

July 27, 2009

Corporate Governance Developments and Proposals

Attached is a presentation we have recently prepared, outlining current legislative and regulatory proposals for changes in corporate governance, including as to board structure, director election, shareholder proxy access, risk management and compensation matters, and including a linked, clickable index of our recent memos on these topics. We thought you might find it a useful resource.

Wachtell, Lipton, Rosen & Katz

Corporate Governance Developments and Proposals

WACHTELL, LIPTON, ROSEN & KATZ

July 27, 2009

Agenda

- (1) Current Regulatory and Legislative Landscape
- (2) Board Structure Proposals
- (3) Director Election Proposals
- (4) Shareholder Proxy Access Proposals
- (5) Risk Management Proposals
- (6) Compensation Proposals
- (7) Corporate Governance: Myth vs. Reality

Current Corporate Governance Regulatory and Legislative Landscape

- The current financial and economic crisis has helped spark new – or, in many cases, has helped breathe new life into old – corporate governance proposals
 - *“The current economic crisis has led many investors to raise serious concerns about the accountability and responsiveness of some companies and boards of directors to the interests of shareholders, and has resulted in a loss of investor confidence.”*
 - **SEC Chair Mary Schapiro, Proposed Rules on Proxy Access**
 - *“During this recession, the leadership at some of the nation’s most renowned companies took too many risks and too much in salary, while their shareholders had too little say. This legislation will give stockholders the ability to apply the emergency brakes the next time the company management appears to be heading off a cliff.”* – **Senator Charles Schumer, Introducing the Shareholder Bill of Rights**
 - *“...among the central causes of the financial and economic crisis that the United States faces today has been a widespread failure of corporate governance.”*
 - **Shareholder Bill of Rights**

Current Corporate Governance Regulatory and Legislative Landscape *(continued)*

- These proposals arise under newly introduced federal legislation, SEC rule-making, state corporation laws and the rules of the New York Stock Exchange (NYSE)
- The most significant changes and potential changes addressed by the various proposals include:
 - Board Structure
 - Director Elections
 - Shareholder Proxy Access
 - Risk Management
 - Compensation

Board Structure Proposals

Separation of Board Chairman / CEO

- All publicly traded companies would be required to split the role of board chairman and CEO (*Shareholder Bill of Rights Act of 2009; Shareholder Empowerment Act of 2009*)
- Board chair role would have to be filled by an “independent” director (*Shareholder Bill of Rights Act of 2009; Shareholder Empowerment Act of 2009*)
- Proposals include different, and sometimes more stringent, definitions of “independence”
 - *Shareholder Bill of Rights Act of 2009* – Defined by rules of relevant exchange and SEC
 - *Shareholder Empowerment Act of 2009* – Person who has not been during the last 5 years:
 - employed by the issuer in an executive capacity (or a relative of an executive);
 - an employee, director or owner of more than 20% of the shares of a firm that is a paid adviser or consultant to the issuer;
 - employed by a significant customer or supplier of the issuer;
 - a party to a personal services contract with the issuer or with the issuer’s chairman, CEO, or other senior executive officer;
 - an employee, officer or director of a foundation, university or other non-profit organization that receives the greater of \$100,000 or 1% of total annual donations from the issuer;
 - part of an interlocking directorate in which the issuer’s CEO or another executive serves on the board of another issuer employing that director; or
 - engaged in any other relationship with the issuer or senior executives that the SEC determines would render that person not an independent director

Board Structure Proposals *(continued)*

Elimination of Classified Boards

- All boards of directors of publicly traded companies would be required to be declassified and therefore directors would be subject to annual election (*Shareholder Bill of Rights Act of 2009*)

Enhanced Disclosures

- On July 10, the SEC released proposed rules that would expand the scope of required disclosure regarding corporate governance, including:
 - a description of, and justification for, a company's leadership structure, including whether and why a corporation has chosen to combine or separate the principal executive officer and board chairman positions, and whether and why a corporation has a lead independent director; and
 - additional disclosure regarding directors' skills and experience, including longer look-back periods for disclosure of other directorships (5 years) and legal proceedings (10 years)

