

# Securities

## E-ALERT

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### Stockholder Proposals in the 2009 Proxy Season: What to Expect and How to Prepare

As the 2009 proxy season is fast approaching for public companies, so too are the annual deadlines for stockholder proposals. In this alert, we review the noteworthy stockholder proposal developments in the 2008 proxy season, likely aspects of the 2009 proxy season, and some of the steps and precautions public companies will want to take in preparation for the 2009 proxy season.

#### Noteworthy Developments in the 2008 Proxy Season

Although there was a general decrease in the number of stockholder proposals in 2008 as compared to 2007, there were several developments worth noting.

- *Focus on corporate governance.* Corporate governance was a major focus of stockholder activity in 2008. In addition to proposals concerning traditional corporate governance topics (e.g., annual elections and majority voting in the election of directors, etc.), stockholders submitted proposals related to less tried governance topics, including the right of stockholders to call special meetings, the right of stockholders to act by written consent, and the reimbursement of the expenses of stockholders who mount proxy contests.
- *Decrease in the number of proposals related to majority voting for elections of directors.* More and more companies have adopted majority voting procedures for elections of directors, and, as a result, the number of majority voting stockholder proposals voted upon in 2008 declined from 38 proposals in 2007 to 27 proposals in 2008, based on RiskMetrics data.
- *Prominence of executive compensation-related stockholder proposals.* Much like proposals concerning corporate governance matters, executive compensation matters were prominent among proposal topics in 2008. Advisory votes on executive compensation (so-called "say-on-pay" proposals) remained in vogue — increasing from 41 proposals in 2007 to 69 proposals in 2008, according to RiskMetrics data. Stockholders also submitted proposals relating to a variety of other compensation matters, including incentive compensation clawback provisions, golden parachutes and SERP policies.
- *SEC certification of questions to Delaware Supreme Court.* In 2007, the Delaware legislature amended the state's constitution to permit the Delaware Supreme Court to consider questions of Delaware law certified to it by the SEC. In *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008) (the "AFSCME" decision), the SEC took advantage of this new process by asking the Delaware Supreme Court to consider the legality of a stockholder proposed bylaw amendment that would have required CA to reimburse proxy solicitation expenses incurred by an insurgent in a successful director election contest. Ultimately, the court concluded that the bylaw amendment was a proper subject for stockholder action under

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Delaware law, but also ruled that the proposal could be excluded because, if implemented, it could cause CA's directors to abrogate their fiduciary duties.

- *Rule 14a-8 and the Courts.* Last year's proxy season saw three significant proposal-related matters in court. In addition to the *AFSCME* decision described above, 2008 also included *Apache v. NYCERS*, 2008 WL 1821728 (S.D.Tex. 2008), where a federal District Court permitted a company to exclude a proposal seeking the adoption of anti-discrimination principles that the court decided improperly implicated ordinary business matters. Also, in *Bebchuk v. Electronic Arts*, (Case No. 1:08-cv-03716-AKH.), a federal District Court in the Southern District of New York dismissed a lawsuit brought by Harvard Professor Lucien Bebchuk to force Electronic Arts, Inc. to include in its proxy materials a proposal that would have required that Electronic Arts include certain stockholder bylaw amendments in future proxy materials.

## What the 2009 Proxy Season Might Bring

It would not be surprising to see an increase in stockholder proposals in 2009 as compared to 2008. First, 2008 was a relatively low year in terms of proposals. Second, the economic crisis and low stock prices have stirred stockholder concerns. In any event, we think there will be three likely areas of particular emphasis in the 2009 proxy season.

### Executive Compensation

By all indications, stockholders will submit a high number of proposals relating to executive compensation matters in 2009. Say-on-pay proposals should continue their favored status among compensation proposals. Support for such proposals in 2008 increased, albeit only slightly (from 41.1% in 2007 to 42.1%, according to RiskMetrics data), and the financial crisis and plummeting stock values may result in higher stockholder support for say-on-pay and other executive compensation proposals in 2009. We also expect clawback provisions, golden parachutes, tax-gross ups and "golden coffin" provisions (i.e., benefits paid to executives upon their death) to be subjects of executive compensation proposals in 2009. To that mix, it would not be surprising if the recent U.S. Emergency Economic Stabilization Act of 2008 (the "EESA") also influenced executive compensation-related proposals in 2009. For instance, according to several media reports, some stockholder groups have announced that they intend to submit proposals that impose additional restrictions on executive compensation for financial services companies that participate in the Troubled Asset Relief Program of the EESA (the "TARP").<sup>1</sup> And, there are predictions of stockholder proposals for TARP-like compensation restrictions at companies in other sectors.

### Other Corporate Governance Matters

As was the case in 2008, we expect corporate governance to remain a focal point in 2009, particularly in light of the high levels of support for governance proposals in 2008 (according to RiskMetrics data, several governance proposals received average support of 50% or more of the votes cast). Some large pension funds have announced plans to submit stockholder proposals that address a variety of key corporate governance topics, including CEO succession planning, independent chairpersons for boards of directors, the right of stockholders to call special meetings and board declassification.

