

**Report of the  
New York Stock Exchange  
Commission on Corporate Governance**

**September 23, 2010**

## TABLE OF CONTENTS

I.	OVERVIEW AND SUMMARY OF CONCLUSIONS.....	1
II.	THE COMMISSION AND ITS WORK .....	8
III.	SUMMARY OF SIGNIFICANT CORPORATE GOVERNANCE DEVELOPMENTS SINCE 2000 .....	10
	A.    Turbulent Financial Markets.....	10
	B.    Dramatic Changes in Shareownership and Shareholdings of Publicly Traded Companies .....	12
	C.    Increased Corporate Governance and Disclosure Regulation .....	17
	D.    Evolution of Corporate Governance Principles .....	23
IV	PRINCIPLES OF CORPORATE GOVERNANCE.....	24
	A.    Board of Directors.....	25
	B.    Management.....	27
	C.    Shareholders.....	30
V.	CONCLUSION.....	32
	APPENDIX A.....	A-1
	APPENDIX B .....	B-1
	APPENDIX C .....	C-1

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**I. OVERVIEW AND SUMMARY OF CONCLUSIONS**

The New York Stock Exchange (“NYSE”) has long been a leading proponent for the highest standards of corporate governance and ethical behavior. The NYSE’s listing standards have included governance rules for approximately 150 years: it was the NYSE that first required companies to issue regular financial statements, as well as to provide quarterly earnings announcements and conduct independent audits of financial statements, all of which were included as part of the NYSE’s listing standards before any of the federal securities legislation coming out of the Great Depression. The leadership role of the NYSE on governance matters continued during the middle of the 20<sup>th</sup> century, when the NYSE pioneered such developments as required proxy statement distribution, a minimum number of outside directors, and audit committees made up entirely of independent directors.

The first decade of the 21<sup>st</sup> century has seen more changes in the governance landscape than at any time since perhaps the Great Depression. During this period the NYSE has continued to foster innovative solutions to critical governance issues. For example, in 2002 the NYSE’s Corporate Accountability and Listing Standards Committee issued a report which, among other things, recommended increasing the role and authority of independent directors, tightening the definition of “independent director” and fostering a focus on good corporate governance at listed companies. These recommendations resulted in enhanced corporate governance listing standards that the Securities and Exchange Commission (“SEC”) approved in 2003.

In 2005, the NYSE established the Proxy Working Group (“PWG”) to review the voting and proxy process, including the rules that allow brokers to vote on certain issues on behalf of the beneficial owners of shares. The PWG issued its report in 2006 and an addendum in 2007. The PWG’s reports made a number of recommendations to both the NYSE and the SEC to improve the proxy voting system, including that the NYSE amend Rule 452 to eliminate the ability of brokers to vote shares without instruction in uncontested elections of directors. The SEC approved the PWG’s proposed amendment to Rule 452 in 2009 while a number of the other issues identified by the PWG were included in the SEC’s “Proxy Plumbing” concept release in July 2010.

In response to the financial crisis of 2008 and 2009, the NYSE decided to sponsor a comprehensive review of corporate governance principles. At a time when Congress, the SEC and other regulators were considering fundamental changes to the governance of corporations, and corporate governance had become a prominent issue in the financial markets and with the public, the NYSE believed it was important to further inform this debate by setting forth certain core governance principles which could be widely accepted and supported by issuers, investors, directors and other market participants and

experts. The NYSE recognized that these groups had different viewpoints on multiple issues, but believed that it was important to bring together divergent views to see if a consensus on governance principles could be obtained.

It was against this backdrop that the NYSE created the Commission on Corporate Governance in 2009. The diverse membership of the group gave rise to spirited discussions on numerous issues, including such fundamental topics as the proper role and scope of a director's authority, management's responsibility for governance and the relationship between a shareholder's trading activities, voting decisions and governance. The Commission also reviewed the numerous governance changes that have occurred over the last decade, and the impact of these changes on how directors view their job as well as their relationship to management and shareholders. As the Commission reviewed these issues, it recognized that despite a number of high profile governance issues over the last decade, the current governance system generally works well. Ultimately, and notwithstanding the broad diversity of views among the various Commission members, the Commission was able to achieve a consensus on a number of principles, which are summarized below and detailed in Section IV below:

#### Principle 1

***The board's fundamental objective should be to build long-term sustainable growth in shareholder value for the corporation, and the board is accountable to shareholders for its performance in achieving this objective.***

This is an important first principle to guide corporate boards at this time because boards have come under increased pressure in recent years as shareholders with competing interests and investment time horizons have sought to influence corporate behavior. The Commission believes that a board has the responsibility, subject to its fiduciary duties, to steer the corporation towards policies supporting long-term sustainable growth in shareholder value. It follows that corporate policies which encourage excessive risk-taking for the sake of short-term increases in stock price performance are inconsistent with sound corporate governance. Additionally, the board and management should establish compensation plans that incorporate goals aligned to various degrees based upon long-term value creation. Consistent with this principle, it is also important for the corporation to establish relationships with a core base of long-term oriented investors who understand the corporation's long-term strategy and recognize that long-term decisions by their very nature will take time to produce results. While many factors other than board performance may affect long-term shareholder value, the Commission believes that shareholders have the right and responsibility to hold a board accountable for its performance in achieving long-term sustainable growth in shareholder value.

## Principle 2

***While the board's responsibility for corporate governance has long been established, the critical role of management in establishing proper corporate governance has not been sufficiently recognized. The Commission believes that a key aspect of successful governance depends upon successful management of the company, as management has primary responsibility for creating an environment in which a culture of performance with integrity can flourish.***

In recent years the debate over what constitutes “good” corporate governance has focused upon the board’s scope of authority and the proper relationship between the board and shareholders. This discussion may improperly ignore the critical role of management in corporate governance. The Commission believes that successful governance depends heavily upon honest, competent and industrious managers. Management’s role in corporate governance includes, among other things, establishing and monitoring processes and procedures for risk management and proper internal controls, as well as evaluating executive talent according to high ethical standards, having systems for open internal communication about problems without the fear of retaliation, and promoting accountability through tailored incentive compensation that encourages, among other things, disciplined and transparent risk taking. Management’s role also includes providing accurate information to the board and developing and communicating the corporation’s strategic plan to shareholders and the market. Consistent with this principle, management should understand that directors may need access to various sources of information in order to fully understand the viewpoints of all major constituencies, and may also disagree with management over strategy or decisions, and that this “constructive tension” between the board and management is a characteristic of good corporate governance so long as debate is conducted within the context of a collegial and productive discussion.

## Principle 3

***Shareholders have the right, a responsibility and a long-term economic interest to vote their shares in a thoughtful manner, in recognition of the fact that voting decisions influence director behavior, corporate governance and conduct, and that voting decisions are one of the primary means of communicating with companies on issues of concern.***

The Commission believes that the right to vote the shares of a company is a basic right and duty of share ownership, and that shareholders should vote their shares in a reasoned and responsible manner. This is even more important now because of the significantly increased ability of shareholders to influence corporate conduct, including through the election of directors. Consistent with this principle, institutional investors should establish and disclose their corporate governance guidelines and general voting policies. These investors should also engage in

dialogue with companies on their corporate governance and voting policies, processes and philosophy. The Commission also recognizes the need that some institutional investors have to use third party proxy advisory services, and while this decision should generally be left to the discretion of the institution, the Commission believes that such a decision does not relieve institutions from discharging their responsibility to vote constructively, thoughtfully and in alignment with the interests of their clients.

#### Principle 4

***Good corporate governance should be integrated with the company's business strategy and objectives and should not be viewed simply as a compliance obligation separate from the company's long-term business prospects.***

The Commission believes that sound corporate governance should be a core element of a company's business strategy, as it includes independent and objective oversight of strategy and management by boards; alignment of interests among shareholders, management and the board; accountability of the board to shareholders and accountability of management to the board; compensation programs that incentivize long-term growth; establishment of criteria that are aligned with the company's business goals; prudent risk management; a culture of integrity; and consideration of the impact of the corporation's activities on society overall. Corporate governance thus must be seen as an integral part of the basic operation of the corporation, and not just a compliance obligation. Yet there is a risk that the number of new governance mandates and "best practice" recommendations over the last decade can lead even the best boards to adopt a "check the box" mentality when trying to adopt and comply with certain corporate governance requirements. This risk is increased by the reality that being a director is still generally not considered a full-time job, and that directors must also have the time to address issues in addition to monitoring and oversight.

#### Principle 5

***Legislation and agency rule-making are important to establish the basic tenets of corporate governance and ensure the efficiency of our markets. Beyond these fundamental principles, however, the Commission has a preference for market-based governance solutions whenever possible.***

The Commission recognizes that legislation and appropriate rulemaking are critical to ensuring that fundamental principles of corporate governance are established and maintained. However, the Commission believes over-reliance on legislation and agency rulemaking may not be in the best interests of shareholders, companies or society. The Commission believes that corporate governance problems can and should be constructively solved through collaboration and dialogue resulting in market-based reforms. This approach results in practices that are customized to individual companies, providing more flexibility, as well as more practical and sustainable solutions. As set forth in Principle 3, shareholders should not be regarded

as adversaries of a company; rather, all corporate constituencies should be encouraged toward a common goal of building companies that generate value over an extended period of time. The Commission believes that ideally legislation and rule-making should operate to set broad principles that encourage such collaboration and dialogue among the corporate constituencies.

#### Principle 6

***Good corporate governance includes transparency for corporations and investors, sound disclosure policies and communication beyond disclosure through dialogue and engagement as necessary and appropriate.***

The Commission recognizes that transparency is a critical element of good corporate governance, and that companies should make regular efforts to ensure that they have sound disclosure policies and practices. While disclosure is the primary method of communication with shareholders, the Commission understands that, where appropriate, management or directors should engage in direct dialogue with investors on governance, performance or strategy concerns. Companies and shareholders should develop best practices to ensure that such conversations are meaningful to the participants, result in increased understanding and trust among boards, shareholders and management, and are conducted in compliance with applicable rules and regulations. Investors should also be held to appropriate levels of transparency and be required to disclose holdings, including derivative or other security ownership, on a timely and equal basis, subject to the recognition that certain information relating to trading and investment strategies may be proprietary.

#### Principle 7

***While independence and objectivity are necessary attributes of board members, companies must also strike the right balance between the appointment of independent and non-independent directors to ensure that there is an appropriate range and mix of expertise, diversity and knowledge on the board.***

The Commission fully supports the NYSE's listing requirements on the importance and role of independent directors. At the same time, the Commission notes that in recent years it has become common to have the company's CEO as the only non-independent director on the board. The Commission recognizes that the NYSE's listing requirements do not limit a board to only one non-independent director, and believes that the appointment of a minority of directors who possess in-depth knowledge of the company and its industry could be helpful for the board as it assesses the company's strategy, risk profile, competition and alternative courses of action. The Commission does not wish to imply that an independent director cannot have equally deep knowledge of the company as a non-independent director. Rather, the Commission believes that, as provided for under the NYSE's listing standards, a properly functioning board can include more than one non-independent director.

