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CORPORATE ALERT

TOP 10 TOPICS FOR DIRECTORS IN 2008

Now that 2007 has drawn to a close, directors of public companies are turning their attention to 2008. Here is our top 10 list of hot topics for the boardroom in the coming year.

CORPORATE GOVERNANCE

1. Rising Tide of Shareholder Activism

Directors of public companies will face increasing pressures in 2008 to respond to a rising tide of shareholder activism. Activist investors ranging from pension funds to hedge funds are demanding, and getting, a bigger say in how companies are run.

- A record number of shareholder proposals were submitted to public companies in 2007 (1,169) and a record number of these proposals (23 percent) were withdrawn, as boards increasingly sought compromises to keep proposals off company ballots.[1]
- A record number of activist campaigns (501) pushing for a change in control or other measures to maximize shareholder value were launched in 2007.[2]
- A record number of proxy fights were announced in 2007 (110) and more than half of them were settled or terminated with the dissidents winning concessions.[3]
- Activist shareholders successfully pressured more than half a dozen major corporations to join a working group to study the say on pay issue that would give shareholders an annual advisory vote on executive compensation.
- Pfizer has even gone so far as to initiate face-to-face meetings between its board of directors and its large institutional investors.

With this unprecedented level of engagement between public companies and activist shareholders, shareholder activism will likely soar to even greater heights in the coming year. Activists will also benefit from recent changes in the federal proxy rules that pave the way for the Internet to become a cheap and effective way for activists to press their agendas. With the SEC's introduction of "e-proxy" in July 2007, activists can now avoid the expense of printing and mailing proxy materials and instead wage their proxy battles online. The SEC also recently exempted Internet shareholder forums from most of the proxy rules to eliminate concerns that participation in these forums could create liability or be viewed as a proxy solicitation. Once visited only by disgruntled individual shareholders, shareholder forums are increasingly attracting mainstream investors and proving to be an effective tool for addressing shareholder concerns.[4]

Activists also will enjoy more leverage over boards in 2008 due to the success of their campaign for majority voting in director elections. Two-thirds of S&P 500 companies have now adopted the majority vote standard. Boards that fail to respond to shareholder demands run the risk of becoming targets of "withhold the vote" campaigns calling for their ouster.

Companies have, however, received relief for the upcoming proxy season from so-called "shareholder access" proposals. In December 2007 the SEC adopted rule changes that reaffirm the SEC's historical position that companies can exclude from their proxy statements shareholder proposals that would effectively require shareholder nominees for director to be included on management's proxy. A court case in late 2006 had called into question the SEC's position. In reaffirming its historical stance, however, SEC Chairman Cox explained that the SEC was doing so to bring certainty to the 2008 proxy season and that the SEC intends to revisit the issue prior to next year's proxy season. The SEC also may address in 2008 a New York Stock Exchange proposed rule change that would eliminate broker discretionary voting in uncontested director elections. Because brokers have historically used their discretion to vote in favor of management candidates, the proposed rule change would make it more difficult to achieve a majority vote at companies that have adopted a majority voting standard.

In view of the increasing level of shareholder activism, all public companies should be taking steps to avoid an activist attack, and have in place a response plan if one occurs. Here the adage that "the best defense is a good offense" generally holds true. Companies with decent performances, good governance practices and reasonable executive compensation policies are less likely to draw the attention of activists. Companies should be proactive in communicating their business strategies to the marketplace and cultivating relationships with core investors. Investors are often willing to give management the benefit of the doubt if management has in place a thoughtful, well-articulated business plan. Companies also should take advantage of the growing power of the Internet by making sure their Web sites are up to date and fully communicating the company's message. In addition, companies should actively monitor shareholder concerns and opinions that are expressed through blogs and other shareholder forums and proactively respond as appropriate to any shareholder issues before they escalate.

If a company is targeted by activists, it is usually wise to engage in a dialogue with them. Directors should, however, be wary of shareholder proposals that unduly interfere with the board's basic responsibility to manage the corporation for the creation of long-term value for all shareholders. Activist shareholders are often motivated by their own economic, social or political agendas and do not necessarily speak for the silent majority of investors. Labor union pension funds, for example, often vote their shares based on whether there are labor relations issues at the company involved,[5] while activist hedge funds typically pursue objectives designed to maximize short-term gains for their own investors, often at the expense of the long-term success of a company.

