The apparent failure of corporate governance practices, including inadequate risk management and excessive compensation policies, is widely perceived as one of the root causes of the current financial and economic crisis. This crisis has led many to ask whether corporate boards are being held accountable for the decisions they make and whether shareholders truly have a voice in how the companies they own are governed.

With these concerns in mind, Congress and the Securities and Exchange Commission have recently proposed new legislation and rules to increase the accountability of executive management and boards of directors. These proposals generally fall into three categories: shareholder proxy access; say on pay; and increased corporate governance standards and disclosure requirements. While the outcome of these proposals is far from certain, it cannot go without notice that one recurring theme is toward a federalization of corporate law. This article provides a brief summary of the federal governance proposals introduced in 2009 and frames the tension these proposals present with respect to state corporate law.

**Shareholder Bill of Rights**

On May 19, Sens. Charles Schumer of New York and Maria Cantwell of Washington state introduced the Shareholder Bill of Rights Act of 2009, which would give shareholders a non-binding vote on executive compensation matters and reassert Congress' intent that the SEC should have full authority to determine the use of the proxy with regard to the nomination and
Specifically, the bill revises Section 14A of the Securities Exchange Act of 1934 by requiring companies to include in their proxy statements a non-binding advisory vote on executive compensation. A non-binding shareholder vote also would be required to approve golden parachute agreements that grant benefits to an employee if employment is terminated in connection with a change in control transaction, i.e., acquisition, merger or consolidation.

The bill also contains provisions for greater shareholder input in board elections and provides for several new corporate governance standards. The bill requires the SEC to establish rules relating to the use by shareholders of proxy solicitation materials for nominating individuals to the board of directors. Presently, Rule 14a-8(i)(8) of the exchange act permits an issuer to exclude from a proxy statement a shareholder proposal relating to the election of directors. On May 20, as discussed below, the SEC voted to propose an amendment to Rule 14a-8(i)(8), which, if approved, would require companies to include any shareholder proposal in a proxy statement to amend, or to request an amendment to, a company's bylaw provisions on nomination procedures or disclosures related to shareholder nominations. Whether this proposal goes as far as the sponsors of the bill intend is not known, but it is clear that members of Congress and the SEC believe the time is ripe to push through shareholder proxy access proposals.

The bill's corporate governance provisions require the SEC to establish rules that direct national securities exchanges to prohibit listing an issuer that does not comply with the corporate governance provisions of the bill, which include: a requirement to provide in a company's governing documents or policies that the chairman of the board be independent according to rules of the exchange and not previously have served as an executive officer of the issuer; elimination of staggered boards; majority voting in the election of directors and plurality voting in contested elections; and a requirement that a risk committee composed entirely of independent directors be responsible for the establishment and evaluation of the risk management practices of the issuer.

**Shareholder Empowerment Act**

On June 12, U.S. Rep. Gary Peters of Michigan introduced the Shareholder Empowerment Act of 2009. Similar to the Shareholder Bill of Rights, the proposed act would require the SEC to establish rules that direct national securities exchanges to prohibit listing an issuer who does not provide for majority voting in uncontested elections and plurality voting in contested elections and to require that the chairman of the board be independent and not previously have served as an executive officer of the issuer. The proposed act goes one step further, however, by mandating that issuers split the chairman and CEO roles. Similarities to the bill are provisions for a non-binding advisory vote on the compensation packages of senior executives and for proxy access that would require issuers to provide for shareholder director nominations.

Additional provisions under the proposed act include requiring the SEC to adopt rules requiring independent compensation consultants. The SEC also would be required to adopt rules directing the national securities exchanges to adopt listing standards requiring companies to recover or cancel payments that were awarded to executives on the basis of fraudulent or faulty earnings statements and prohibiting the board or compensation committee from entering into agreements providing for severance payments for executives terminated for poor performance. The proposed act also directs the SEC to adopt rules prohibiting brokers from voting securities in uncontested
elections if beneficial owners have not provided instructions. This last provision may be rendered moot because of the SEC's approval on July 1 to amend Rule 452 of the New York Stock Exchange eliminating broker discretionary voting for the election of directors.