Director Election Proposals

Majority Voting

- All publicly traded companies would be required to elect directors under a majority-voting standard (*Shareholder Bill of Rights Act of 2009*; *Shareholder Empowerment Act of 2009*)
 - The currently proposed majority-voting standard would require that the number of shares voted “for” a director’s election exceed 50% of the number of votes cast with respect to that director’s election
 - Majority voting would be required in uncontested elections only; plurality voting would continue to apply in elections where there are more nominees than available seats
- Incumbent directors who are not re-elected by a majority vote would be required to tender their resignation to the board of directors (with the *Shareholder Bill of Rights Act of 2009* mandating that the board accept such resignations)
 - The majority voting procedures that many public companies have adopted over the last several years similarly require directors who fail to receive a majority vote to offer to resign; however, in most cases, the board has discretion to accept or reject such resignations based on the best interests of the company

Director Election Proposals *(continued)*

Broker Non-Votes

- In early July 2009, the SEC approved a change to NYSE Rule 452 to prohibit brokers from voting on behalf of clients who fail to provide voting instructions in uncontested director elections
 - The amendment will apply to all shareholder meetings held on or after January 1, 2010
 - Among other things, the new rule may disenfranchise some retail stockholders, and may make it more difficult to achieve majority votes for board members, increase the voice of activists and other special interest groups, and enhance the influence of proxy advisory firms such as RiskMetrics
- Proposed legislation would prohibit broker discretionary voting in uncontested director elections (*Shareholder Empowerment Act of 2009*)

Shareholder Proxy Access Proposals

Proposed SEC Rules

- Proposed Rule 14a-11 would be a mandatory rule permitting shareholders to nominate directors on the company's proxy statement and proxy card
- For large accelerated filers, shareholders holding 1% or more of a company's outstanding shares for at least 1 year would be allowed to use the company's proxy statement to nominate directors
 - Shareholders can aggregate holdings to meet the ownership threshold
- Qualifying shareholders would be permitted to include a number of director nominees representing up to 25% of the entire board
 - Determined based on size of board, regardless of the number of seats up for election, and, if a company has fewer than 4 seats, shareholders would get 1 nomination
 - Directors nominated pursuant to Rule 14a-11 whose term extends past an annual meeting (*e.g.*, in a staggered board) will count toward a qualifying shareholder's 25% limit until such director is no longer on the board
- Shareholder nominees would be included on a "first nominated" basis
 - Relative size of nominators' shareholdings would not be taken into consideration if there are more nominations than available slots

Shareholder Proxy Access Proposals *(continued)*

Proposed SEC Rules *(continued)*

- Specific Rule 14a-11 requirements would include:
 - *Advance Notice.* As with Rule 14a-8 proposals, nominations would have to be submitted 120 days prior to the publication date of the previous year's proxy materials, or earlier if the company's advance notice bylaw so requires
 - *Statement of Intent.* Shareholders would have to sign a statement indicating their intent to hold their shares through the annual meeting and that they are not seeking control of the board
 - *Disclosure.* Shareholders would have to make certain disclosures on Schedule 14N regarding nominees and nominating shareholders, and although companies would be required to provide such information in proxy statements, the proposing shareholders would have liability for false statements
 - *Independence.* Nominees would be required to meet the listing standards for independence from the company, but there would be no requirement that nominees be independent from nominators

Shareholder Proxy Access Proposals *(continued)*

Proposed SEC Rules *(continued)*

- In addition to mandating proxy access in Rule 14a-11, the SEC's proposal would amend Rule 14a-8 to permit shareholder proposals relating to proxy access
- Amendment would allow shareholders to adopt proxy access bylaws that are more permissive than Rule 14a-11 (*e.g.*, lower ownership threshold; shorter holding period requirement; shareholders can nominate more than 25% of the board)