## Principle 8

***The Commission recognizes the influence that proxy advisory firms have on the market, and believes that such firms should be held to appropriate standards of transparency and accountability. The Commission commends the SEC for its issuance of the Concept Release on the U.S. Proxy System, which includes inviting comments on how such firms should be regulated.***

Although many large investors use proxy advisory services primarily as a source of information and research, that is not necessarily the practice of all institutional investors, and there is an increased level of concern regarding the impact of advisory firms. As a result, the Commission believes that the SEC should engage in a study of the role of proxy advisory firms to determine their potential impact on, among other things, corporate governance and behavior and consider whether or not further regulation of these firms is appropriate. At a minimum, such firms should be required to disclose the policies and methodologies that the firms use to formulate specific voting recommendations, as well as all material conflicts of interest, and to hold themselves to a high degree of care, accuracy and fairness in dealing with both shareholders and companies by adhering to strict codes of conduct. The advisory services should also be required to disclose the company's response to its analysis and conclusions.

## Principle 9

***The SEC should work with the NYSE and other exchanges to ease the burden of proxy voting and communication while encouraging greater participation by individual investors in the proxy voting process.***

The SEC should work with all parties to the proxy system to ensure that companies and investors are able to communicate about proxy voting issues on a timely basis without undue costs or burdens, recognizing that there are privacy and other concerns from investors regarding the proprietary nature of their investment strategies. As a part of this process, the Commission believes that the SEC should establish a committee of market participants and outside experts, including representatives of the various constituencies, to consider its recent concept release on improving the proxy process. In addition, in light of the declining participation of individual investors in recent years, the SEC should consider whether there are more effective and efficient ways for individual investors to participate in the system, as well as providing such investors with pertinent information to help ensure they make informed decisions.

## Principle 10

***The SEC and/or the NYSE should consider a wide range of views to determine the impact of major corporate governance reforms on corporate performance over the last decade. The SEC and/or the NYSE should also***



***periodically assess the impact of major corporate governance reforms on the promotion of sustainable, long-term corporate growth and sustained profitability.***

As summarized in Section III of this Report, the past decade has seen a significant amount of regulatory and other initiatives designed to improve corporate governance with the goal of improving performance. The Commission recognizes that it is difficult to measure the impact of corporate governance regulations given that performance is impacted by many factors. Nevertheless, the Commission believes that because of the significance of these reforms, and because of the numerous entities involved in regulating corporate governance in the United States, the SEC and other regulators should consider a wide range of views and perspectives before adopting new regulations, including the practical implications of new regulations on directors' ability to perform their existing duties, the potential costs and benefits to the company and its shareholders and the efficacy of existing regulations. The Commission notes that being a director is not a full-time job, and that creating new mandates risks limiting the time directors can spend on other tasks. Accordingly, the Commission believes the SEC should also consider the expanded use of "pilot" programs, including the use of "sunset provisions," and phased-in implementation dates to identify any implementation problems before a program is fully rolled out.

The next section of this Report describes our charter, the membership of the Commission and a brief review of the process leading to our detailed principles. Section III reviews some of the most significant developments in corporate governance and the broader market in the last decade that have put significant strains on traditional concepts of corporate governance. Section IV contains our specific principles, including detailing the separate principles applicable to the board, management and shareholders.

## II. THE COMMISSION AND ITS WORK

On September 1, 2009, the NYSE announced that it would form the Commission on Corporate Governance to address U.S. corporate governance and the proxy process.<sup>1</sup> In creating the Commission the NYSE explicitly sought to include a diverse group of governance experts, including representatives of issuers, investors and others with significant backgrounds and experience in corporate governance and related issues. The NYSE selected Larry W. Sonsini, chairman of the law firm Wilson Sonsini Goodrich & Rosati, who had been chair of the Proxy Working Group and a member of the NYSE's Corporate Accountability and Listing Standards Committee, as Chairman of the Commission. The members of the Commission are as follows:<sup>2</sup>

Larry Sonsini (Chair)	Chairman, Wilson Sonsini Goodrich & Rosati, P.C.
Andrew Bonzani	Vice President, Assistant General Counsel & Secretary, International Business Machines Corp.
Glenn Booraem	Principal, Vanguard Group
Kristin Campbell	Senior Vice President, General Counsel & Corporate Secretary, Staples Inc.
Douglas Chia	Assistant General Counsel & Corporate Secretary, Johnson & Johnson
Hye-Won Choi	Senior Vice President, Corporate Governance, TIAA-CREF
Peter Clapman	Chairman and President, Governance for Owners USA, Inc.
Scott Cutler	Executive Vice President, Head of Listings - Americas, NYSE Euronext
James Duffy	Interim Chief Executive Officer, NYSE Regulation (retired)
Lorna Ferguson	Managing Director - Fund Governance, Nuveen Investments
Matthew Furman	Senior Vice President, Group General Counsel - Corporate & Governance & Corporate Secretary, The Travelers Companies, Inc.
Gary Glynn	President, U.S. Steel & Carnegie Pension Fund
Cary Klafner	Vice President, Legal & Corporate Affairs; Director of Corporate Legal & Corporate Secretary, Intel Corporation
Mark Kleinman	Vice President, Corporate Secretary & Chief Compliance Officer, Pioneer Natural Resources Company
Ellen Koplow	Executive Vice President, General Counsel, and Corporate Secretary, TD Ameritrade Holding Corp.
Daniel Kosowsky	Managing Director, Legal, Morgan Stanley

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<sup>1</sup> See Press Release, "NYSE Forms 'Commission on Corporate Governance' to Examine U.S. Corporate Governance" (Sept. 1, 2009) and Press Release, "NYSE Completes Formation of 'Commission on Corporate Governance'" (Nov. 12, 2009), both available at <http://www.nyse.com/about/listed/1265973393069.html>.

<sup>2</sup> Titles are listed for identification purposes only. Benjamin Heineman, Jr., Distinguished Senior Fellow - Program on Legal Profession, Harvard Law School and the former General Counsel of GE, was an early Commission member, but he had to reduce his role with the Commission due to his other time commitments. The Commission is grateful for his efforts and support. The Commission also wishes to acknowledge the staff of the NYSE who provided valuable assistance to the Commission in its work, as well as Martin Cohen, Managing Director and Corporate Secretary of Morgan Stanley, for his contributions.

Stephen Lamb	Partner, Paul, Weiss, Rifkind, Wharton & Garrison LLP
Don Liu	Senior Vice President, General Counsel & Corporate Secretary, Xerox Corp.
Michael McAlevey	Vice President & Chief Corporate, Securities & Finance Counsel, General Electric Co.
Peter Mixon	General Counsel, California Public Employees' Retirement System
Stephen Norman	President, S.P. Norman and Co.
Beverly O'Toole	Managing Director & Associate General Counsel, Goldman Sachs Group Inc.
James Parsons	Coordinator—Corporate Securities & Finance, Exxon Mobil Corporation
Richard Sandler	Partner, Davis Polk & Wardwell LLP
Carol Schwartz	Secretary & Corporate Governance Officer, American Express Co.
Kurt Stocker	Professor - Medill School of Journalism, Northwestern University
Paul Washington	Senior Vice President, Deputy General Counsel, & Corporate Secretary, Time Warner Inc.

David J. Berger, Partner, Wilson Sonsini Goodrich & Rosati, served as counsel to the Commission. Richard C. Blake, Vijaya V. Gadde and Katherine Henderson of Wilson Sonsini Goodrich & Rosati worked with Mr. Berger in advising the Committee.

The Commission's Mission Statement, which is included in its entirety in Appendix A, indicated, among other things, that it would:

address U.S. corporate governance reform and the overall proxy voting process for publicly traded entities [and] take a comprehensive look at the multitude of issues facing Directors, Management, Stockholders, regulators and other constituencies in the on-going public debate about best practices for corporate governance.

The Commission met formally eight times beginning in October 2009. In February 2010, the Commission formed three sub-committees: a Sub-Committee on the role and responsibilities of the Board of Directors, chaired by Richard Sandler; a Sub-Committee considering the duties and responsibilities of Management in Corporate Governance, chaired by Michael McAlevey; and a Sub-Committee examining the role of Shareholders in governance, chaired by Peter Mixon. The sub-committees were tasked with developing principles of corporate governance applicable to each group. Each sub-committee met several times to develop, discuss and review principles of corporate governance relevant to boards, management and shareholders, respectively. The Commission is particularly grateful to the chairs of these sub-committees for their efforts in leading the sub-committees.

### III. SUMMARY OF SIGNIFICANT CORPORATE GOVERNANCE DEVELOPMENTS SINCE 2000

The first decade of the 21<sup>st</sup> century has seen multiple turbulent cycles in our nation's financial markets, widespread changes in shareholdings of public companies, and technological advances affecting listed companies and the manner in which their securities are traded. Separately and together these factors have contributed to a decade of sweeping and almost continuous changes in corporate governance rules, regulations and practices, as well as public company disclosure requirements. These factors have fundamentally affected the way public company boards and board committees interact with shareholders, management, regulators, the public and themselves.

In order to understand the state of corporate governance practices today, the Commission believes that one must first recognize the dramatic changes that have occurred over the last decade as well as the environment in which the various actors in the corporate governance community find themselves today. These changes created some confusion about what constitutes "good governance," as definitions of "best practices" often changed on an annual basis, bringing about a range of views regarding how corporations should act and what the proper standards of conduct are. Yet fundamental concepts of governance remain tied to certain key principles, and these principles are designed to assist and incentivize management and boards to make good decisions and disclose the rationale for such decisions.

#### A. *Turbulent Financial Markets*

In early 2000, U.S. stock markets peaked after five years of increases driven to a large extent by the market growth of information technology companies. The so-called "tech bubble" led the Dow Jones Industrial Average to a then high of 11,722.98 on January 14, 2000, while just two months later, on March 10, 2000, the NASDAQ peaked at 5,132.52. However, the tech bubble burst soon thereafter, and by 2001 the Dow traded below 8,500, and the NASDAQ, which dropped by over 70%, traded below 1,500. The number of U.S. initial public offerings ("IPOs") severely contracted after 2000 as well. According to one source that tracks U.S. IPOs, in 1999 there were 486 IPOs that raised approximately \$92.6 billion, and in 2000 there were 407 IPOs that raised approximately \$97.0 billion. In 2001, in contrast, there were only 86 IPOs, which raised a mere \$41.3 billion.<sup>3</sup>

The markets were still roiling in the turmoil of the bursting of the tech bubble when the terrorist attacks of September 11, 2001, occurred. As a result of these attacks, the NYSE and other U.S. markets were closed until September 17, 2001. Despite the

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<sup>3</sup> See Renaissance Capital, "IPO Pricings," available at <http://www.renaissancecapital.com/ipohome/press/ipovolume.aspx> (hereinafter "IPO Data"); see also Stephen M. Bainbridge, "The Creeping Federalization of Corporate Law," 26 Regulation 26 (2003) ("The new millennium has not been kind to Wall Street. In 2000-'01, the stock market recorded back-to-back years of losses for the first time since 1973-'74. With a further loss in 2002, the market fell for three consecutive years for the first time since the Great Depression.").

resiliency and cooperation of the NYSE and its member firms to re-open the exchange under incredibly difficult circumstances,<sup>4</sup> on September 17, 2001, the Dow Jones Industrial Average suffered its steepest single day point decline to date.<sup>5</sup> The U.S. capital markets were shortly to suffer additional shocks as a result of the corporate scandals at companies such as Enron and WorldCom. These scandals led to some very large bankruptcies and declining investor confidence in the capital markets, public companies and the public accounting profession. In addition, these scandals led to new legislation and regulation, as described in Section III.C below.<sup>6</sup> In some respects, the markets are still recovering from these shocks, as the NASDAQ has barely reached half of its March 2000 high, and maintaining investor confidence continues to be a challenge today.

