

# ClientAlert

December 2009

## RiskMetrics 2010 U.S. Corporate Governance Policy Updates

Recently, RiskMetrics Group released updates to its corporate governance policies which will govern its proxy voting recommendations for the upcoming 2010 proxy season. A copy of the 2010 U.S. company guidelines can be found at [www.riskmetrics.com/sites/default/files/RMG2010USPolicyUpdates.pdf](http://www.riskmetrics.com/sites/default/files/RMG2010USPolicyUpdates.pdf). The new policy guidelines applicable to U.S. companies include updates to the corporate governance issues described below. For a description of the new policy guidelines on executive compensation matters, please see our separate [Client Alert](#).

### Voting on Director Nominees in Uncontested Elections

#### ***Adoption or Renewal of Non-Shareholder Approved Poison Pills***

Under its updated policy, RiskMetrics will recommend a "vote against" or "withhold" vote on all director nominees (except new nominees, who will be considered on a case-by-case basis) where the board, without shareholder approval: (1) adopts a poison pill with a term of more than 12 months; (2) renews any existing pill of any duration; or (3) makes a material, adverse change to an existing pill. A commitment to put a newly adopted pill to a shareholder vote may offset an adverse vote recommendation. RiskMetrics will provide recommendations on a case-by-case basis where the board adopts a poison pill with a term of 12 months or less without shareholder approval taking into account certain factors designated in the policy. Under its new policy, RiskMetrics will review companies with classified boards every year and companies with annual elections once every three years, and will recommend a "vote against" or "withhold" vote if the company still maintains the poison pill without shareholder approval. Previously, RiskMetrics' policy did not distinguish between short-term or long-term poison pills or provide for recurring review.

#### ***Definition of "New Nominee"***

A "new nominee" will be defined as any current nominee who has not already been elected by shareholders and who joined the board after the problematic action in question occurred or, if such determination is not possible, who joined the board within the 12 months prior to the upcoming shareholder meeting. Previously, a "new nominee" referred to a director being elected by shareholders for the first time.

#### ***Egregious Actions***

RiskMetrics will recommend, under extraordinary circumstances, a "vote against" or "withhold" vote for directors individually, directors serving on a committee, or the entire board, due to (1) material failures of governance, stewardship, or fiduciary responsibilities at the company; (2) failure to replace management as appropriate; or (3) egregious actions related to the director(s)' service on other boards that may raise substantial doubt about his or her ability to effectively oversee management and serve the best interest of the shareholders at any company. The change reflects that RiskMetrics will consider a

potential adverse vote recommendation at the board, committee or individual level if a director has had significant involvement with a failed company and/or where a director has in the past appeared not to have acted in the best interest of all shareholders.

### Director Independence

RiskMetrics has updated its evaluation of director independence for 2010. Transactional relationships will be examined if the transaction is between the company and (1) the director (or an immediate family member) or (2) an entity in which the director (or an immediate family member) is a partner, controlling shareholder or executive officer. To determine the materiality of any related transactions, the updated policy will apply the NYSE-based test of the greater of \$1 million or two percent of the recipient's gross annual revenues to companies listed on the NYSE and Amex exchanges. Companies listed on the Nasdaq exchange or that do not follow Nasdaq or NYSE listing standards will remain subject to the Nasdaq -based test of the greater of \$200,000 or five percent of the recipient's gross annual revenues.

RiskMetrics has also clarified how it will evaluate professional services provided by directors to the company. The \$10,000 *de minimis* threshold for professional services will apply to professional services provided (1) directly by the director (or an immediate family member), or (2) where the director (or an immediate family member) is affiliated with the organization that provides the professional service to the company. Previously, its policy could be interpreted to apply only to cases where the director (or an immediate family member) provided professional services directly to the company.

