KIRKLAND & ELLIS LLP

KIRKLAND GOVERNANCE WATCH

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Despite Reprieve, 2010 Proxy Season Still Fraught with Peril

Recent revisions to the policies of the SEC staff and RiskMetrics may create pitfalls in the 2010 proxy season. Companies and their boards should begin to develop a robust and cohesive strategy to deal with these new developments.

Despite populist outrage at the corporate governance and executive compensation landscape, governmental bodies and shareholder activists have failed to implement major legislative or regulatory change in 2009 (outside the banking world). However, notwithstanding the high-profile news of deferral of proxy access and the distraction of Congress in general, recent Securities and Exchange Commission and RiskMetrics Group actions show that activists have found new avenues to successfully pursue their agendas. These developments have the potential to create pitfalls in the 2010 proxy season.

- ***Shareholder Proposals — SEC Removes Historical Barriers.*** On October 27, 2009, the SEC staff issued a staff legal bulletin that significantly reduces the applicability of the ordinary business exception to shareholder proposals. The SEC staff announced that it will depart from its historical approach of generally allowing companies to exclude shareholder proposals that necessitate an internal evaluation of risk. Instead, the SEC staff will now allow shareholder proposals that implicate significant social policy issues that transcend day-to-day business matters of the company, even though involving an internal evaluation of risk. These social policy issues likely include a board's oversight of a company's risk management, particularly with respect to environmental and public health issues. The SEC staff also indicated that it has reversed course to recognize that shareholder proposals relating to CEO succession planning often raise significant social policy issues that transcend ordinary business matters and thus may no longer be excludable.

  This new guidance represents a significant victory for activists and will result in previously excludable shareholder proposals being included in 2010 proxy statements.

- ***Non-Shareholder Approved Poison Pills — RiskMetrics 2010 Draft Policies.*** In its 2010 Draft Policy, RiskMetrics has stiffened its stance with respect to "long-term" non-shareholder approved poison pills. Under the Draft Policy, RiskMetrics would continue to evaluate members of the board of a company that adopts a "short-term" pill (12 months or less) without shareholder approval on a case-by-case basis. However, RiskMetrics would automatically recommend a WITHHOLD/AGAINST vote on the full board of a company that adopts a non-shareholder approved poison pill of greater duration. In addition, RiskMetrics would conduct a review at least once every three years of any company that has adopted a "long-term" pill without shareholder approval. In such reviews, RiskMetrics may recommend (or continue to recommend) that shareholders vote AGAINST, or WITHHOLD votes from, the entire board.

  While the list of items that trigger a WITHHOLD/AGAINST vote gets longer each year and should be noted, it is important that directors continue to exercise their judgment based on what is in the best interests of shareholders regardless of RiskMetrics' policies.

- ***"Say on Pay" — Not a Guaranteed Vote.*** Public companies have felt tremendous pressure from Congress, the SEC and shareholder activists to provide greater accountability with respect to executive compensation. But legislation that would mandate say on pay resolutions for all public companies has stalled in Congress. Proponents of say on pay resolutions are downplaying the substantial risks of a board submitting a say on pay resolution to shareholders in light of the 100 percent passage rate in 2009 for the companies that submitted a say on pay resolution to shareholders — either voluntarily (approximately 20) or as required by TARP (more than 250). Although the 2009 say on pay resolutions achieved an average approval rate of approximately 89 percent, directors should remain wary of implementing a say on pay policy. As was the case recently with director elections, it is possible that broker discretionary voting on say on pay resolutions could be eliminated in the future. If eliminated (which some activists are advocating), the absence of broker votes that traditionally support the board's recommendation could make attaining shareholder approval of say on pay resolutions less certain.

While Washington's pursuit of its investor-focused agenda has faced delays and obstacles, recent revisions to the policies of the SEC staff and RiskMetrics may well have an impact on the 2010 proxy season. Companies and their boards should begin to develop a robust and cohesive strategy to handle (1) an increase in shareholder proposals relating to social policy and CEO succession planning, (2) changes in RiskMetrics policies, especially with respect to poison pills, and (3) unknown risks associated with the adoption of currently popular governance reforms like say on pay.

If you have any questions about the matters addressed in this *Kirkland Governance Watch*, please contact the following Kirkland authors or your regular Kirkland contact.

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