The middle of the decade saw a rebound in the capital markets, with higher market indices and greater U.S. IPO activity from 2004 to 2006 than from 2001 to 2003.<sup>7</sup> By 2007, the Dow Jones Industrial Average re-achieved the levels it had obtained in 2000, and 2007 IPO activity was robust.<sup>8</sup>

The market recovery peaked in 2007, however, and the financial crisis of 2008 led to what many believe was the deepest recession since the Great Depression. At its nadir, the Dow Jones Industrial Average hit a 12-year low of approximately 6,600 in March 2009, while the number of U.S. IPOs in 2008 and 2009 reached another low for the decade, with the total IPOs in 2008 just half the number of such offerings in 2001.<sup>9</sup> While the causes of the financial crisis and recession are beyond the scope of the Commission's work,<sup>10</sup> their implications cannot be ignored, particularly insofar as the crisis spawned multiple calls for improved corporate governance and also gave rise to a question of confidence by investors.

The twin bear markets of the decade left one commentator to remark: "In nearly 200 years of recorded stock-market history, no calendar decade has seen such a dismal performance as the 2000s."<sup>11</sup> According to data prepared by the Yale International

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<sup>4</sup> See, e.g., Peggy Noonan, "Lessons Learned from the Recovery of 2001," Wall Street Journal, Apr. 10, 2009.

<sup>5</sup> See NYSE, "NYSE Timeline," available at [http://www.nyse.com/about/history/timeline\\_2000\\_Today\\_index.html](http://www.nyse.com/about/history/timeline_2000_Today_index.html).

<sup>6</sup> See "President Bush Signs Corporate Corruption Bill," available at <http://georgewbush-whitehouse.archives.gov/news/releases/2002/07/20020730.html>; "President's Ten-Point Plan," available at <http://georgewbush-whitehouse.archives.gov/infocus/corporateresponsibility/index2.html>; Paul S. Atkins, "The Sarbanes-Oxley Act of 2002: Goals, Content, and Status of Implementation," available at <http://www.sec.gov/news/speech/spch032503psa.htm>.

<sup>7</sup> See IPO Data, *supra* note 3.

<sup>8</sup> See *id.*

<sup>9</sup> See *id.* For other comparative economic data regarding the recession, see Financial Crisis Inquiry Commission, "Selected Financial Market & Economic Data" (Jan. 13, 2010), available at <http://fcic.gov/reports/pdfs/2010-0113-EconomicData.pdf> (hereinafter "Selected Data").

<sup>10</sup> Many other sources have chronicled, or are in the process of reviewing, the potential causes. The place to start for a review of these issues is the Financial Crisis Inquiry Commission, which was created by Congress to investigate the causes. See Fraud Enforcement and Recovery Act of 2009, § 5(a), Pub. L. No. 111-21 (S. 386), and <http://fcic.gov/>; see also Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee (Aug. 18, 2009), n. 86 (hereinafter "ABA Report").

<sup>11</sup> Tom Lauricella, "Investors Hope the '10s Beat the '00s," Wall Street Journal, Dec. 20, 2009.

Center for Finance, annual returns from the beginning of 2000 to the end of 2009 for a broad measure of stock ownership was -0.5%, compared to 16.6% in the 1980s and 17.6% in the 1990s.<sup>12</sup> This was the poorest performance in a single decade for more than 80 years, as even the 1930s depression-era decade performed at a better level, losing only -0.2% over the course of the decade.<sup>13</sup>

Market volatility has continued into 2010. After a year-long bull market, worries about the pace and sustainability of the U.S. economic recovery and concerns about the European economy have resulted in what some are calling a market correction, and the Dow Jones Industrial Average recently experienced its greatest intraday and single day point decline ever, with even more market volatility predicted for the near future.<sup>14</sup>

*B. Dramatic Changes in Shareownership and Shareholdings of Publicly Traded Companies*

The first decade of the 21<sup>st</sup> century also brought about widespread changes in the composition and influence of shareholders of publicly traded companies. These changes impacted the way shareholders own, hold and trade shares, as well as the relationship between and among directors, shareholders and management.

For example, the decade saw an increasing trend away from individual stock ownership towards institutional ownership. While individuals directly held over 93% of U.S. equities in 1950, by 2006 that amount had fallen to approximately 33%, and by 2009, had decreased further to about 25%.<sup>15</sup> At the same time, institutional investor ownership of U.S. equities dramatically increased, particularly of the companies with the largest market capitalizations.<sup>16</sup>

The growth of institutional ownership, as well as changes in trading technology, brought a dramatic increase in trading volumes and a corresponding decline in the amount of time individual stocks are held. For example, studies estimate mutual fund turnover to be about 100% annually, with hedge fund turnover as high as 300%

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<sup>12</sup> See *id.*

<sup>13</sup> See *id.*

<sup>14</sup> See Tom Lauricella, "Market Plunge Baffles Wall Street," *Wall Street Journal* (May 7, 2010) at A1; see also Emma Moody, "Dow's Worst May Since '40," *Wall Street Journal* (May 29, 2010) at A1; Brett Arends, "May's Big Selloff Could Be Just the Beginning," *Wall Street Journal* (May 30, 2010).

<sup>15</sup> See ABA Report, *supra* note 10, at 15; see also The Aspen Institute, "Overcoming Short-termism" (Sept. 9, 2009), at 2, available at [http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/overcome\\_short\\_state0909\\_0.pdf](http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/overcome_short_state0909_0.pdf) (hereinafter "Short-termism"); The Aspen Institute, *Long-Term Valuation Creation: Guiding Principles for Corporations and Investors* (June 2007), available at [http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/Aspen\\_Principles\\_with\\_signers\\_April\\_09.pdf](http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/Aspen_Principles_with_signers_April_09.pdf).

<sup>16</sup> See ABA Report, *supra* note 10, at 15; John C. Bogle, Reflections on "Toward Common Sense and Common Ground?" 33 *Iowa J. Corp. L.* 31, 31 (2007).

annually.<sup>17</sup> Annualized turnover of stocks traded on the NYSE is now estimated to be over 100%, which means that on average an NYSE-listed company experiences trading volume each year exceeding the total number of its issued and outstanding shares.<sup>18</sup> The rapid trading system raises significant governance and strategic issues for officers and directors of public companies; yet the Commission believes that to the extent this creates questions for directors, it should be clear that their duties are to the long-term interests of the corporation and its owners. Markets by their very nature provide liquidity and involve some degree of turnover and short-term holdings. While some investors' strategies have resulted in significant turnover, other key constituencies maintain long-term ownership characteristics. Consistent with their fiduciary duties, boards should be free to consciously and transparently adopt policies favoring the interests of long-term owners.<sup>19</sup>

Institutional investors themselves have become a more diverse group with varied objectives and strategies, ranging from: insurance companies and pension funds, with generally longer-term investment motivations; mutual funds, with medium range investment focus but which must also look at the quarterly metrics by which they are often measured; and hedge funds, "with a time horizon potentially measured in minutes."<sup>20</sup> Institutional investors hold shares of publicly traded companies on behalf of their clients or investors, a phenomenon one leading commentator described as the "separation of ownership from ownership,"<sup>21</sup> and potentially leading to conflicts between their own interests, the interests of their investors, and the interests of their portfolio companies.<sup>22</sup> In addition to differences in general holding periods and investment strategies, institutional investors may differ in a number of other key ways, such as the level of government regulation to which they are subject, their level of interest in the corporate governance of their portfolio companies, the degree to which political or social policy factors may influence their decision-making or voting decisions, and their level of corporate activism (both litigation and non-litigation based).<sup>23</sup> This diversity can lead corporations responding to shareholder pressure or demands left wondering: are we

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<sup>17</sup> See Leo E. Strine, "The Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?" (Apr. 8, 2010), at 9.

<sup>18</sup> See Bogle, *supra* note 16, at 33. While some large capital companies may have a relatively stable core of ownership by index funds and other long term holders, it is the remaining shares which may change hands even more frequently.

<sup>19</sup> See Damon Silvers, "Commentary on 'Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance' by Leo E. Strine, Jr.," 33 *Iowa J. Corp. L.* 85, 87 (2007); see also Iman Anabtawi, "Some Skepticism About Increasing Shareholder Power," 53 *UCLA L. Rev.* 561, 579-80 (2006).

<sup>20</sup> See ABA Report, *supra* note 10, at p. 18-19; Strine, *supra* note 17, at 8-15.

<sup>21</sup> Leo E. Strine, Jr., "Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance," 33 *Iowa J. Corp. L.* 1 (2007); see also Strine, *supra* note 17, at 8-15.

<sup>22</sup> See ABA Report, *supra* note 10, at 18; Strine, *supra* note 17, at 9-10; Short-termism, *supra* note 15.

<sup>23</sup> See ABA Report, *supra* note 10, at 18-20; Stephen J. Choi and Jill E. Fisch, "On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance," 61 *Vand. L. Rev.* 315 (2008); John J. Brennan, "Improving Corporate Governance: A Memo to the Board," *Wall Street Journal* (May 10, 2010) (describing Vanguard's approach to corporate governance matters).

responding to the interests of our shareholders generally or to the voices of the vocal minority?<sup>24</sup>

Another development in the last decade is the proliferation of derivative or synthetic securities and hedging transactions.<sup>25</sup> Often these securities or transactions are employed for good economic reasons, but derivative positions are also used in connection with takeover scenarios,<sup>26</sup> as well as shareholder voting campaigns, whereby investors gain the ability to vote shares while effectively having no economic interest in those shares (referred to as “empty voting”).<sup>27</sup>

Regulators and courts in both the U.S. and Europe have begun to scrutinize empty voting and its implications for corporations in those jurisdictions.<sup>28</sup> For example, the Delaware Supreme Court recently examined a potential empty voting situation, stating: “For many years, Delaware decisions have expressed consistent concerns about transactions that create a misalignment between the voting interest and the economic interest of shares. As then Vice-Chancellor (now Chief Justice) Steele explained, generally speaking, courts closely scrutinize vote-buying because a shareholder who divorces property interest from voting interest fails to serve the community of interest among all shareholders, since the bought shareholder votes may not reflect rational, economic self-interest arguably common to all shareholders.”<sup>29</sup> The court in that case did not find that there was improper vote buying because the economic interests and the voting interests of the shares remained aligned. The court also reaffirmed its concern about the use of corporate resources to purchase votes, as well as about the use of fraud or the exploitation of inside information to influence elections.<sup>30</sup>

More recently, in its “proxy plumbing” concept release, the SEC acknowledged that empty voting and the “decoupling” of economic and voting interests “raises practical and theoretical considerations for voting of shares.”<sup>31</sup> The SEC has asked for comments

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<sup>24</sup> See ABA Report, *supra* note 10, at 18-20; Short-termism, *supra* note 15.

<sup>25</sup> See, e.g., Chester S. Spatt, “The Growth of Derivative Securities” (Dec. 8, 2005), available at <http://www.sec.gov/news/speech/spch120805css.htm>; Mark C. Brickell, “In Defense of Over-the-Counter Derivatives,” *Wall Street Journal* (May 14, 2010).

<sup>26</sup> See Floyd Norris, “Porsche Reinvents the Short Squeeze,” *New York Times* (Oct. 30, 2008).

<sup>27</sup> The leading academic scholarship on this issue was a series of articles by Professors Hu and Black. See, e.g., Henry T. Hu and Bernard Black, “The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership,” 79 *S. Cal. L. Rev.* 811 (2006); *see also* Marcel Kahan and Edward Rock, “The Hanging Chads of Corporate Voting,” 96 *Georgetown L.J.* 1227, 1265-68 (2008). In 2009 Professor Hu was named as the first director of the SEC’s Division of Risk, Strategy and Financial Innovation. See <http://www.sec.gov/news/press/2009/2009-199.htm>.