2. More Hedge Funds at the Gate

Leading the activist charge, there are now more than 125 hedge fund managers devoted to activist strategies, with many more hedge funds applying an activist approach in conjunction with their primary investment strategy.[6] Seeking primarily to boost short-term share prices rather than take over a company, activist hedge funds typically buy at least a five percent stake in a company to trigger a Schedule 13D filing. These funds then seek to influence corporate policy by pushing their own agenda to improve shareholder value, whether it is through seeking a divestiture of assets or non-core businesses, a sale of the company, a stock repurchase program, a recapitalization, increased dividends or a change in management. After the initial Schedule 13D is filed, a "wolf pack" of other hedge funds often will acquire stakes in the target company.

Often, hedge funds will wage or threaten to wage proxy fights to gain board seats or otherwise generate support for their proposals. This hedge fund strategy has been remarkably successful, with management acquiescing to some or all of the funds' proposals at least 60 percent of the time.[7] During 2007 hedge funds were involved in over half of the record 501 activist campaigns that were launched[8] and in two-thirds of the record 110 proxy fights that were announced.[9] With the proliferation of hedge funds (there are now more than 9,000, compared to 5,000 in 2002) and more than $1.7 trillion in assets under management, it is inevitable that more activist hedge funds will enter the fray. The growing practice of "empty voting," whereby hedge funds vote shares borrowed from brokerage firms and institutional fund managers, further compounds the challenge hedge funds pose for Corporate America.

If a company is approached by a hedge fund or other shareholder activist threatening a proxy fight, the company should carefully weigh its options before deciding whether to fight or settle with the insurgents. Of the 36 proxy fights in 2007 that went all the way to a shareholder vote, dissidents won only one-fourth of them.[10] Even experienced, well-financed insurgents do not always win the battle. In 2007 Carl Icahn failed to win any seats on Motorola's board, and in 2006 Highland Capital Management lost its election bid at Motient Capital and Nelson Peltz managed to win only two of the five seats he was seeking on the board of H.J. Heinz. Moreover, stockholders may not be as receptive to hedge fund campaigns in 2008, as the credit crunch has significantly curtailed the viability of two strategies often advocated by hedge funds, the leveraged recapitalization and a sale of the company.[11] The tight credit market, however, has not deterred the activists, who launched 135 new campaigns in the fourth quarter of 2007.[12]

3. Charting a Course Through Choppy Waters: Strategic Planning and M&A Challenges for 2008

Long-term strategic planning is typically one of the most challenging and critical decisions that directors face. The task will be even more daunting in 2008 as many companies will be forced to reevaluate their business plans in light of the widening fallout from the housing collapse and subprime mortgage crisis and the slowing pace of the U.S. economy.

A big challenge for many companies in 2008 will be access to capital. Almost all companies can expect to continue to be subject to tight credit standards in 2008, both for their short-term funding needs and for their longer-term capital expenditure and expansion plans. While massive cash infusions by the Federal Reserve and other central banks have eased the credit crisis that seized worldwide credit markets in late summer and early fall, lenders remain cautious. At 2007 year-end, the market for short-term corporate debt was still stagnant, the spreads on investment grade corporate bonds over Treasurys were at their highest levels in five years, and the spreads on below-investment grade bonds, which had hit a record low 2.4 percentage points in the summer of 2007, had widened to 5.9 percentage points.[13] Companies having difficulty accessing the debt markets are increasingly having to resort to equity and convertible bond offerings to attract investors. During 2007, a record amount of convertible debt was issued, most of it in late 2007 after the credit crunch hit.[14] However, if economic conditions worsen, the equity markets will become less attractive as well.

While the capital markets remain turbulent, companies should find a small benefit from recent changes in SEC rules that effectively reduce the cost to companies and the risk to investors of raising capital through private transactions. Amendments to Rule 144, which are scheduled to go into effect February 15, 2008, cut the holding period for privately placed securities from one year to six months and significantly relax the restrictions on resales of such securities by nonaffiliates.

The tight credit markets also will force directors to reassess their companies' acquisition plans. Much of the M&A boom of recent years has been fueled by cheap and plentiful debt. Although 2007 was a record year for M&A activity, with worldwide transactions totaling $4.4 trillion and U.S. transactions hitting $1.57 trillion, it was a tale of two halves, as global merger activity declined 27 percent in the second half of the year and U.S. activity fell 46 percent.[15] Particularly hard hit by the credit crunch were large leveraged buyouts by private equity firms. When banks were unable to move these loans, private equity bids all but stopped and some private equity firms were forced to seek to renegotiate their existing deals or walk away from them, either paying a reverse termination fee to the seller or testing the limits of their rights to walk away under "material adverse change" clauses in merger agreements. Private equity buyouts, which accounted for as much as 41 percent of U.S. deal volume as of the first week of July, plummeted to just 15 percent of weekly volume in the second half of the year.[16]