A related update clarifies the types of services that will generally be considered to constitute professional services. These changes clarify the manner in which RiskMetrics applies its policy, which considers whether the services are "advisory in nature, generally involve access to sensitive company information or to strategic decision-making, and typically having a commission- or fee-based payment structure." Previously, RiskMetrics characterized professional services only as those being "advisory in nature." Services now listed as generally constituting professional services include insurance services, information technology services, marketing services, lobbying services, executive search services and realtor services. Educational services will no longer generally be considered professional services.

Other updates to RiskMetrics' director independence guidelines include changes to the criteria for "inside directors" and a redesign and update of its Director Classification Table, which summarizes the criteria for categorizing directors as "inside directors," "affiliated outside directors" or "independent outside directors." Directors that are "among the five most highly paid individuals" will be considered "inside directors" under the new criteria, regardless of whether the director is an officer. Previously, a director would be considered an "inside director" only if the director was both a non-employee officer of the company and among the five most highly paid. Furthermore, for non-employee directors serving as officers due to statutory requirements, payment of additional compensation in excess of \$10,000 per year for serving in such capacity would result in classification of the director as an "inside director."

## Board-Related Shareholder Proposals

### ***Nominee Qualifications***

RiskMetrics has also expanded its policy for shareholder proposals relating to director nominee qualifications. Under the new policy, RiskMetrics will provide recommendations on a case-by-case basis for shareholder proposals that seek a director nominee candidate with a particular subject matter expertise. RiskMetrics' previous policy only considered shareholder proposals that establish or amend director qualifications (which policy remains for 2010 with recommendations provided on a case-by-case basis).

### ***Board Committees***

RiskMetrics will generally recommend a "vote against" shareholder proposals to establish a new board committee, as such proposals seek a specific oversight mechanism/structure that potentially limits a company's flexibility to determine an appropriate oversight mechanism for itself. This new policy thus removes the qualifier "standing" on board committees so that even shareholder proposals seeking to establish temporary committees will also be subject to a "vote against" recommendation.

## Shareholder Rights and Defenses

### ***Protection of Net Operating Losses***

Two new updates address the desire of previously profitable companies to protect their tax net operating losses (which may be lost upon an acquisition of 5% of a company's shares) through the adoption by the company of protective amendments to the charter/bylaw or through poison pills. RiskMetrics has adopted a new policy considering on a case-by-case basis management proposals to adopt (1) a protective charter/bylaw amendment and (2) poison pills for the purpose of protecting a company's NOLs. Addressing such charter/bylaw amendments is a new policy for RiskMetrics while the policy considering such poison pills has been updated to include the company's governance structure and responsiveness to shareholders as additional factors to consider in the determination.

### ***Shareholder Rights***

RiskMetrics has also updated its policies on proposals that affect shareholders' rights (1) to call special meetings, or (2) to act by written consent. Under the updated policy, RiskMetrics will recommend a "vote against" proposals that restrict or prohibit shareholders' ability to call special meetings or to act by written consent. Furthermore, RiskMetrics will generally recommend a "vote for" proposals that allow shareholders to call special meetings or act by written consent, considering factors such as the current right for shareholders to call special meetings or act by written consent, minimum ownership or consent thresholds and other exclusionary language, investor ownership structure and management's response to previous shareholder proposals. Previously, RiskMetrics did not specify the factors it would consider.

### ***Supermajority Vote Requirements***

With respect to supermajority vote requirements, RiskMetrics will recommend a "vote against" proposals requiring a supermajority shareholder vote and will recommend a "vote for" proposals reducing supermajority vote requirements. However, for companies with shareholder(s) with significant ownership levels, RiskMetrics will provide a recommendation on a case-by-case basis, taking into account the ownership structure, quorum requirements and supermajority vote requirements. Previously, RiskMetrics would recommend "votes for" all proposals that lowered supermajority vote requirements. Considering whether supermajority vote requirements will protect minority shareholders where a company has significant shareholders represents an important change to RiskMetrics' policy.