<sup>28</sup> See Committee of European Securities Regulators, Consultation Paper, “CESR Proposal to Extend Major Shareholding Notifications to Instruments of Similar Economic Effect to Holding Shares and Entitlements to Acquire Shares” (Jan. 2010); “Statement of the European Corporate Governance Forum on Empty Voting and Transparency of Shareholder Positions” (Feb. 20, 2010).

<sup>29</sup> *Crown EMAK Partners, LLC v. Kurz*, No. 64, 2010 (Del., Apr. 21, 2010), at 25 (quotations, citations and alterations omitted).

<sup>30</sup> See *id.* at 22-28.

<sup>31</sup> “Concept Release on the U.S. Proxy System,” Release No. 34-62495 (July 14, 2010) at 139 (hereinafter “Proxy Plumbing Release”).



from interested parties on the implications of empty voting and the advisability of various proposed regulatory responses.

The last decade also saw the rise of proxy advisory services, whose growth was spurred by earlier rulings by the Department of Labor (relating to ERISA-governed pension plans)<sup>32</sup> and the SEC (relating to registered investment advisors)<sup>33</sup>, which made clear that certain institutional investors had a duty under applicable regulations to vote shares in corporate elections. While proxy advisory services can significantly reduce the logistical burdens for their institutional clients by streamlining the voting process for them, some commentators have questioned whether they use a “one-size-fits all” approach when making voting recommendations,<sup>34</sup> and have noted the considerable influence such services can have in corporate elections, and by extension, over corporate policy making.<sup>35</sup> For example, some such firms have policies that recommend a vote against a director in the annual director election if during the previous year the director voted in favor of certain corporate actions,<sup>36</sup> leading some boards to ask before approving certain actions, “What are the proxy advisory firms’ policies on this action?” Recognizing the increasing use of proxy advisory firms and noting the concerns many commentators have raised about such firms,<sup>37</sup> the SEC solicited comments in its “proxy plumbing” concept release regarding whether such firms should be subject to greater oversight by regulators.<sup>38</sup>

The Commission recognizes that a proxy advisory firm’s policies should represent, at least to some extent, the views of their clients and may also provide meaningful input for directors. At the same time, the Commission believes that it is critical for investors, particularly institutional investors, to exercise independent judgment and thought with respect to specific companies, and to vote on the merits of the specific situation rather than on a “one-size-fits-all” or with a “check the box” mentality.

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<sup>32</sup> See Letter from U.S. Dep’t of Labor to Helmut Fandl, Chairman of Retirement Board, Avon Products, Inc. (Feb. 23, 1988).

<sup>33</sup> See Proxy Voting by Investment Advisors, 68 Fed. Reg. 6585 (Feb. 7, 2003) (“The duty of care requires an adviser with proxy voting authority to monitor corporate events and to vote the proxies. To satisfy its duty of loyalty, the adviser must cast the proxy votes in a manner consistent with the best interest of its client and must not subrogate client interests to its own” (internal citations omitted)).

<sup>34</sup> Charles Nathan, “The Parallel Universes of Institutional Investing and Institutional Voting” (Mar. 2010), available at [http://www.lw.com/upload/pubContent/\\_pdf/pub3446\\_1.pdf](http://www.lw.com/upload/pubContent/_pdf/pub3446_1.pdf); see also Charles Nathan, “Future of Institutional Share Voting: Three Paradigms” (July 2010), available at [http://www.lw.com/upload/pubContent/\\_pdf/pub3617\\_1.pdf](http://www.lw.com/upload/pubContent/_pdf/pub3617_1.pdf).

<sup>35</sup> See Shareholder Coalition, “Coalition Views on Shareholder Communications” (Aug. 13, 2008), at 2-3, available at <http://www.shareholdercoalition.com/CoalitionStatementofPrinciplesFinal81308.pdf>.

<sup>36</sup> See RiskMetrics Group, “2010 U.S. Proxy Voting Guidelines Summary” (Jan. 8, 2010), available at [http://www.riskmetrics.com/sites/default/files/RMG\\_2010\\_US\\_SummaryGuidelines20100108.pdf](http://www.riskmetrics.com/sites/default/files/RMG_2010_US_SummaryGuidelines20100108.pdf); Glass Lewis & Co., “U.S. Proxy Paper Policy Guidelines,” available at <http://www.glasslewis.com/downloads/policies/USPolicyGuidelinesSummary2009.pdf>.

<sup>37</sup> Such concerns include conflicts of interest resulting from providing consulting services to corporations while giving proxy voting recommendations to investment advisors and institutional stockholders, lack of accuracy and transparency in formulating voting recommendations, use of a “one-size-fits-all” approach to governance, lack of regulatory oversight, and dominance in the industry by one proxy advisory firm. See Proxy Plumbing Release, *supra* note 31, at 114-22.

<sup>38</sup> See *id.* at 122-26.

In addition, the Commission recognized the potential issues arising if one proxy advisory firm becomes the sole or dominant firm in the market, and that a number of significant groups have called for greater oversight and regulation of proxy advisory firms.<sup>39</sup>

One effect of the growing influence of both institutional investors and proxy advisory firms has been the dramatic decline in public corporations' use of structural "defensive" measures.<sup>40</sup> For example, in 2005, 47% of S&P 500 companies had declassified boards with annual votes for all directors; in 2006 that number grew to more than half (55%).<sup>41</sup> The number of companies with poison pills shrank each year in the 2000s, and by early 2010, less than 1,000 companies had an active poison pill—the lowest number in over twenty years.<sup>42</sup> As one learned commentator recognized, "stockholders of public companies are no longer passive, weak, and incapable of concerted action."<sup>43</sup> Additionally, in 2006 less than 20% of the S&P 500 companies had adopted some form of majority voting; recent estimates now place that figure at over 70%, a number that can be expected to increase.<sup>44</sup>

Another effect of the increased influence of institutional investors and proxy advisory firms has been the changing role and composition of the board itself. For example, as the role of the board has changed from one of working with management on the corporation's business and strategy to a greater focus on monitoring and oversight,

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<sup>39</sup> See The Society of Corporate Secretaries and Governance Professionals and the National Investor Relations Institute, "Proxy Advisory Services: The Need for More Regulatory Oversight and Transparency," submitted to the Securities and Exchange Commission, Discussion Draft, March 4, 2010 available at <http://www.niri.org/Main-Menu-Category/advocate/Regulatory-Positions/Proxy-Advisory-Services.aspx>; The Millstein Center for Corporate Governance and Performance, Policy Briefing No. 3, "Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry" (Mar. 2, 2009), available at <http://millstein.som.yale.edu/Voting%20Integrity%20Policy%20Briefing%2002%2027%2009.pdf>.

<sup>40</sup> See generally John Laide, "Shareholder Activism Continues to Increase While Takeover Defenses Decline" (Jan. 7, 2008), available at [https://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs\\_20080107.html&rnd=133234](https://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs_20080107.html&rnd=133234); John Laide, "Trend Toward Removing Takeover Defenses Continues" (Jan. 17, 2006), available at [https://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs\\_20060117.html&rnd=808576](https://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs_20060117.html&rnd=808576); ABA Report, *supra* note 10, at 13-14.

<sup>41</sup> See Jared A. Favole, "Big Firms Increasingly Declassify Boards," *Wall Street Journal*, Jan. 10, 2007; see also RiskMetrics Group, "Postseason Report 2009" (Oct. 2009), at 5, available at [http://www.riskmetrics.com/system/files/private/2009\\_PSR\\_Public\\_final.pdf](http://www.riskmetrics.com/system/files/private/2009_PSR_Public_final.pdf) (showing number of shareholder proposals calling for declassified boards for 2007 through 2009, as well as level of shareholder support for such proposals) (hereinafter "2009 RiskMetrics Report").

<sup>42</sup> See John Laide, "A New Era in Poison Pills - Specific Purpose Poison Pills" (Apr. 1, 2010), available at [https://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs\\_20100401.html&Specific\\_Purpose\\_Poison\\_Pills&rnd=691644](https://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs_20100401.html&Specific_Purpose_Poison_Pills&rnd=691644).

<sup>43</sup> Strine, *supra* note 17, at 10; see also ABA Report, *supra* note 10, at 11, 16.

<sup>44</sup> See Claudia H. Allen, "Study of Majority Voting in Director Elections" (Nov. 12, 2007), available at <http://www.ngelaw.com/files/upload/majoritystudy111207.pdf>; "CalPERS Seeks Majority Vote Standard at Top Publicly Traded Companies" available at <http://www.calpers-governance.org/marketinitiatives/initiatives/press-releases/majority-vote-standard>; see also 2009 RiskMetrics Report *supra* note 41 at 5 (showing number of shareholder proposals calling for majority voting in director elections for 2007 through 2009, as well as level of shareholder support for such proposals).

particularly with respect to legal and regulatory issues, the importance and number of independent directors on a board have increased. Thus less than 20 years ago approximately 40% of boards were composed of insiders or other individuals affiliated with the corporation, such as someone affiliated with the corporation's bank, law firm, customer or supplier; in contrast, recent studies of large public companies show that more than 90% of boards today have two or fewer non-independent directors.<sup>45</sup>

The combined effect of these measures raises the potential for a misaligned incentive system for directors. For example, while directors are supposed to take action in the long-term interests of shareholders, the combination of the decline in classified boards and rise in majority voting requirements has resulted in directors facing increasing pressure to take actions that are primarily intended to increase stock price in the short term if the directors want to obtain the support of investors who focus on annual stock price increases. Additionally, investors who measure results by quarterly returns, as well as managements who are compensated on the basis of short-term results, can magnify the pressure on directors to maximize short-term stock price at the expense of long-term planning.

### C. *Increased Corporate Governance and Disclosure Regulation*

The past decade also saw widespread regulatory changes imposing substantial additional disclosure and/or governance requirements on public companies. The following list summarizes the most significant of the regulations adopted in the last decade; a more complete list is contained in Appendix B.

- Sarbanes-Oxley Act of 2002.<sup>46</sup> This Act, adopted in the wake of the accounting fraud scandals of Enron and WorldCom, was (at the time it was adopted) the most significant legislation affecting public companies since the securities acts of the 1930s.<sup>47</sup> In some cases, it created direct requirements on public companies; in other cases, it required the SEC to adopt rules affecting issuers; and in others, it required the SEC to require the stock exchanges to adopt listing standards regulating public company corporate governance and public disclosure. In a way not seen since the 1930s, the Sarbanes-Oxley Act also addressed a number of corporate governance matters as a matter of federal law that traditionally had been dealt with as matters of state law.<sup>48</sup> Among other things, the Act:
  - Established the Public Company Accounting Oversight Board, or PCAOB, which regulates the public accounting firms used by listed companies<sup>49</sup>

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<sup>45</sup> See Jeffrey N. Gordon, "The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices," 59 *Stan. L. Rev.* 1465, 1472-76 (2007).

<sup>46</sup> Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.) (hereinafter "Sarbanes-Oxley Act").

<sup>47</sup> See John Bostelman et al., *Public Company Deskbook* (2009) at A2; see also Securities Act of 1933 (15 USC § 77a et seq.); Securities Exchange Act of 1934 (15 USC § 78a et seq.).

