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Corporate Governance Provisions Added to Financial Reform Bill

Senator Dodd unveiled his 1,136-page financial reform bill discussion draft today, which proposes a variety of new financial industry regulations and regulatory agencies. While the bill focuses on these wide-ranging and controversial financial reform proposals, a number of corporate governance reforms are also buried in the bill on pages 755 to 762, and are largely taken, albeit in somewhat weakened form, from Senator Schumer's proposed Shareholder Bill of Rights Act. As we have previously commented, these governance reforms, while presented as a means of enhancing corporate governance and restoring stability to American companies, are likely to have just the opposite effect. See "A Crisis Is a Terrible Thing to Waste: The Proposed 'Shareholder Bill of Rights Act of 2009' Is a Serious Mistake" and "Corporate Governance in Crisis Times."

The corporate governance provisions of the discussion draft would:

- require (1) a majority voting standard in uncontested elections of directors, (2) that any director who does not receive a majority vote submit a resignation, and (3) that the board accept the resignation or vote unanimously to reject it, in which case the company must disclose the reasons for the rejection and why the rejection was in the best interests of the company and its shareholders;

- require the SEC to adopt proxy access rules within 180 days, under which shareholders would be permitted to nominate directors using the company's proxy materials on terms to be determined by the SEC;

- require companies to disclose in their annual meeting proxy statements why they have chosen either to separate or not to separate the positions of the chairman and CEO of the company; and

- prohibit staggered boards unless adopted or ratified by the shareholders of the company.

In our view, the intrusion of this type of federal legislation into areas of corporate governance traditionally governed by state law is unwarranted and dangerous. While some of the provisions of the Dodd discussion draft are improvements over the Schumer approach – for example, requiring disclosures regarding the company's choice on whether to separate the chairman and CEO positions, rather than mandating separation and requiring an independent chairman – other provisions, such as mandated proxy access, are likely to increase the ability of shareholder activists and hedge funds to exert the kind of short-term pressures that helped create the current economic crisis. Moreover, we believe that allowing state law and individual companies and their shareholders to address these issues at the company level, which they have been doing, is far preferable to the federally mandated "one-size-fits-all" approach represented by the Dodd and Schumer proposals (and other legislative proposals such as the Shareholder Empowerment Act of 2009). Finally, we believe there is enough to debate in the financial industry reforms proposed by Senator Dodd's discussion draft. The effort to tack on these types of corporate governance proposals is simply a mistake.

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