Proposed Federal Legislation

- Shareholders that, in the aggregate, have owned at least 1% of a company's shares for at least 2 years prior to annual meeting would be permitted to nominate directors on the company's proxy statement and proxy card (*Shareholder Bill of Rights Act of 2009; Shareholder Empowerment Act of 2009*)

Shareholder Proxy Access Proposals *(continued)*

Delaware Law Developments

- The Delaware state legislature adopted legislation in April 2009 that provides shareholders of Delaware corporations with easier and cheaper access to proxy materials for director nominations
 - Amendments will become effective on August 1, 2009
- DGCL § 112: Authorizes shareholders or the board to adopt a bylaw requiring the company to include shareholder nominees in its proxy materials
 - The amended section provides a non-exclusive list of conditions that bylaws can impose on such a right of access:
 - Limitation on the number of permissible nominees
 - Minimum holding period and beneficial ownership level (bylaws can define beneficial ownership to include derivatives)
 - Disclosures relating to the shareholder and its nominees
 - Preclude nominations by shareholder who has acquired or publicly proposed to acquire a specified percentage of the company's voting stock (*i.e.*, limit use of the company's proxy materials in the takeover scenario)

Shareholder Proxy Access Proposals *(continued)*

Delaware Law Developments *(continued)*

- DGCL § 113: Authorizes shareholders or the board to adopt a bylaw requiring the company to reimburse shareholders for their proxy solicitation expenses
 - The amended section provides a non-exclusive list of conditions that bylaws can impose on reimbursement:
 - Limitations based on the number of directors that a shareholder can nominate or the number of previous nominations for which the shareholder was reimbursed
 - Limitations based on the proportion of votes cast in favor of the shareholder's nominees or based on the amount spent by the corporation on the election
 - Limitations based on whether the company has cumulative voting

Risk Management Proposals

Shareholder Bill of Rights Act of 2009

- Companies would be required to establish a risk committee comprised entirely of independent directors and responsible for the establishment and evaluation of risk management practices

Enhanced Disclosure Regarding Risk Management

- On July 10, the SEC released proposed rules that would, among other things, require a company to provide specific disclosure addressing the relationship between its overall compensation policies and risk management, to the extent specific matters might have a material impact on the company

Compensation Proposals

Compensation Principles

- On June 10, the Department of Treasury, working with the Federal Reserve and the SEC, issued a statement regarding compensation “reform” goals that address “say on pay,” compensation committee independence and what it believes to be key compensation principles
- The announced principles, which Treasury hopes to use over time to develop compensation legislation and SEC rules, would apply to public companies generally and address:
 - Aligning pay and performance
 - Time horizon risk in compensation plans
 - Risk management
 - Aligning severance and retirement packages with shareholders’ interests
 - Transparency and accountability

Compensation Proposals

Recent Draft Legislation and Regulations

- On July 10, the SEC released proposed rules that would, among other things, require a company to provide enhanced disclosures with respect to the relationship between risk and compensation and with respect to compensation consultant independence
- To advance the compensation principles it announced on June 10, Treasury delivered draft legislation to Congress on July 16 that would require publicly traded companies to include a non-binding, advisory “say on pay” vote on executive compensation packages for each annual meeting and in the context of a change-in-control transaction, and to take steps intended to ensure the independence of compensation committees
- On July 17, Congressman Barney Frank, Chairman of the House Committee on Financial Services, circulated a discussion draft of legislation (*Corporate and Financial Institution Compensation Fairness Act of 2009*) regarding executive compensation to members of the House Committee on Financial Services based in part on previous legislation and in part on the legislative proposals delivered by Treasury on July 16

Compensation Proposals *(continued)*

“Say on Pay”

- Require a non-binding shareholder vote on executive compensation (*Shareholder Bill of Rights Act of 2009; Shareholder Empowerment Act of 2009; Corporate and Financial Institution Compensation Fairness Act of 2009; Draft Treasury Legislation*)
- Require a *binding* vote on any compensation to an employee that exceeds 100x the average compensation to all employees (*Excessive Pay Shareholder Approval Act*)
- Troubled Asset Relief Program (TARP) participants are currently required to give shareholders a non-binding vote on executive compensation