<sup>48</sup> See Bainbridge, *supra* note 3, at 26; Jill E. Fisch, "The New Federal Regulation of Corporate Governance," 28 *Harv. J. of L. & Pub. Pol.* 39 (2004).

<sup>49</sup> See Sarbanes-Oxley Act Title I; see also Bostelman, *supra* note 47, at Ch. 24.

- Tightened auditor independence standards, including audit committee pre-approval of fee requirements and auditor rotation requirements<sup>50</sup>
  - Required officer certification of quarterly and annual reports and acceleration of the timing of filing such reports<sup>51</sup>
  - Required forfeiture of certain compensation upon a restatement as a result of misconduct<sup>52</sup>
  - Shortened Section 16 reporting deadlines for executive officers and directors and required electronic Section 16 reporting for such persons<sup>53</sup>
  - Established the need for “real time” reporting rules that expanded the scope of current reports on Form 8-K and generally shortened the filing deadline to four business days<sup>54</sup>
- Other related stock exchange listing standards. Even before the Sarbanes-Oxley Act was adopted, the SEC asked the stock exchanges to review their listed company standards and determine whether enhancements were advisable.<sup>55</sup> In response, the NYSE commissioned the Corporate Accountability and Listing Standards Committee “to review the NYSE’s [then] current listing standards, along with recent proposals for reform, with the goal of enhancing the accountability, integrity and transparency of the Exchange’s listed companies.”<sup>56</sup> That committee recommended a number of corporate governance enhancements,<sup>57</sup> and in the years following, the NYSE<sup>58</sup> adopted listing standard changes, in addition to those required by Sarbanes-Oxley, generally requiring, among other things:
    - Boards consisting of a majority of “independent directors”<sup>59</sup>
    - Regular executive sessions of the independent directors without management directors present<sup>60</sup>
    - Published charters for nominating/governance committees, compensation committees and audit committees, with each committee having specific

<sup>50</sup> See Sarbanes-Oxley Act Title II; see also Bostelman, *supra* note 47, at Ch. 22-23.

<sup>51</sup> See Sarbanes-Oxley Act § 302; see also Bostelman, *supra* note 47, at Ch. 17; SEC Regulation S-K Item 601.

<sup>52</sup> See Sarbanes-Oxley Act § 304; see also Bostelman, *supra* note 47, at § 31:4; “Improper Influence on Conduct of Audits,” Release No. 34-47890 (May 20, 2003).

<sup>53</sup> See Sarbanes-Oxley Act § 403; see also Bostelman, *supra* note 47, at § 11:2.

<sup>54</sup> See Sarbanes-Oxley Act § 409; see also Bostelman, *supra* note 47, at §§ 19:4, 20:1; “Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002,” Release No. 33-8177A (Mar. 26, 2003).

<sup>55</sup> See Report of NYSE Corporate Accountability and Listing Standards Committee at 1, available at [http://www.nyse.com/pdfs/corp\\_govreport.pdf](http://www.nyse.com/pdfs/corp_govreport.pdf) (hereinafter “Committee Report”).

<sup>56</sup> *Id.* at 1.

<sup>57</sup> See *id.* at 2-3.

<sup>58</sup> The Nasdaq Stock Market adopted similar listing standards at approximately the same time.

<sup>59</sup> See NYSE Listed Company Manual § 303A.01-02; Nasdaq Marketplace Rule 5605(a)(2), 5605(b)(1); see also Bostelman, *supra* note 47, at Ch. 3.

<sup>60</sup> See NYSE Listed Company Manual § 303A.03; Nasdaq Marketplace Rule 5605(b)(2); see also Bostelman, *supra* note 47, at § 3:1.3[F].

- responsibility for various matters within their respective subject matter areas<sup>61</sup>
  - Shareholder approval of all equity compensation plans<sup>62</sup>
  - Annual CEO certification of compliance with corporate governance standards<sup>63</sup>
  - Disclosure requirements in annual reports or proxy statements of various corporate governance requirements<sup>64</sup>
  - Website disclosure of certain corporate governance matters<sup>65</sup>
- Other SEC public company disclosure requirements. In the intervening years since the Sarbanes-Oxley Act, and in addition to the rulemaking required by that Act, the SEC has adopted a series of rules and interpretations requiring enhanced disclosure in a number of areas, including:<sup>66</sup>
  - Enhanced MD&A requirements and interpretations<sup>67</sup>
  - Repurchases of an issuer's own securities<sup>68</sup>
  - New executive compensation and related person transaction disclosure rules<sup>69</sup>

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<sup>61</sup> See NYSE Listed Company Manual §§ 303A.04-.07; Nasdaq Marketplace Rule 5605(a)-(e); see also Bostelman, *supra* note 47, at Chs. 4-6.

<sup>62</sup> See NYSE Listed Company Manual § 303A.08; Nasdaq Marketplace Rule 5635; see also Bostelman, *supra* note 47, at Ch. 14.

<sup>63</sup> See NYSE Listed Company Manual § 303A.12; see also Nasdaq Marketplace Rule 5625; Bostelman, *supra* note 47, at Ch. 8.

<sup>64</sup> See NYSE Listed Company Manual §§ 303A.00, .02-05, .07, .09-11; Nasdaq Marketplace Rule 5605(b)(1), (d)(3), (e)(3), 5615(c)(2).

<sup>65</sup> See NYSE Listed Company Manual §§ 303A.04-05, .07(b), .09-10.

<sup>66</sup> In recent years, the staff of the Division of Corporation Finance has also consolidated previously published "telephone interpretations" and "frequently asked questions" regarding a wide variety of securities law and disclosure matters into compliance and disclosure interpretations ("C&DIs"). See "Compliance and Disclosure Interpretations" available at <http://www.sec.gov/divisions/corpfin/cfguidance.shtml>. Hundreds of pages of staff interpretations on over two dozen categories of securities laws topics have been released to date. The C&DIs are updated every few months with additional interpretations. While the C&DIs have not been approved by the SEC and do not carry the force of law, they are an important source of information on how the securities laws should be interpreted.

<sup>67</sup> See "Commission Guidance Regarding Management's Discussion and Analysis of Final Condition and Results of Operations," Release No. 33-8350 (Dec. 19, 2003); "Concept Release Concerning Management's Reports on Internal Control Over Financial Reporting," Release No. 34-54122 (July 11, 2006); see also "Summary by the Division of Corporation Finance of Significant Issues Addressed in the Review of the Periodic Reports of the Fortune 500 Companies," available at <http://www.sec.gov/divisions/corpfin/fortune500rep.htm>; "Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies," Release No. 33-8098 (May 10, 2002) (proposed rule).

<sup>68</sup> See "Purchases of Certain Equity Securities by the Issuer and Others," Release No. 33-8335 (Nov. 10, 2003); see also "Purchases of Certain Equity Securities by the Issuer and Others," Release No. 34-61414 (Jan. 26, 2010) (proposed rule).

<sup>69</sup> See "Executive Compensation and Related Person Disclosure (conforming amendments)," Release No. 33-8732A (Aug. 29, 2006); "Shareholder Approval of Executive Compensation of TARP Recipients," Release No. 34-61335 (Jan. 12, 2010).

- Notice and access and Internet availability of proxy materials for annual meetings, as well as rules regarding shareholder forums<sup>70</sup>
- Enhanced proxy statement disclosure regarding risk management, compensation consultants, background and qualifications of directors, diversity of directors, board leadership structure (including separation of board chair and CEO roles), and real-time disclosure of shareholder meeting results<sup>71</sup>
- Proxy access rules that allow longer-term shareholders or shareholder groups that have held at least 3% of the corporation's stock for at least 3 years to gain access to a corporation's proxy statement and proxy card.<sup>72</sup>

In addition, there are several significant outstanding concept releases that the SEC has not yet acted on but may in the near term:

- “Proxy plumbing.” The SEC recently issued a concept release to solicit comments regarding various aspects of the U.S. proxy system, including: the accuracy, transparency and efficiency of the voting process; shareholder communication and participation; and the alignment of voting power and economic interest.<sup>73</sup>
- Equity market structure. The SEC's concept release on equity markets, released earlier this year, is part of its “conducting a broad review of the current equity market structure,” including “an evaluation of equity market structure performance in recent years and an assessment of whether market structure rules have kept pace with, among other things, changes in trading technology and practices.”<sup>74</sup>
- NYSE Rule 452. In April 2005, the NYSE created the Proxy Working Group (“PWG”) to review the proxy voting process.<sup>75</sup> After a comprehensive, 16-month information-gathering process, the PWG issued its report and recommendations in June 2006.<sup>76</sup> In its report, the PWG gave recognition to the complex and integrated nature of the proxy and shareholder communications process and advocated for a holistic review of the overall proxy process.<sup>77</sup> As part of its recommendation for a holistic approach to reforming the proxy voting process,

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<sup>70</sup> See “Internet Availability of Proxy Materials,” Release No. 34-55146 (Jan. 22, 2007); “Shareholder Choice Regarding Proxy Materials,” Release No. 34-56135 (July 26, 2007); “Electronic Shareholder Forums,” Release No. 34-57172 (Jan. 18, 2008); “Amendments to Rules Requiring Internet Availability of Proxy Materials,” Release No. 33-9108 (Feb. 22, 2010).

<sup>71</sup> See “Proxy Disclosure Enhancements,” Release No. 33-9089 (Dec. 16, 2009); “Proxy Disclosure Enhancements; Correction,” Release No. 33-9089A (Feb. 23, 2010).

<sup>72</sup> See “Facilitating Shareholder Director Nominations,” Release No. 33-9136 (Aug. 25, 2010).

<sup>73</sup> See Proxy Plumbing Release, *supra* note 31.

<sup>74</sup> See “Concept Release on Equity Market Structure,” Release No. 34-61358 (Jan. 14, 2010).

<sup>75</sup> The report is available at [http://www.nyse.com/pdfs/PWG\\_REPORT.pdf](http://www.nyse.com/pdfs/PWG_REPORT.pdf) (hereinafter the “Initial Report”).

<sup>76</sup> See *id.*; see also <http://www.nyse.com/about/listed/1265973393069.html>. The initial report was followed by an addendum, available at <http://www.nyse.com/pdfs/PWGAddendumfinal.pdf> (hereinafter the “Addendum”).

<sup>77</sup> See Initial Report, *supra* note 75, at 3-6.

the PWG recommended that the NYSE move forward to amend NYSE Rule 452 to eliminate the ability of brokers to vote uninstructed shares held in customer accounts in the election of directors even in uncontested elections.<sup>78</sup> In October 2006, the NYSE submitted a rule filing to the SEC seeking to amend Rule 452 as recommended by the PWG.<sup>79</sup> The SEC approved the NYSE's rule filing in July 2009, to take effect for shareholder meetings scheduled to occur on or after January 1, 2010.<sup>80</sup>

- Delaware corporate law changes and considerations. During the first decade of the 21<sup>st</sup> century, a number of changes to the Delaware General Corporation Law (“DGCL”) were made affecting corporations’ governance structure. Among the most significant are the following:
  - “Technology amendments” in 2000 to permit, in a corporation’s bylaws, the use of broader electronic media for a number of board and shareholder purposes<sup>81</sup>
  - Amendments to Section 141 and Section 216 to explicitly permit majority voting in director elections and advanced resignation by directors<sup>82</sup>
  - Amendments to Section 141 to permit corporations to grant certain directors voting rights that differ from or are in addition to those granted to other directors<sup>83</sup>
  - Adoption of Section 112, permitting proxy access bylaws<sup>84</sup>
  - Adoption of Section 113, permitting reimbursement of shareholders’ expenses in proxy contests<sup>85</sup>
  - Amendment to Section 213 to permit dual record dates (partially addressing the empty voting phenomenon)<sup>86</sup>
  - Amendment to Section 145 to clarify when indemnification rights in a corporation’s charter documents “vest”<sup>87</sup>

While a comprehensive survey of Delaware corporate governance jurisprudence in the last ten years is well beyond the scope of this Report, it must be noted that during this period the Delaware courts have continued to closely scrutinize the actions of

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<sup>78</sup> See *id.* at 18, 21; Addendum, *supra* note 76, at 1.