### **Capital/Restructuring**

#### ***Common Stock and Preferred Stock Authorization***

In line with last year's policy, RiskMetrics will evaluate on a case-by-case basis proposals which increase the number of shares of common stock or preferred stock authorized for issuance. For 2010, however, the company-specific factors that RiskMetrics will consider have been expanded. These factors include the following: disclosure in the proxy statement of the specific reasons for the proposed increase, the dilutive impact of the request, and, with respect to common stock, the risks to shareholders of not approving the request. For preferred stock, instead of considering the risks to shareholders of not approving the request, RiskMetrics will evaluate whether the requested shares are blank check preferred shares and whether they are "declawed" (*i.e.*, cannot be used as a takeover defense). For both common stock and preferred stock, RiskMetrics will also consider the company's historical use of existing shares, including share usage during the last three years, recent total shareholder return, and the board's governance structure and past practices.

RiskMetrics will also recommend a "vote against" proposals at companies with more than one class of common stock or preferred stock, as applicable, to increase the number of authorized shares of the class with superior voting rights. This updated policy clarifies that such proposals at companies with two or more classes of common stock or preferred stock, as applicable, will receive an adverse vote recommendation and is not limited to just those companies with a "dual-class" capital structure.

### **Social/Environmental Issues**

#### ***Climate Change and the Environment***

RiskMetrics will generally recommend a "vote for" proposals that request a report on greenhouse gas (GHG) emission from company operations and/or products, unless the company already provides adequate disclosure and there are no significant controversies, fines, penalties or litigation associated with the GHG emissions. This represents no change from last year's policy.

RiskMetrics will evaluate on a case-by-case basis proposals that call for the adoption of GHG reduction goals from products and operations, taking into account certain factors including the company's current

disclosure, the feasibility of reducing GHGs and overly prescriptive requests. Previously, RiskMetrics generally recommended a "vote against" such proposals.

### ***Board Diversity***

RiskMetrics will generally recommend "vote for" requests for reports on the company's efforts to diversify the board, unless the gender and racial minority representation of the company's board is reasonably inclusive compared to its peers, and the board already reports on its nominating procedures and gender and racial minority initiatives. RiskMetrics has expanded this policy from last year to define diversity as gender and racial minority representation rather than, for example, professional diversity.

RiskMetrics will evaluate on a case-by-case basis proposals that ask the company to increase the gender and racial minority representation on the board, considering factors such as the degree of existing diversity at the company and among its peers, the company's process for addressing gender and racial minority board representation, overly prescriptive requests to amend nominating committee charter language, the independence of the nominating committee, whether an outside search firm is used to identify potential nominees and whether the company has had any recent issues regarding equal employment practices. Compared to last year's policy, RiskMetrics has expanded the description of the factors considered and added the factor relating to overly prescriptive proposals.

### ***General Corporate Issues***

RiskMetrics will generally recommend "vote against" proposals linking executive compensation to environmental and social criteria (such as corporate downsizings, customer or employee satisfaction, environmental performance or human rights), considering factors such as whether the company has significant and persistent controversies or violations regarding such issues, management systems and oversight mechanisms in place, use of similar non-financial performance criteria among industry peers, and current disclosure regarding environmental and social performance. RiskMetrics notes in its policy that there is a lack of widely accepted standards linking executive compensation and corporate non-financial performance. Previously, RiskMetrics had evaluated such proposals on a case-by-case basis. RiskMetrics will maintain its policy to generally recommend a "vote against" proposals calling for an analysis of pay disparity between corporate executives and other non-executive employees, noting that the value of such information is unclear.

### ***Routine/Miscellaneous***

Other new policies for 2010 include application of RiskMetrics' benchmark policies to publicly traded limited partnerships and limited liability companies and the analysis of and voting recommendations on proposals seeking approval of bankruptcy reorganization plans as they relate to equity holders.

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These U.S. corporate governance policies for 2010 will be effective for annual meetings beginning on and after February 1, 2010. RiskMetrics may also adopt policies prior to its next formal annual update to cover new issues that may arise due to regulatory developments or shareholder proposals.

**Our client alerts are for general informational purposes and should not be regarded as legal advice.  
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