Compensation Proposals *(continued)*

“Say on Pay” – Current Practices

- Companies receiving TARP assistance (approximately 400 companies) must already provide their shareholders with advisory “say on pay” votes
- Approximately 15 U.S. companies not receiving TARP assistance also included advisory “say on pay” votes for the 2008 and 2009 proxy seasons
- The following is an example of a TARP-mandated advisory compensation resolution used by Citigroup in its 2009 proxy:

Resolved, that the stockholders approve the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the compensation discussion and analysis, the compensation tables and any related material disclosed in this proxy statement.

The board recommends that you vote for the foregoing resolution approving Citi’s executive compensation as disclosed in the CD&A, the compensation tables and any related materials contained in this proxy statement.

Compensation Proposals *(continued)*

“Say on Pay” – Current Practices *(continued)*

- RiskMetrics governance guidelines do not currently require a “say on pay” vote, and take a case-by-case approach to recommendations on management-sponsored “say on pay” proposals
- In evaluating “say on pay” proposals, RiskMetrics urges shareholders to examine a company’s adherence to five basic principles:
 - Align pay with performance and emphasize long-term shareholder value
 - Avoid “pay for failure” arrangements
 - Safeguard compensation committee’s independence, expertise and efficacy
 - Provide timely and informative compensation disclosure to shareholders
 - Avoid compensating outside directors inappropriately or excessively
- In addition, RiskMetrics has identified several specific criteria, including peer group benchmarking and pay-trend comparisons, that shareholders should consider in evaluating executive compensation policies and practices

Compensation Proposals (*continued*)

Golden Parachutes

- Require a *non-binding* shareholder vote on compensation paid to a principal executive officer in connection with a change of control of the corporation (*Shareholder Bill of Rights Act of 2009*)
- Require a *non-binding* shareholder vote on compensation paid in connection with a change-of-control transaction (*Corporate and Financial Institution Compensation Fairness Act of 2009; Draft Treasury Legislation*)
- Note that TARP participants are generally prohibited from paying *any* severance to designated top executives and high earners

Severance for Poor Performance

- Prohibit boards of directors from granting severance payments to senior executive officers terminated for poor performance (*Shareholder Empowerment Act of 2009*)

Independent Compensation Advisors and Committees

- Require any person who advises the board of directors of a publicly traded corporation on executive compensation to be independent of the corporation, its executives and its directors (*Shareholder Empowerment Act of 2009; Corporate and Financial Institution Compensation Fairness Act of 2009; Draft Treasury Legislation*)
- Require compensation committees to meet independence standards, and have their own authority and funds to hire independent compensation consultants and outside legal counsel (*Corporate and Financial Institution Compensation Fairness Act of 2009; Draft Treasury Legislation*)

Compensation Proposals *(continued)*

Clawback on Unearned Performance-Based Pay

- Require all publicly traded corporations to develop and disclose a policy for reviewing any unearned bonus, incentive or equity payments that were awarded to executive officers owing to fraud, financial statements that require restatement, or some other cause (*Shareholder Empowerment Act of 2009*)
- Such policy would require recovery or cancellation of such unearned payments to the extent feasible or practical
- Note that (i) TARP participants are currently subject to special clawback requirements under circumstances involving materially inaccurate financial statements or performance metrics and (ii) Section 304 of the Sarbanes-Oxley Act requires a CEO or CFO to return incentive-based compensation to an issuer in the event of a financial restatement that occurs “as a result of misconduct”