<sup>79</sup> The rule filing, as well as amendments, is available at the NYSE’s website at <http://www.nyse.com/about/listed/1265973393069.html>.

<sup>80</sup> See *id.*

<sup>81</sup> See DGCL §§ 141, 211, 228, and 232 (permitting use of electronic media in various situations); see also F.H. Alexander & L. S. Black, “Analysis of the 2000 Amendments to the Delaware General Corporation Law” (Aspen 2000).

<sup>82</sup> See DGCL §§ 141, 216; see also W.J. Haubert and B.V. Fresco, “2006 Amendments to the Delaware Corporation Law,” *Insights: The Corp. & Sec. L. Advisor* (Aug. 1, 2006).

<sup>83</sup> See DGCL §§ 141; see also M.B. Tumas and J.F. Grossbauer, “2005 Amendments to the Delaware General Corporation Law,” *The Business Law Report*, Vol. 11, No. 3 (Fall 2005).

<sup>84</sup> See DGCL § 112; see also J.R. Wolters and J.D. Honaker, “Analysis of the 2009 Amendments to the Delaware General Corporation Law” (Aspen 2009).

<sup>85</sup> See DGCL § 113; see also Wolters and Honaker, *supra* note 84.

<sup>86</sup> See DGCL § 213; see also Wolters and Honaker, *supra* note 84.

<sup>87</sup> See DGCL § 145; see also Wolters and Honaker, *supra* note 84.

officers and directors, even in the turbulent times in which they have had to serve, to determine whether they are upholding their fiduciary duties to the corporations to which they are entrusted.<sup>88</sup>

- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”).<sup>89</sup> In response to the financial crisis of 2008 and 2009, a number of proposed bills were introduced in the 111<sup>th</sup> Congress addressing financial reform, as well as numerous corporate governance, public disclosure and executive compensation matters, such as say on pay, proxy access, classified boards, majority voting of directors, compensation committee independence, and clawing-back of executive compensation.<sup>90</sup> On July 21, 2010, President Obama signed Dodd-Frank, a comprehensive financial reform bill making sweeping changes to the financial sector.<sup>91</sup> It is reported that Dodd-Frank will require nearly a dozen agencies to engage in over 240 rulemakings and conduct over 65 studies. The corporate governance and executive compensation aspects of Dodd-Frank are certainly not the primary purposes of the legislation; however, they are significant in their own right, including in the manner in which they legislate matters traditionally left to state laws. Among other things, Dodd Frank:
  - Permits the SEC to adopt rules on proxy access, which the SEC subsequently adopted
  - Requires a periodic non-binding vote on named executive officer compensation, as well as approval of “golden parachute” compensation arrangements
  - Mandates enhanced stock exchange listing standards on compensation committee independence and hiring of advisors
  - Requires additional disclosure of the relationship between executive compensation and financial performance, as well as internal pay equity
  - Mandates corporate policies on claw-back of executive compensation in certain circumstances

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<sup>88</sup> A starting point for any review of cases on directors’ duties and the business judgment rule is Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* (6<sup>th</sup> ed. 2009).

<sup>89</sup> Public Law No: 111-203. It is also noteworthy that the Financial Reporting Council, the United Kingdom’s independent regulator responsible for promoting confidence in corporate governance, including through excellent corporate reporting, recently amended the UK Corporate Governance Code to address matters of annual director elections, board composition, board performance, risk management and executive compensation. Certain of these changes, however, only apply to the 350 companies with the largest market capitalizations traded on the London Stock Exchange, and as is widely known, the Code as a whole “is not a rigid set of rules” but rather operates under a “comply or explain” standard. Financial Reporting Council, “The UK Corporate Governance Code” (June 2010).

<sup>90</sup> A short listing of these include the Shareholder Bill of Rights Act, the Excessive Pay Shareholder Approval Act, the Excessive Pay Capped Deduction Act, the Shareholder Empowerment Act, the Corporate and Financial Institution Compensation Fairness Act and the Restoring American Financial Stability Act.

<sup>91</sup> See Kara Rowland, “Historic Wall Street Reform Bill Signed,” *Washington Post* (July 21, 2010).



*D. Evolution of Corporate Governance Principles.*

Given the far-reaching developments affecting corporate governance and public company disclosure during the first decade of the 21<sup>st</sup> century, it should come as no surprise that during that same time period, various organizations, coalitions and groups have released corporate governance studies, white papers, and statements of aspirational ideals of best corporate governance practices. These documents set forth certain core aspects of corporate governance, as seen by the various authoring groups. While not necessarily highlighting any one publication, it seems important to document, among other things, the sheer number of publications expounding best principles and practices of corporate governance (see Appendix C for the most significant of these documents).

Not surprisingly, and as with the widespread developments in law affecting governance and related disclosure obligations, corporations' management and directors have felt a need to stay current with these statements of best practices in the last decade so that they are not seen as falling behind the curve with respect to corporate governance matters.<sup>92</sup> Director education programs have proliferated, in an effort to bring the classroom into the boardroom, while proxy advisory services seem to develop on an annual basis new policies that constitute best practices for directors or boards, and then use the "stick" of a recommended "withhold" vote for directors not following their current notion of best practices.<sup>93</sup> In addition, most of the largest institutional investors have their own proxy voting policies with which they evaluate boards and shareholder votes.<sup>94</sup>

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<sup>92</sup> See ABA Report, *supra* note 10, at 12.

<sup>93</sup> See note 35; see also Voting Integrity, *supra* note 39, at 6-12; Short-termism, *supra* note 15, at 2.

<sup>94</sup> See, e.g., California Public Employees Retirement System, "Global Principles of Accountable Corporate Governance" (Feb. 2010), available at <http://www.calpers-governance.org/docs-sof/principles/2010-5-2-global-principles-of-accountable-corp-gov.pdf>; TIAA-CREF, "Policy Statement on Corporate Governance," available at <http://www.tiaa-cref.org/public/about/governance/index.html>.

## IV PRINCIPLES OF CORPORATE GOVERNANCE

It was against the background of unprecedented changes in the economy and corporate governance, as well as the evolving trends in share-ownership and the continuing changes in what it means to be a director, officer and even a shareholder as described in Section III, that the Commission began its deliberations. Given this background, as well as the work of many other groups which have previously issued reports on governance principles, some members questioned whether it was useful for the Commission to create yet another set of new corporate governance guidelines or principles.

At the same time, the Commission recognized certain fundamental principles that were appropriate and needed to be communicated and re-emphasized. Perhaps most importantly, the Commission believed that the respective roles of boards, management and shareholders needed greater understanding. For example, the Commission found that boards, management and shareholders have different, yet sometimes overlapping and inter-dependent roles in helping the corporation achieve its objectives. By law, the board has primary responsibility for governing the corporation, and with that responsibility comes important legal and equitable duties to the corporation and its shareholders. Management operates the business on a day-to-day basis, and as such is the body generally most knowledgeable about the corporation and its business, yet is operating the business for the benefit of the company's shareholders, and by extension, the company's other stakeholders. Because of this, management also owes legal and equitable duties to the corporation and also must play a key role in the governance of the corporation. In contrast to both the board and management, shareholders generally owe no legal duty to either the corporation or its stakeholders (and have limited liability, which is generally capped at the value of their investment), but have a significant economic interest in the long-term performance of the corporation and for this reason have important but limited rights to vote on fundamental corporate issues. The Commission also recognized that in addition to these three groups, other corporate stakeholders have critical interests in the long-term success of the corporation, including, for example, the corporation's employees who rely on the corporation to provide jobs and wages, the corporation's customers and vendors, as well as the communities in which the corporation operates and society at large, which look to the corporation to help address society's challenges, to innovate and to promote durable and sustainable economic growth.

Given these challenges, another fundamental issue considered by the Commission was the manner in which the board exercises its duties in the face of shareholders who may have competing interests and investment time horizons, an especially formidable question given the changing definition of "shareholder," and the likely continued evolution of share-ownership as technology continues to transform trading patterns.<sup>95</sup> As the Commission considered this issue, it repeatedly returned to the principle that the

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<sup>95</sup> This debate has been on-going for nearly a century, at least since the Adolph A. Berle Jr. and Gardiner C. Means classic treatise *The Modern Corporation and Private Property* was written in 1932, and continues to be part of a vigorous debate today. See, e.g., Stevens & Rudnick, "What Berle and Means Have Wrought," *The Deal*, May 14, 2010.

fundamental objective of the board must be to help the corporation build long-term, sustainable growth in value for shareholders and, by extension, other stakeholders, and that corporate governance principles must follow from this objective. Precisely because there will be occasions when the interests among shareholders and/or among shareholders and other stakeholders differ from one another, it is important for the board's actions to be guided by this overarching objective.

Following lengthy deliberation of these and related issues, the Commission reached a consensus on fundamental principles that it believes are essential to strong corporate governance. Many of these principles are derived from and subject to principles of state corporate law and the federal securities laws; others do not originate from legal requirements but are nonetheless viewed by the Commission as fundamental.

The Commission considered these principles in the context of the three key corporate actors identified above: boards, management and shareholders. At the same time, however, the Commission recognized that a critical aspect of these principles is the interdependence and inter-relatedness of the board, management and shareholders. For example, it is unrealistic to expect boards and/or management to adopt policies that look to generate long-term economic wealth for shareholders when shareholders are focused primarily on quarterly results and short-term stock price maximization. Similarly, shareholders cannot be expected to be passive when boards appear to act in their own self-interest or in the interests of management, without adopting policies that are consistent with increasing shareholder value. The Commission believes that regulatory policies must similarly recognize this interdependence.

The principles governing each group are set forth below:

A. *Board of Directors*

1. *Composition and Role*

- Independent board oversight is essential to successful governance. For this reason, the Commission supports the current NYSE listing standards, which require that a majority of a listed company's board consist of independent directors, as well as the current NYSE definitions of independence. At the same time, and as also provided for under the NYSE's listing standards, a properly functioning board can include more than one non-independent director, such as persons familiar with the Company and its operations, or who have some relationship with the Company. An effective board includes a variety of skill sets, backgrounds, experiences and knowledge. Diversity on the board allows for more constructive and informed debate and more thoughtful decision-making. The Commission believes that a board which includes a minority of directors who have some prior familiarity

and/or history with the Company and its industry may allow the board to operate more effectively as a whole.<sup>96</sup>

- A board should be both diverse and collegial to be effective. Diversity should be broadly defined, to include experience as well as other criteria. Boards should consider the ability of directors to work together on a confidential, professional and collegial basis when discussing the qualifications of individuals to serve as directors. At the same time, collegiality and professionalism should not prohibit directors from being independent and candid with their views. Candor, both to shareholders and between and among the directors, is essential for effective board decision-making and oversight.
- Specific qualifications for directors and boards, including such issues as term limits, mandatory retirement and other personal factors relating to an individual director's ability to be a positive force in the board room, are generally best decided by the board with input from management and the corporation's shareholders. As a general matter, there is no "one size fits all" test for such issues, and as such these types of issues are generally better determined on a case-by-case basis, based upon the status, challenges, strategy and culture of the enterprise, rather than by mandatory rules. At the same time, the board should be open to discussing its approach to these issues with shareholders, particularly long-term shareholders, to the extent that can be done in an effective manner, particularly to the extent the board's views differ from those of a significant number of shareholders.
- Board service is not expected to be a full-time job. While shareholders properly expect boards to be both monitors and strategic advisors, adding tasks to the board's existing duties should be carefully evaluated and balanced with the effect those tasks may have on the ability of a director or board to perform other critical tasks. Calls for reform are obviously not intended to create a "check the box" mentality, but may have that effect to the extent mandates create additional obligations on board members while not taking into account the limited time available to directors to meet the existing demands.