While the window appears to have closed for large companies seeking to go private, other merger opportunities are opening up. With private equity sitting on the sideline, strategic buyers, who can use their own cash or stock as currency, are beginning to take advantage of lower valuations. In December 2007 U.S. deal volume rebounded to $121 billion, its first time over $100 billion since July, and 87 percent of U.S. deal volume in the fourth quarter was attributable to corporate buyers.[17] In addition, foreign investment in the U.S. is picking up. Foreign investors, lured by the cheap dollar, accounted for half of U.S. M&A activity in the fourth quarter of 2007[18] and the volume of deals by foreign buyers hit its highest quarterly total in the past decade.[19] Sovereign wealth funds made several multi-billion dollar investments in private equity firms and financial institutions in 2007 and are expected to be even more active in 2008.[20]

Foreign companies planning U.S. acquisitions need to be sensitive to the potential political attention and increased regulatory requirements that their deals may face. In response to the Dubai Ports controversy, Congress passed legislation in 2007 strengthening the Exon-Florio Act. The new law, which went into effect in October 2007, expands the scope of foreign investment transactions that are subject to national security review to include matters relating to "homeland security," with particular emphasis on infrastructure, energy and technology assets. The statute also heightens the level of review of acquisitions by foreign government-controlled entities and requires reports to Congress. While the new law does not appear to have slowed the influx of foreign buyers, it has the potential to delay cross-border transactions and expose them to greater political risk.

There is also increasing sensitivity to the growing financial clout of sovereign wealth funds. These funds, which reportedly have about $2 trillion in assets, [21] have largely been content to take passive minority stakes in U.S. companies. Several high profile investments by these funds in 2007, however, have raised concerns that these funds may become more active and use their investments for political, rather than purely economic, purposes. In response to a meeting in October 2007 between the Group of Seven nations and the leaders of several major sovereign wealth funds, the International Monetary Fund is working on a code of "best practices" for sovereign wealth funds to, among other things, improve their transparency. The new code, however, is not expected to address political or national security issues or propose upper limits on investments by these funds. [22]

Parties to M&A transactions in 2008 will be seeking greater deal certainty and paying closer attention to contract provisions spelling out their rights and remedies in the event the deal goes sour. Many of last year's broken deals have ended up in litigation over "MAC" out clauses, termination rights and seller remedies. After private equity buyers walked away from several deals by invoking "MAC" clauses or by paying relatively modest "reverse" termination fees, sellers are demanding stricter conditions for termination and greater compensation for busted deals. Parties are also focusing more closely on sellers' rights to specific performance and other remedies if the buyer breaches the agreement.

In addition to gauging the effects of the economy and the capital markets on their companies' business plans, boards of public companies should also keep in mind that this is an election year. Companies contemplating acquisitions or joint ventures with potential antitrust or environmental issues might want to accelerate those projects if they believe that the Democrats have a good chance of taking the White House since it is widely expected that a Democratic administration will be much tougher enforcing antitrust and environmental regulations.

Companies also might want to move up the timetable for any planned acquisitions in light of new accounting rules that will have a major impact on the financial reporting of M&A transactions next year. Under new FASB Statement No. 141(R), which will apply for fiscal years commencing after December 15, 2008, transaction costs (such as fees paid to investment bankers, attorneys and accountants), as well as most restructuring costs, will have to be expensed, which will impact earnings in the short term. In addition, the new rule requires greater use of fair value measurements, such that earn-out arrangements, acquired contingencies and in-process research and development will be subject to remeasurement in later periods, with any changes having to run through the P&L statement. Also, equity deals will face increased uncertainty because the equity that is issued in the transaction will have to be valued at closing, rather than at the time the deal is announced.

4. E-proxy

In July 2007, the SEC amended the proxy rules to allow companies to distribute their proxy materials over the Internet. Under the new rules, companies can satisfy proxy information delivery requirements by posting their proxy materials on the Internet and sending a notice to stockholders at least 40 days before the meeting. With the 2008 proxy season just around the corner, boards of public companies will need to decide quickly whether to use the new procedure or stick with the traditional method of mailing paper documents.

E-proxy is intended to make the proxy solicitation process easier and cheaper for companies. However, the jury is still out on the new procedure. Companies using the new method still must budget for the printing and mailing costs of at least some paper copies because shareholders can request delivery of materials in hardcopy. Companies also must make sure that their Web sites are up to date and easy to navigate for stockholders wanting to cast their votes, and companies must have their annual report and proxy statement completed in sufficient time to meet the 40-day notice requirement. In addition, some early adopters of e-proxy have experienced significantly lower turnout for their annual meetings. A study of 12 companies using the new method showed that only 3.4 percent of retail shareholder accounts voted at the companies' 2007 annual meetings, compared to 15.1 percent of retail accounts voting in 2006 when e-proxy was not available.[23] On the other hand, not all companies have had difficulties with the new procedure. Sun Microsystems, for example, did not experience any lower turnout for its meeting and did not have to resort to any supplemental mailings urging shareholders to vote.[24]

In view of the challenges of implementing e-proxy and some early results showing lower voter turnout, we expect most companies to adopt a "wait and see" approach before deciding whether to try the new method. While companies are expected to be slow adopters of e-proxy, the new procedure will likely be quickly embraced by activist shareholders who will be able to mount relatively inexpensive proxy fights via the Internet.