Compensation Proposals *(continued)*

Enhanced Compensation Disclosures

- Require all publicly traded corporations to disclose specific performance targets used to determine senior executive officers' eligibility for bonus, equity and incentive compensation (*Shareholder Empowerment Act of 2009*)
- On July 10, the SEC released proposed rules that would, among other things, require a company to provide specific disclosure addressing:
 - the relationship between a company's overall compensation policies and risk management to the extent specific matters might have a material impact on the company; and
 - the potential conflicts of interest with regard to compensation consultants

Corporate Governance: Myth vs. Reality

- The proposition that “poor” corporate governance caused the current financial crisis is not supported by the facts
- Of the 15 S&P 500 companies with the worst-performing stocks in 2008:
 - 80% did not have staggered boards
 - 80% did not have a poison pill in place
 - 73% had majority voting or a director resignation policy
- In fact, the biggest decliners were less likely to have staggered boards than the average S&P 500 company (20% vs. 33%) and no more likely to have a poison pill

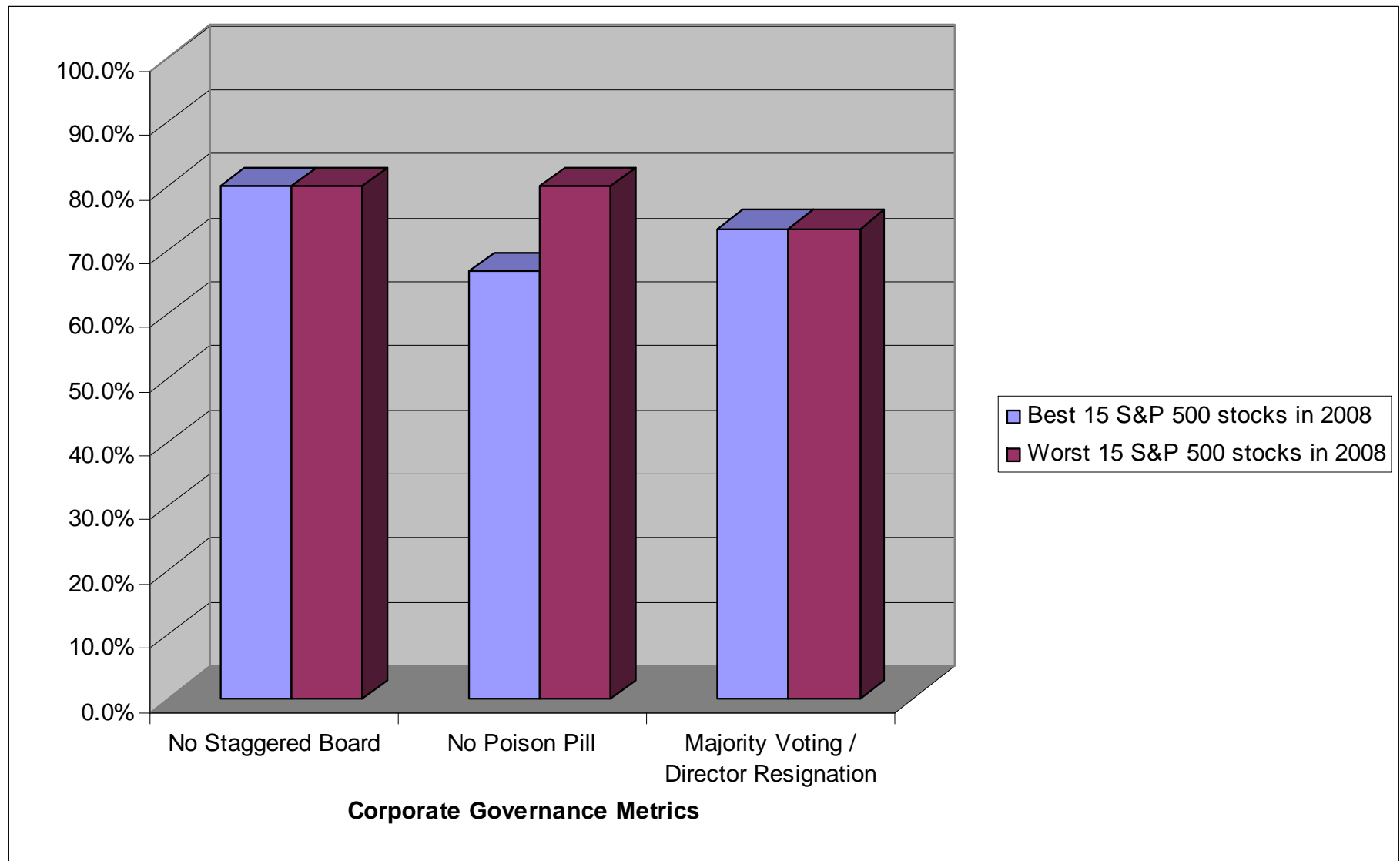
S&P 500 Worst Performing Stocks: 2008

Name	Current Ticker	Percent Change
Lehman Brothers	<i>Delisted</i>	-99.96
Washington Mutual	<i>Delisted</i>	-99.84
Fannie Mae	FNM	-98.10
Freddie Mac	FRE	-97.86
AIG	AIG	-97.31
Circuit City	<i>Delisted</i>	-96.90
General Growth Properties	GGP	-96.87
EW Scripps	SSP	-95.09
Ambac Financial	ABK	-94.96
XL Capital	XL	-92.65
American Capital	ACAS	-90.17
Bear Stearns	<i>Merger</i>	-89.43
National City	NCC	-89.00
Genworth Financial	GNW	-88.88
Developers Diversified	DDR	-87.26

S&P 500 Best Performing Stocks: 2008