## 2. *Duties and Obligations*

- A director's duties are to the corporation as a whole, with the goal of assisting management in creating durable, long-term growth in shareholder value through decisions that, by their nature, involve economic or other types of risk-taking. In assessing shareholder concerns and demands, it is appropriate for directors to consider

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<sup>96</sup> The Commission also observed the effect of antitrust laws to limit the directors in certain industries from serving on a board of a company in a similar or related industry, and that this too reduces the pool of qualified directors with particular knowledge of the company and its industry. See, e.g., Clayton Antitrust Act of 1914 §8; Miguel Helft and Brad Stone, "Board Ties at Apple and Google Are Scrutinized," New York Times (May 4, 2009).

whether any constituencies (or their agents) have interests other than to maximize the long-term, sustainable profitability of the corporation. For corporate governance to work properly and to help contribute to better long-term performance, it should be part of the foundation of the corporation's business strategy.

- The board should also ensure that appropriate risk management systems are in place so that excessive risk taking is avoided. The decision of whether risk issues are better addressed through existing committees or the board as a whole is generally best left to the board to consider, except where legal requirements mandate otherwise.
- Directors should ensure that shareholders have a way to express their views about the corporation and its leadership, including the board. This process can encompass a wide variety of different mechanisms, and there is not necessarily any one method which is appropriate for every corporation. Boards should consider whether there are particular topics as to which the board and/or individual directors may need to communicate directly with shareholders and whether there are appropriate mechanisms in place to allow for this to take place in an effective manner.
- One fundamental role of the board is to work with the corporation's CEO to create a culture of high integrity, including adherence to both the rule of law and appropriate ethical standards. This role includes hiring the corporation's CEO and senior managers, and taking such action as is necessary to ensure that basic values such as honesty, trust, candor and transparency are maintained throughout the corporation. Insisting that the management team create a strong ethical culture is essential to proper risk management and governance.
- The board should establish appropriate incentive and compensation principles to ensure that employees, including senior management and the corporation's CEO, are incentivized to act in the long-term best interests of the corporation and its shareholders. Such systems can encompass a wide variety of mechanisms together with incentives for appropriate—but not excessive—risk taking, and should be tailored to suit the particular circumstances and needs of each corporation.

## *B. Management*

### *1. Responsibilities of Management*

- Management has a fundamental role in corporate governance. Working at the direction of the board, it has responsibility for managing the corporation on a daily basis, as well as executing the corporation's basic operations and strategy, with the goal of creating long-term sustainable growth in value for the corporation's shareholders. This includes developing and implementing the corporation's strategic plan, as well as developing appropriate

measurement tools so that the corporation's performance against the plan can be measured and understood.

- Management, along with the board, is responsible for creating and maintaining an ethical "tone at the top" of the corporation, including systems for open internal communication about problems without the fear of retaliation. As part of this task, management should ensure that (i) it has processes that allow it to identify, assess and mitigate risks, (ii) those processes are operated and overseen by competent personnel who are accountable for the performance of the risk management system and (iii) senior management has established appropriate policies and strategies to identify and develop future leaders who understand the importance of ethical leadership.
- A critical role of management is to establish and maintain processes and procedures for recruiting, developing and maintaining executive talent. This includes developing incentive and other programs designed to foster high ethical standards and promote accountability. These programs need to involve realistic goal setting which balances short term results with long term risks.

## 2. *Management's Relationship with the Board*

- Management is the primary source of information about the corporation for the board, and thus has a critical responsibility to be candid and open with the board on issues relating to the corporation and to ensure that competing viewpoints (including those of shareholders) are communicated to the board. This responsibility includes providing the board with necessary, relevant and timely information to allow the board to perform its oversight and monitoring functions, including information necessary to allow the board to assess the corporation's strategic direction, monitor the corporation's risk profile, and generally oversee the performance of the corporation. Management and the board should focus on selecting key information (so as not to overload the board with too much information) and improving the board's understanding of the business. Management should also acknowledge that the board may need to have access to a number of different sources of information in order to fully understand the viewpoints of all major constituencies.
- An active and informed board will constructively engage management over the corporation's strategy and plans on a regular basis, and may disagree with management on various issues related to the corporation's business or other issues. This "constructive tension" in the relationship between management and the board is both necessary and advisable and should not be considered a negative factor. To the contrary, while management and the board must have respect for each other, and dealings between management and the board must be conducted in a professional and constructive manner, it is to be

expected that there will be some tension in the relationship since part of the board's responsibility is to question the decisions, recommendations and information being provided by management.

- Management should promote broader exposure to corporation leaders below the senior-most level, in part to facilitate the board's role in succession planning, and encourage open lines of communication between the board and business leaders throughout the organization. Management should consider educating the corporation's employees about the board, its functions and objectives in order to promote a broader and deeper understanding throughout the corporation of the interrelationship between management and the board and the board's importance in helping management achieve its objectives.

### 3. *Management's Relationship with the Shareholders*

- Consistent with its legal obligations, management has a duty to the corporation to act with due care and loyalty to the corporation and its shareholders. Part of this obligation is to act in an ethical and transparent manner to create long-term growth in value for the corporation and its shareholders, and avoid practices that involve excessive risk or which may benefit the corporation's stock price in the short-term while harming the corporation and its shareholders in the long-term.
- Shareholders have a fundamental right to certain information from the corporation, and management, working with the board, should provide shareholders with the appropriate information necessary for shareholders to be reasonably informed about the corporation, its strategic goals and plans, its risks and its competitive position, and appropriate information to allow management's performance to be measured against relevant criteria.
- Shareholders should expect that management will align compensation with the corporation's performance, including creating incentives for management to engage in appropriate risk.
- Shareholders should expect that management, working with the board, will be transparent about the risks to the corporation's business and competitive standing, and will be best suited to appropriately monitor those risks and position the corporation accordingly. Management needs to be proactive in understanding and responding to risks, both market-based and operational, and should openly communicate with shareholders regarding success and failure in this regard. Management should provide adequate disclosure under SEC regulations regarding its risk management and controls such that shareholders can gain a clear understanding of the corporation's approach to this topic.

## C. *Shareholders*

### 1. *Rights of Shareholders*

- Shareholders have a right to vote on fundamental issues relating to the corporation, including certain mergers and other proposed transactions as well as the election of directors. Shareholders have a right to expect that voting on these issues is fair, honest, accurate and transparent, and that the board and management give due weight to shareholder votes.
- A shareholder's fundamental right to vote includes a meaningful ability to oppose the election (or re-election) of a board of directors or an individual director. In addition, the Commission notes that many large companies have adopted majority-voting policies for election of directors, which many investors and companies believe to be a more appropriate policy than the traditional plurality-voting standard. Long term shareholders can also hold boards accountable through the use of the SEC's new proxy access rules.
- Shareholders have the right to freely buy and sell shares, and as a general rule have limited liability (beyond the investment of their capital) for their actions as shareholders.
- Shareholders have a right to expect transparency from the corporation, including receiving timely information about the corporation and its strategic goals and plans, material developments, governance and risk profile. The information provided to shareholders by management and the board should be sufficient to allow shareholders to measure and evaluate management and the board's performance against the plan and other relevant criteria.
- Shareholders have a right to expect that the board and management of the corporation will regard themselves as fiduciaries for the corporation and its shareholders and will act in the best interests of the corporation and its shareholders, and may be held to account to the corporation and its shareholders for their actions.

### 2. *Responsibilities of Shareholders*

- Shareholders have a responsibility to vote shares in a thoughtful manner based upon the particular situation, in alignment with their economic interest. If these shareholders are institutional investors, then this includes considering the long-term interests of their investors. This may include obtaining the assistance of advisers, including proxy advisory firms as appropriate. Nevertheless, shareholder agents who rely on third parties to assist them in their voting decisions remain responsible for the votes that are cast by them or on their behalf, and are responsible for ensuring that their votes are cast only after the exercise of thoughtful judgment.



- Shareholders should attempt to engage in constructive communication with the corporation before submitting proposals or proxy access nominations or engaging in public campaigns which tend to be adversarial in nature. Shareholders should use the most moderate means first to work collaboratively with companies and seek common ground on issues of concern, recognizing there may be times when talks break down and such communication is no longer productive.
- Investors should facilitate appropriate communication between those responsible for voting and/or governance decisions and those responsible for investment decisions. This communication should be designed so that voting decisions by institutions represent the collective view of the governance and investment functions of the organization.
- Investors should establish and disclose their corporate governance guidelines and voting decisions to individual companies whose shares they own in a timely manner, explain why they voted in the manner they did, and engage in dialogue with those companies on their corporate governance and voting policies, processes and philosophy.

## V. CONCLUSION

The NYSE created the Commission to see if a consensus could be reached on certain core governance principles among the most diverse corporate constituencies. The Commission believes that such a consensus does exist, and that such consensus is in fact critical if investor confidence is to be re-established in the markets. At the same time, many members of the Commission recognized the tremendous changes in the corporate governance environment over the last decade, and that in many ways it is still too early to determine the full impact or effectiveness of these changes.

As the Commission debated these issues, it could not ignore the work that had gone before it, as well as the current issues being debated—which include such critical issues as proxy access, financial regulatory reform, an expanded federal role in corporate governance, and so-called “proxy plumbing” initiatives. The Commission found it difficult to reach consensus on many of these specific issues, and also believes that a great deal of information already exists on these specific issues. Accordingly, the goal of the Commission was not to add to this debate, but rather to step back from it and instead put forward certain fundamental principles of governance that apply to the three cornerstones of the corporation—boards, management and shareholders.

Finally, it is important to note that as the Commission reviewed these issues, it did so in the context of the reality that, notwithstanding certain governance failures over the last decade, the current governance system generally works well. The Commission believes that failures of corporate governance were not the sole reason for the financial crisis of 2008, and more broadly believes that most of the thousands of public companies in this country are well governed, with hard-working and ethical boards and shareholders who are involved in the companies. This does not mean that the system is perfect, but it does mean that before further fundamental change is sought, all parties considering such change should recognize the strengths of the current system and the benefits it provides to investors and the economy.

## **APPENDIX A**

### **New York Stock Exchange Commission on Corporate Governance**

#### **Mission Statement**

The NYSE's Commission on Corporate Governance will address U.S. corporate governance reform and the overall proxy voting process for publicly traded entities. The Commission will take a comprehensive look at the multitude of issues facing Directors, Management, Stockholders, regulators and other constituencies in the on-going public debate about best practices for corporate governance.

