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ABA Business Law Section Urges Boards To Enhance Communications With Investors

In order to maximize a corporation's potential to achieve long-term wealth creation, it is important that boards of directors maintain strong communications with the company's shareholders, the Committee on Corporate Laws of the American Bar Association's Section of Business Law said in a recent report.

The committee Jan. 26 released a report to accompany amendments adopted Dec. 17 to the Model Business Corporation Act that contain significant clarifications and changes related to requirements for proxy access and reimbursement bylaw provisions (7 CARE 1498, 12/25/09).

The committee's amendments to shareholder proxy access and expense reimbursement include rules that prevent corporate bylaws for proxy access and reimbursement from restricting the authority of the board to direct or oversee the affairs of the company.

According to the committee's report, the growing influence of institutional investors—which has generated an increase in trading activity—has enhanced the scrutiny of the performance of executives and boards of directors. As a result, this has greatly altered the dynamics between boards and shareholders, it said.

Meanwhile, attorneys and other consultants in a Jan. 28 Foley & Lardner LLP Webcast on corporate governance developments said that given the current economic environment, it is imperative that boards take a close and careful look at their overall governance structure on a proactive basis.

Boards Must Consider Shareholder Interests. The committee's corporate model vests managerial and oversight power of the corporation in the board. Thus, shareholders can reasonably expect boards to be attentive to shareholders' interests, the report said.

Communication between boards and shareholders "goes beyond conferring with shareholders regarding director selection, extending to other aspects of the relationship between boards and shareholders," the report said. Boards need to seriously consider shareholders' feedback and suggestions for improving the performance of the corporation and of the board itself, it said.

Establishing a good relationship with shareholders requires that a company confront difficult issues that

include identifying shareholders with whom communications would be "most beneficial to the corporation," the report said. Companies should also identify the directors who should perform the communications with investors and be ready to support any additional burdens directors may face, it said.

With regard to shareholder responsibilities to a company, the report said, "While some advocate fiduciary duties for activist or large shareholders, the committee is not supporting that position. It would be impractical and unwise to view the model act as being a principal and unwelcome shareholder activities," it said.

Investors Should Have Full Access to Elections. According to the report, "shareholders should have not only the right to elect but also the right to have a meaningful role in the process of selecting, the candidates for election."

"The committee accepts as a core principle that shareholders must have the opportunity to participate in a fair and sensible manner in the board selection process, and should have the ability to adopt a mandatory model for their involvement in that process if they so choose," the report said.

This flexibility is crucial because a good director nomination and election process for one enterprise may not be advantageous for another, the report said.

According to the report, the committee's amendments also take into consideration the significant shift to a majority vote requirement to elect directors with the adoption of an "opt-in" bylaw provision.

Furthermore, while shareholders historically have had the state-law right to nominate director candidates, the amendments to the act allow for shareholder participation in the nomination and election of the directors to be entirely voluntary, the report said.

"[By] seeking input from interested shareholders on the important issue of board composition and chemistry, boards will foster greater understanding, provide a less adversarial avenue for selecting and changing board members, and reduce the likelihood of proxy fights," the report said.

Managing Duties Should Remain Under Board. The committee's report said, "In the last decade, we have witnessed an accelerating shift in the ownership of corporate America from individual investors to institutional investors." This shift is followed by a broadening of the types of institutional investors and in the forms of investing and trading activities, it said.

If corporations were directly managed by shareholders, “the ability to rely on management teams would be diluted and the time and attention of managers could, in many cases, be diverted from activities designed to pursue sustainable economic benefit for the corporation,” the report said.

The committee’s model act supports a centralized model of corporate governance, and gives the board power and corresponding responsibility to direct and oversee the management of the corporation, the report said.

The act also allows for statutory flexibility within the centralized model, and avoids a more “prescriptive one-size-fits-all approach,” the report said.

In an economic environment in which boards are facing more demands, “directors may be inclined to view a greater role for shareholders as an additional burden,” the report said. Nonetheless, boards of public corporations need to be receptive to increased shareholder involvement, it said.

Boards Are Encouraged to Set Good Tone. In a Jan. 28 Foley Webcast, attorneys said that they have already begun to see an increase in the number of proxy fights in the market. Boards need to address this and other issues by setting a strong “tone from the top,” Peter C. Underwood, a partner at the Milwaukee, Wis., office of Foley & Lardner LLP, said.

“Boards need to evaluate the tone set by directors and consider improving relationships with shareholders,” Underwood said. “Leadership should look at corporate governance as an ongoing process that will ensure the long-term integrity and success of the business, and not a list of items required by the government,” he said.

The increasing influence of shareholders creates a need for boards to be proactive and find out about key issues affecting shareholders, and fully comprehend and try to address these issues, Underwood said.

An active dialogue with shareholders has its pros and cons, according to Underwood. “While the board may become more informed, there is a risk of empowering investors who have goals and business strategies that differ greatly from the board,” he said.

“Boards should examine whether increased and improved communication with shareholders would be appropriate to begin with,” Underwood said. “Issues such as governance policies—especially where they deviate from industry standards or Risk Metrics Governance policies—and the company’s strategic direction should be shared with investors,” he said.

Disclosures to Shareholders May Be Tricky. Companies must be careful when making disclosures to shareholders as compliance issues may be affected, Underwood said. “The sanctity and confidentiality of the boardroom must be maintained,” he said.

“In any event, whether a board believes more or better communication with shareholders is a good move, it is absolutely crucial that boards ensure the company’s long term strategy is well understood by shareholders,” Underwood said.

According to Underwood, the key driver behind investor activism is company performance. “A close second has got to be a lack of understanding of the board’s strategies. The better a board can communicate its vision, the more likely shareholders will understand and even embrace its ideas,” he said.

“Improved communication of long-term business strategies will serve to minimize the potential disruptions that an aggrieved shareholder base—with so many new tools at its disposal—could bring,” Underwood said.

However, in addition to being a preventative measure, enhanced communication lays the foundation for future events, Underwood said. “At some point, the board is going to need shareholders to buy into one or more of its key positions,” he said. “Establishing a productive relationship prior to such an event can certainly benefit a board when the time comes,” he said.

BY TINA CHI

The amendments to the Model Business Corporation Act are available at http://www.abanet.org/buslaw/tbl/tblonline/2009_064_04/home.shtml.

The committee’s report is available at http://www.abanet.org/media/nosearch/task_force_report.pdf.