Name	Current Ticker	Percent Change
Wrigley	<i>Acquired</i>	36.58
Family Dollar	FDO	35.57
Anheuser-Busch	<i>Acquired</i>	31.03
UST	UST	26.61
Amgen	AMGN	24.35
Barr Pharma.	<i>Acquired</i>	23.92
Safeco	<i>Acquired</i>	22.50
H&R Block	HRB	22.35
Electronic Data	<i>Acquired</i>	20.41
Celgene	CELG	19.63
Wal-Mart	WMT	17.95
Rohm And Haas	ROH	16.43
Autozone	AZO	16.31
Hasbro	HAS	14.03
Gilead Sciences	GILD	11.15

Corporate Governance: Myth vs. Reality *(continued)*



Corporate Governance Developments and Proposals

Wachtell, Lipton, Rosen & Katz Memos

July 27, 2009

- 1 [Corporate Governance Update: Activist Shareholders Would Gain Power from Proposed Rule Change, March 26, 2009](#)
- 2 [Strategies for the New Reality of Shareholder Proxy Access, May 7, 2009](#)
- 3 [A Crisis Is a Terrible Thing to Waste: The Proposed “Shareholder Bill of Rights Act of 2009” Is a Serious Mistake, May 12, 2009](#)
- 4 [SEC Approves Proposal for Shareholder Proxy Access, May 20, 2009](#)
- 5 [Proxy Access 2009: Will the Bad Economy Lead to Bad Governance?, May 28, 2009](#)
- 6 [Administration Releases Executive Compensation Principles, June 10, 2009](#)
- 7 [SEC Releases Proposed Rules “Facilitating Shareholder Director Nominations”, June 11, 2009](#)
- 8 [SEC Eliminates Broker Discretionary Votes for Directors and Seeks Enhanced Proxy Disclosures, July 2, 2009](#)
- 9 [SEC Proposes Changes to Proxy Solicitation Rules and Expanded Governance and Executive Compensation Disclosures, July 13, 2009](#)
- 10 [Corporate Governance in Crisis Times, July 16, 2009](#)
- 11 [Treasury Submits Draft Legislation Mandating Say-on-Pay and Independence Standards for Compensation Committees to Congress, July 17, 2009](#)
- 12 [Executive Pay and Directors’ Duties, July 20, 2009](#)
- 13 [SEC Pursues Unprecedented Sarbanes-Oxley “Clawback”, July 24, 2009](#)