Consistent with the NYSE's historic role as a leader in corporate governance issues, the Commission will bring together experts and representatives from corporations, stockholder advocacy groups, regulators and others in an effort to forge a consensus on a variety of today's most controversial corporate governance issues, including a review of:

- The roles of, and relationships, accountability and communications among, Boards of Directors, Management, Stockholders and other corporate stakeholders;
- The proxy voting process, including transparency of the process, the benefits and costs of recent and continuing regulatory initiatives in the proxy process;
- The role of proxy advisory services, institutional investors and individual investors within the proxy process, including practices which can further educate investors about, and encourage them to participate in, the proxy process;
- Corporate governance structures and corporate mechanisms impacting the governance of the corporation; and
- Stockholder access to corporate proxy cards, including recent developments in state law and the proposed initiatives by the SEC.

The Commission will also review, and comment upon as appropriate, the proposed policy initiatives, rules and legislative developments affecting corporate governance. As it considers these issues, the Commission will consider both the potential risks and benefits that may be associated with the expansion of regulatory obligations imposed on Directors, Management and Stockholders, including the risk that increasing such obligations may alter the balance of responsibility and accountability among such constituencies and may impede the focus of creating long-term shareholder value.

The Commission will seek input from experts in a variety of fields as appropriate, and will report on its progress periodically. The Commission will ensure that all constituents, including the SEC, issuers, broker/dealers, institutional investors, individual stockholders and other interested parties, will have an opportunity to provide input into this process.

## **APPENDIX B**

### **Selected Corporate Governance and Disclosure Related Laws and Regulations 2000 to present**

#### **FINAL SEC RULES—SARBANES-OXLEY**

1. “Ownership Reports and Trading by Officers, Directors and Principal Security Holders,” Release No. 34-46421 (August 27, 2002).
2. “Certification of Disclosure in Companies’ Quarterly and Annual Reports,” Release No. 33-8124 (August 29, 2002).
3. “Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports,” Release No. 33-8128 (September 5, 2002), Release No. 33-8128A (April 8, 2003).
4. “Conditions for Use of Non-GAAP Financial Measures,” Release No. 33-8176 (January 22, 2003).
5. “Insider Trades During Pension Fund Blackout Periods,” Release No. 34-47225 (January 22, 2003).
6. “Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002,” Release No. 33-8177 (January 23, 2003), Release No. 33-8177A (March 26, 2003).
7. “Retention of Records Relevant to Audits and Reviews,” Release No. 33-8180 (January 24, 2003).
8. “Disclosure in Management’s Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations,” Release No. 33-8182 (January 28, 2003).
9. “Strengthening the Commission’s Requirements Regarding Auditor Independence,” Release No. 33-8183 (January 28, 2003), Release No. 33-8183A (March 26, 2003).
10. “Implementation of Standards of Professional Conduct for Attorneys,” Release No. 33-8185 (January 29, 2003).
11. “Standards Relating to Listed Company Audit Committees,” Release No. 33-8220 (April 9, 2003).
12. “Mandated Electronic Filing and Website Posting for Forms 3, 4 and 5,” Release No. 33-8230 (May 7, 2003).

13. “Improper Influence on Conduct of Audits,” Release No. 34-47890 (May 20, 2003).
14. “Management’s Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports,” Release No. 33-8238 (June 5, 2003).
15. “Management’s Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports,” Release No. 33-8392 (February 24, 2004).
16. “Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date,” Release No. 33-8400 (March 16, 2004), Release No. 33-8400A (August 4, 2004).

## **FINAL SEC RULES—OTHER**

1. “Purchases of Certain Equity Securities by the Issuer and Others,” Release No. 33-8335 (November 10, 2003).
2. “Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors,” Release No. 33-8340 (November 24, 2003).
3. “Securities Offering Reform,” Release No. 33-8591 (July 19, 2005), Release No. 33-8591A (February 6, 2006).
4. “Executive Compensation and Related Person Disclosure (conforming amendments),” Release No. 33-8732A (August 29, 2006), Release No. 33-8765 (December 22, 2006).
5. “Internet Availability of Proxy Materials,” Release No. 34-55146 (January 22, 2007).
6. “Shareholder Choice Regarding Proxy Materials,” Release No. 34-56135 (July 26, 2007).
7. “Definition of the Term Significant Deficiency,” Release No. 33-8829 (August 3, 2007).
8. “Shareholder Proposals Relating to the Election of Directors,” Release No. 34-56914 (December 6, 2007).
9. “Electronic Shareholder Forums,” Release No. 34-57172 (January 18, 2008).
10. “Internet Availability of Proxy Materials; Regulation of Takeovers and Security Holder Communications; Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings; Certain Other Related Rule Corrections (Corrected, March 18, 2008),” Release No. 34-55146A (March 17, 2008).
11. “Interactive Data to Improve Financial Reporting,” Release No. 33-9002 (January 30, 2009), Release No. 33-9002A (April 1, 2009).
12. “Proxy Disclosure Enhancements,” Release No. 33-9089 (December 16, 2009), Release No. 33-9089A (February 23, 2010).
13. “Shareholder Approval of Executive Compensation of TARP Recipients,” Release No. 34-61335 (January 12, 2010).
14. “Amendments to Rules Requiring Internet Availability of Proxy Materials,” Release No. 33-9108 (February 22, 2010).

15. "Facilitating Shareholder Director Nominations," Release No. 33-9136 (August 25, 2010).

## **OUTSTANDING SEC PROPOSED RULES**

1. “Disclosure in Management’s Discussion and Analysis about the Application of Critical Accounting Policies,” Release No. 33-8098 (May 10, 2002).
2. “Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers,” Release No. 33-8982 (November 14, 2008) and Release No. 33-9005 (February 3, 2009).
3. “Purchases of Certain Equity Securities by the Issuer and Others,” Release No. 34-61414 (January 26, 2010).



## **SEC INTERPRETIVE RELEASES**

1. “Commission Guidance Regarding Management’s Discussion and Analysis of Final Condition and Results of Operations,” Release No. 33-8350 (December 19, 2003).
2. “Commission Guidance Regarding the Public Company Accounting Oversight Board’s Auditing and Related Professional Practice Standard No. 1,” Release No. 33-8422 (May 14, 2004).
3. “Commission Guidance Regarding Management’s Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934,” Release No. 33-8810 (June 20, 2007).
4. “Commission Guidance on the Use of Company Web Sites,” Release No. 34-58288 (August 1, 2008).
5. “Commission Guidance Regarding Disclosure Related to Climate Change,” Release No. 33-9106 (February 2, 2010).

## **SEC CONCEPT RELEASES**

1. “Concept Release Concerning Management’s Reports on Internal Control Over Financial Reporting,” Release No. 34-54122 (July 11, 2006).
2. “Concept Release On Allowing U.S. Issuers To Prepare Financial Statements In Accordance With International Financial Reporting Standards (Correcting Amendment),” Release No. 33-8831A (September 13, 2007).
3. “Concept Release on Equity Market Structure,” Release No. 34-61358 (January 14, 2010).
4. “Concept Release on the U.S. Proxy System,” Release No. 34-62495 (July 14, 2010).

## **AMENDMENTS TO DELAWARE'S GENERAL CORPORATION LAW**

### **2000**

Section 211 – Permitted a shareholder meeting to be conducted entirely by remote communication without a venue for physical attendance and ballots to be submitted by electronic transmission, if so determined by the board.

Section 232 – Permitted electronic notice to a shareholder if such shareholder has consented to receive notices in such format.

Section 228 – Permitted use of electronically submitted stockholder consents.

Section 141 – Permitted director resignations and actions by consent to be taken by electronic transmission.

### **2003**

Section 114 – Granted Delaware courts personal jurisdiction over certain executive officers of Delaware corporations with respect to alleged wrongful conduct during their tenure in office; previously personal jurisdiction was limited to directors of Delaware corporations.

Section 220 – Established presumption that a director requesting inspection of a corporate books and records did so for a proper purpose; corporation must establish improper purpose before resisting such request. Expanded right of inspection by shareholder to reach books and records of a subsidiary if such books and records are in the possession of the corporation or could be obtained through control of the subsidiary.

### **2005**

Section 141 – Permitted corporations to grant certain directors voting rights that different than or in addition to those granted to other directors.

### **2006**

Section 141 – Allowed corporations and directors to establish voting standards that differ from the default plurality standards in Section 216. Increased flexibility for assigning directors to a classified board.

Section 216 – Prevented a bylaw adopted by shareholders that prescribes the required vote for the election of directors from being amended or repealed by the board.

## **2008**

Section 219 – Shifted the standard of proof to the corporation when rejecting a shareholder request for access to the stockholder list; increased the remedies available to the Chancery Court to resolve such disputes by postponing the meeting or voiding election results.

## **2009**

Section 112 – Permitted corporations to adopt a proxy access bylaw.

Section 113 – Permitted corporations to establish different record dates for determining shareholders entitled to notice of a stockholder meeting and shareholders entitled to vote at such meeting; permitted corporations to adopt a proxy expense reimbursement bylaw;

Section 225 – Granted corporations (and shareholders acting derivatively) to bring an action in Chancery Court to remove a director who has been convicted of a felony in connection with his duties to the corporation or has been found in a judicial proceeding to have breached the duty of loyalty.

Section 145 – Established indemnification “vesting” whereby a director entitled to indemnification or advancement for acts or omissions at a given time cannot be deprived of such indemnification rights through subsequent amendments to such indemnification provisions.

## APPENDIX C

### **Selected Corporate Governance and Disclosure Related Studies and Initiatives 2000 to present**

1. American Bar Association, “Report of the American Bar Association Task Force on Corporate Responsibility” (March 31, 2003).
2. American Bar Association, “Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee on Delineation of Governance Roles & Responsibilities” (August 1, 2009).
3. Aspen Institute, “Long-Term Valuation Creation: Guiding Principles for Corporations and Investors” (June 2007).
4. Michael Bloomberg & Charles Schumer, “Sustaining New York’s & the U.S.’ Global Financial Services Leadership” (2007).
5. Richard Breedan, “Restoring Trust: Report to the Hon. Jed S. Rakoff, the United States District Court for the Southern District of New York, on Corporate Governance for the Future of MCI, Inc.” (August 2003).
6. Business Round Table, “Principles of Corporate Governance” (May 2002, revised November 2005 and April 2010).
7. California Public Employees Retirement System, “Global Principles of Accountable Corporate Governance” (March 2009).
8. Committee for Economic Development, “Restoring Trust in Corporate Governance: Six Essential Tasks for Boards of Directors and Business Leaders” (2010).
9. Committee for Economic Development, “Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals” (2009).
10. Committee for Economic Development, “Built to Last: Focusing Corporations on Long-Term Performance” (2007).
11. Conference Board, “Commission on Public Trust and Private Enterprise: Findings and Recommendations” (January 9, 2003).
12. Corporate Library, The Future of Corporate Reform (2009).
13. Council of Institutional Investors, “Corporate Governance Policies” (March 1998, revised April 2008 and April 13, 2010).
14. International Corporate Governance Network (ICGN), “ICGN Statement on Global Corporate Governance Principles” (1999, revised 2005 and 2009).

15. Millstein Center for Corporate Governance and Performance, “Agenda for Private Sector Reform: Omnibus Policy Recommendations for a Post-Crisis Market” (June 2009).
16. National Association of Corporate Directors, “Report of the NACD Blue Ribbon Commission on Director Professionalism” (November 1996, reissued 2001, 2005).
17. National Association of Corporate Directors, “Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies” (2009).
18. Organization for Economic Cooperation and Development, “Principles of Corporate Governance” (1999, revised 2004).
19. TIAA-CREF, “Policy Statement on Corporate Governance” (eff. 2009).
20. The Vanguard Group, Inc., “Our Views on Corporate Governance.”