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<sup>1</sup> Under the EESA, companies that participate in the TARP program will be subject to a number of executive compensation restrictions. For example, the TARP program imposes limitations on the amounts and types of compensation that participants may pay to their senior executive officers and mandates clawback provisions for certain participating companies. The TARP program also places limits on "golden parachute" payments and deductions that participating companies may take for executive compensation.

In this area, it will be interesting to see what impact, if any, the SEC's Delaware certification process will have on the 2009 proxy season. At a minimum, we expect there to be proposals for bylaws relating to reimbursement of proxy contest expenses that will have been drafted around the *AFSCME* decision by including "fiduciary out" provisions. Also, we expect that stockholders and companies alike will ask the SEC staff to certify questions to the Delaware Supreme Court as a quasi right of appeal.

## Financial Crisis

It is likely that the current financial crisis will generate a special class of stockholder proposals in 2009. In addition to executive compensation proposals mentioned above, these will include proposals relating to lending practices, conflicts of interest and risk management practices. Obvious targets will be home builders, banks, mortgage companies and other financial firms, particularly, of course, those that participate in the TARP program.

## Things Companies Should be Doing Now

By now, companies should be readying themselves for the 2009 stockholder proposal process, including by taking the following steps:

- *Establish Good Housekeeping Measures.* As a practical matter, a company should conduct a bit of housekeeping to ensure it has adequate procedures for receiving and processing stockholder proposals when they are submitted. The procedural bases for excluding stockholder proposals under Rule 14a-8 depend on the timeliness of a company's response, and the clock begins ticking upon the company's receipt of the proposal. To that end, we advise that a company ensure that its first line of defense (i.e., the corporate secretary's office, members of the legal department, the investor relations team and the infamous fax room) has the tools at hand to receive and respond to stockholder proposals promptly.
- *Conduct Due Diligence.* Once a company receives a stockholder proposal (or an indication that a stockholder may submit a proposal), it should conduct some limited due diligence. In particular, it should determine the stockholder's identity and history, including its past levels and instances of activism. If the stockholder has submitted stockholder proposals before, the company should find out how those proposals were resolved, particularly if the proposal was excluded from those companies' proxy materials in reliance on Rule 14a-8. To this end, as the Division of Corporation Finance recently announced in Staff Legal Bulletin 14D, companies may find the SEC's website, which now posts incoming no-action requests (including any subsequent correspondence between the company and the SEC) and the no-action letters issued by the staff, to be a useful tool.
- *Keep the Lines of Communication Open.* It is rare that a company is the first company to have received a particular stockholder proposal. Companies that engage prior recipients of the same stockholder proposal save money and time in the long run. Perhaps more importantly, companies should maintain open lines of communication with their stockholders. Indeed, gaining a greater understanding of the concerns of these stockholders may help avoid the submission of a stockholder proposal or facilitate the expedient withdrawal such proposal.
- *Engage a Firm for a Legal Opinion.* The *AFSCME* decision highlighted the importance of opinions of counsel, which are required when seeking to exclude stockholder proposals based on matters of state law. Even before receiving a stockholder proposal, a company should know who will be licensed, prepared and conflict-free to opine on pertinent state corporate law matters.

- *Review the Legal Bases for Excluding Proposals.* Company counsel should review with company management, and perhaps the board, the potential bases for the exclusion of proposals under Rule 14a-8. This will allow for crisper decision-making upon receipt of any proposal. To that end, it may be useful for companies (with the aid of counsel) to develop a Rule 14a-8 primer that clearly and simply explains the practical application of the rule.

## Conclusion

For most public companies, the annual stockholder proposal season is just starting. While the legal landscape this year will not be dramatically different from years past, several notable factors will influence the manner in which the season progresses and, accordingly, should affect the manner in which companies prepare for and address this season's crop of proposals. Executive compensation proposals will be animated by the ideas that are being developed in response to the financial crisis, and ongoing stockholder interest in corporate governance will also be acute in 2009. It also would not be surprising if Rule 14a-8 matters again made their way into court.

With these considerations in mind, companies should attend to good housekeeping measures, plan carefully and maintain open lines of communication. These practices will not only help preserve options, but also allow for better processing and decision-making regarding stockholder proposals.

David B.H. Martin  
Keir D. Gumbs  
Brandon K. Gay

If you have any questions concerning the material discussed in this client alert, please contact the following members of our securities practice group:

Bruce C. Bennett	212.841.1060	bbennett@cov.com
Bruce R. Deming	415.591.7051	bdeming@cov.com
Peter A. Laveran-Stiebar	44.(0)20.7067.2021	plaveran@cov.com
David B.H. Martin	202.662.5128	dmartin@cov.com

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