To date, there has been no debate in Congress on either the bill or the proposed act; therefore, it is impossible to assess the likelihood of either becoming law or how they may be reconciled. Although Congress may regulate corporate conduct affecting interstate commerce, attempts to do so in the area of corporate governance have failed in the past because, as the U.S. Supreme Court held in *CTS Corp. v. Dynamics Corp.*, "State regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law. … It thus is an accepted part of the business landscape in this country for states to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares." State law governs the formation and powers of corporations and establishes the rights and duties of directors and officers. State law also establishes the rights of shareholders, proscribes which matters are subject to a shareholder vote and governs the conduct of shareholder meetings. If these bills become law, one indication of how the SEC may debate the apparent conflict between federal corporate governance standards and state corporate law can be found in the recent rule proposal concerning shareholder proxy access described below.

**Facilitating Shareholder Director Nominations**

On May 20, the SEC voted to release yet another proposal on shareholder proxy access representing the agency's fourth attempt in nearly seven years to implement such rules. In the current release, the SEC proposes new Rule 14a-11 that would require companies to include shareholder nominees for director in a company's proxy materials. The requirement under Rule 14a-11 would apply unless state law or a company's governing documents prohibit shareholders from nominating directors. Shareholders would be eligible to have their nominees included in proxy materials if they own at least 1 percent, 3 percent or 5 percent of an issuer's securities that are entitled to be voted on the election of directors at the annual meeting for large accelerated, accelerated and non-accelerated filers, respectively. The proposal also would amend Rule 14a-8 by requiring companies to include in their proxy statements shareholder proposals to amend governing documents' provisions regarding the right to nominate directors. The comment period for this proposal ends Aug. 17.

An intriguing aspect of the shareholder proxy access proposal was the narrow SEC 3-2 vote and the dissenting statements of Commissioners Troy Paredes and Kathleen Casey. While Chairwoman Mary Schapiro stated her belief that the proxy access proposal "would turn what would otherwise be a somewhat illusory right to nominate into something that is real," Paredes stated his belief that the proposal "encroaches far too much on internal corporate affairs, the traditional domain of state corporate law" and wondered aloud whether the "fundamental essence of the proposal is to realign corporate control at the federal level." Paredes' dissent was focused on three main points. First was the relationship between state corporate law and the federal securities laws where the core of federal law is mandatory disclosure and state corporate law "determines the powers, rights and duties of corporate actors and constituents."

Second was the market discipline that has already resulted in shareholder empowerment marked by a trend away from plurality voting, which is the default standard in most corporation codes,
toward majority voting for directors "even in the absence of legislative or regulatory mandates." Finally, Paredes pointed to the Delaware Legislature's passage of new Sections 112 and 113 to the General Corporation Law discussed below.

Casey's dissent pointedly stated that the proposal "places the Commission squarely into the territory of creating a federal corporate governance regime." She argued that states are in a much better position "to respond to the needs of the constituents affected by their laws — including the companies organized under their laws" and that states function as "'laboratories' for innovation and experimentation." She also pointed to Delaware's enactment of Sections 112 and 113 as an example of the "state laboratory process" and questioned whether the SEC had the authority to enact the rules as proposed, stating, "The Supreme Court has made clear that, in the absence of an explicit federal law, state law governs the internal affairs of the corporation."

**Delaware General Corporation Law**

Seemingly in anticipation of federal action in the area of shareholder proxy access, the Delaware Legislature enacted April 10, Sections 112 and 113 of the General Corporation Law. Section 112 provides that the bylaws of an issuer may provide that if a corporation solicits proxies with respect to an election of directors, it may be required to include in its proxy solicitation materials (including any form of proxy it distributes) one or more individuals nominated by a stockholder, in addition to individuals nominated by the board of directors. Section 113 provides that the bylaws may provide for the reimbursement by the corporation of expenses incurred by a stockholder in soliciting proxies in connection with an election of directors, subject to such procedures or conditions as the bylaws may prescribe. Sections 112 and 113 will become effective Aug. 1.

**Conclusion**

History has demonstrated that financial crises and corporate wrongdoings result in legislative and administrative actions to remediate perceived deficiencies in federal securities laws. We need only look back seven years to the passage of the Sarbanes-Oxley Act of 2002 for such an example. Some shareholder advocates view today's financial and economic crisis as an opportunity to push for new corporate governance and executive compensation standards. Consider, however, the resistance to some of these efforts as evidenced by companies that have returned federal bailout money in order to regain control of their corporate affairs. While chaos could lead to order, only time will tell whether federal lawmakers will honor what has traditionally been left to the states or whether the current financial and economic crisis will mark another step toward the federalization of corporate law.