are looking for someone to blame. For some shareholders, corporate executives and boards of directors have emerged as the clear villains.

In response, some of these shareholders are looking for greater input on the day-to-day business decisions that have typically been the provenance of the board of directors and senior management. And politicians and regulatory officials are considering allowing shareholders just that sort of input.

“There are three related issues that are part of the broader shareholder democracy movement—‘say on pay,’ shareholder ballot access and majority voting by shareholders,” says [Frank M. Placenti](#), partner and chair of the Corporate Transactions, Finance and Governance practice at [Squire, Sanders & Dempsey L.L.P.](#)

In times of economic turmoil, shareholders’ rights issues tend to surface, according to [David A. Zagore](#), a partner at Squire Sanders. “These are the next steps in a long battle among boards and activist shareholders

to gain control over American business institutions,” he says.

In many cases, activist shareholders are relatively small stakeholders with their own interests. Their interests do not always align with the interests of other institutional and retail investors in corporations who are focused on corporate performance and total shareholder return. “General counsel need to be aware that this is not just about good governance—it’s about power,” says Zagore.

Say on Pay

With say-on-pay initiatives, shareholders are looking to provide input on the compensation packages of senior executives. Proponents may argue that such measures will reform out-of-control pay at struggling companies. Critics argue that such policies do not effectively control compensation and diminish the authority of a company’s board of directors.

“The general movement has been a backlash against executive pay,” says Placenti. “There is a view that shareholders can help curb the excesses in executive compensation.”

The federal government has gotten involved, too. On June 10, U.S. Treasury Secretary Timothy Geithner announced that the federal government would set pay limits for executives at companies that received funds from the Troubled Asset Relief Program (TARP). And the U.S. Securities and Exchange Commission is considering new disclosure rules that would require corporations to provide more in-depth information on compensation, although these proposals would not dictate pay.

Despite all the publicity around say on pay, few shareholders are actually approving these types of initiatives. According to Placenti, of about 80 such proposals during the most recent proxy season, the vast

majority of shareholders—generally in the 90 percent range—have not supported such measures. Shareholders at Motorola, Inc. represent somewhat of an exception. During that company’s May 4 annual meeting, more than a third of shareholders voted in favor of a tighter rein on executive compensation. However, Motorola is in a unique situation, since its shareholders are particularly irate that the struggling telecom company paid co-CEO Sanjay Jha \$17.3 million when it hired him last year, according to Placenti.

“It is consistent with my general view that people are angry and upset about what goes on in a small number of companies,” says Placenti. “That is borne out by the results of the say-on-pay votes at the companies that have had them. Virtually all of them result in resounding approvals of the plans put forth by the management.”

While there may be a great deal of buzz about say-on-pay initiatives, the actual impact of such initiatives has not been large. “These are nonbinding resolutions,” says Zagore.

Shareholder Ballot Access

Along with say on pay, some shareholders are also agitating for increased access to the annual meeting ballot. Such ballot access initiatives could allow more shareholders to nominate members of the board of directors, place bylaw proposals on ballots and undertake other initiatives.

Interest in shareholder ballot access is growing at both the state and federal level as well. In May, the SEC proposed several amendments that would make it easier for shareholders to nominate directors on corporate boards. According to the SEC, the economic crisis has led “many” to question whether boards of directors are being held accountable, exercising appropriate oversight, considering shareholder interests or appropriately compensating management.

Since slates of candidates are typically nominated by the current board, shareholders rarely have any say in who appears on the ballot. Often, the only way to get nonboard-affiliated nominees on to the ballot is an expensive and contentious proxy fight.

Under the proposed SEC rules, shareholders would be required to have a minimum threshold of ownership before they could

nominate a candidate, and they are limited in the number of candidates they could nominate.

Federal legislation may also be on the horizon. U.S. Sens. Charles E. Schumer, D-N.Y., and Maria Cantwell, D-Wash., have introduced legislation that is designed to increase accountability and oversight at publicly traded corporations. The proposed legislation incorporates some of the same proposals that the SEC is considering. It would also require all publicly traded companies to hold an advisory shareholder vote on executive compensation.

The Delaware General Assembly has also amended the state’s General Corporation Law, which could affect shareholder ballot access

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for companies that are incorporated there. Effective Aug. 1, the amendments include a provision that may require corporations to include candidates for director slots that have been nominated by stockholders in the organization’s proxy materials.

“This was broadly seen as an effort by Delaware to forestall action by the SEC or federal legislation,” says Placenti. “It didn’t work. It appears this issue is alive and well.”

Two Issues, Two Responses

While say-on-pay and shareholder ballot access proposals may stem from some of the same sources of frustration, in-house counsel should approach each problem separately and manage them differently, advises Placenti.

When it comes to say-on-pay questions, companies should consider their own industries and shareholders before taking any actions. “Generally, executives are paid fairly. Most boards of directors have made an honest and honorable judgment about a company’s pay packages,” he says.

If a company has reason to believe a say-on-pay initiative may be raised, in-house counsel should meet with the board and

senior management and decide whether this is a concern that should be addressed.

“Just because an issue is raised doesn’t make it right,” says Placenti. “I don’t believe in the ‘Good Governance Idea of the Month Club.’”

However, when it comes to ballot shareholder access, Placenti does not advocate the wait-and-see approach. Companies should have a plan in place and be ready to submit their own bylaw amendments for shareholder ballot access, rather than allow shareholder versions to be presented first. “Corporations should get ready and begin working on the bylaws they want to see advance,” he says. “You should be prepared to act. In this area, it is better to be pre-emptive rather than reactive.”

While say-on-pay initiatives haven’t been as successful, Zagore believes that shareholder ballot access measures have an excellent chance of being approved. “It is more likely to succeed at this time than ever before, because of the political and economic climate and the current makeup of the SEC,” he says.

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