5. Succession Planning

Directors ranked CEO succession as one of the top three concerns for boards according to the 2007 National Association of Corporate Directors Public Company Governance Survey.[25] Although boards recognize the importance of CEO succession, nearly half of the survey respondents indicated that they did not have a formal plan for succession and consider themselves less than effective in the area of CEO succession.[26]

With the importance placed on CEO succession, why do boards fail at having effective plans in place? Perhaps it is because the current CEO is performing well so they think succession planning can wait, or because it involves uncomfortable conversations with the current CEO or because much of a board's time is spent addressing the day-to-day obligations so succession planning gets pushed to the backburner. Whatever the reason, boards need to turn their time and attention to addressing CEO succession and be sure they have a credible, specific and actionable CEO succession plan in place at all times. The departure of a CEO, whether it is a surprise departure or a planned retirement, has a significant impact on an organization's operations, culture and morale and the failure to have an effective plan to handle the situation can damage the company's credibility and erode shareholder value.

So what should boards be doing? Directors should periodically have in-depth discussions on CEO succession, preferably at least once a year. Boards need to have a clear understanding of the leadership talent and skills necessary for the position and potential candidates, both internal and external, should be identified. Boards should not wait for a CEO vacancy to get to know the candidates and their strengths and weaknesses. If the candidates are internal, the board should take a proactive role in grooming candidates for the position by ensuring they have the right leadership skills and are receiving necessary training for the CEO role. To minimize the disruption of a CEO's departure, boards should also have a process in place that details the board's plan for CEO succession, as well as the procedures and governance response necessary once a CEO has announced his or her departure. Selecting the right CEO is one of the most important actions that boards will take so it is critical that boards make an investment in CEO succession planning.

EXECUTIVE COMPENSATION

6. Pay Practices Under Fire

Executive compensation, already one of the most controversial topics in America today, will be an even hotter topic in 2008. The ongoing stock option backdating scandal, repeated incidences of hefty pay packages for executives of underperforming companies, and increased focus on the gap between executive compensation and employee wages continue to fuel a rising public indignation over executive pay. Over 77 percent of U.S. adults believe that senior executives are overpaid.[27] More than 90 percent of institutional investors think that executives are "dramatically overpaid."[28] Even two-thirds of public company directors believe that boards are having difficulty controlling the size of CEO compensation.[29]

The spotlight on executive compensation will be even brighter in 2008 as investors will have had the opportunity to digest additional compensation disclosures included in 2007 proxy statements. SEC rules adopted before the 2007 proxy season require companies to explain in plain English why they pay executives what they do, and to provide a "total compensation" number for each executive. The rules also require much more disclosure about fringe benefits and severance packages.

Disclosure in 2008 should be even more transparent after the SEC issued comment letters in September 2007 to 350 companies and provided additional guidance on how to comply with the new rules. Among other things, the SEC wants clearer explanations of how and why companies make compensation decisions. It also wants companies to disclose corporate and individual performance targets that are used in setting compensation, and, if a company chooses not to disclose these targets, to justify to the SEC why the disclosure would cause competitive harm. Although most companies decided not to include performance targets in their 2007 proxy statements, we expect to see more disclosure of these targets in 2008.

Directors, of course, often find themselves caught between a rock and a hard place when it comes to executive compensation. If the board does not pay enough to attract top talent, the board takes the heat when the company underperforms; if the board pays the rates necessary to attract and retain top talent, the board is criticized for excessive pay practices.[30] Defenders of the U.S. model for executive pay point out that it has created an enormous amount of shareholder value.[31] Also, there is strong demand for top executives, with U.S. companies competing not only among themselves, but also with private equity shops and foreign firms.[32]

Directors can, however, quell some of the criticism by ensuring that pay is tightly tied to performance, by avoiding outlandish severance packages and by cutting back on perks. Few topics stir the ire of investors more than reading about company-provided apartments, financial services, personal use of corporate aircraft and other perks provided to executives who already have what many perceive to be generous pay packages. Under the new SEC disclosure rules that lowered the threshold for reporting perks, disclosure of "all other compensation" for executives almost tripled from a median $270,000 in 2005 to $787,000 in 2006. [33]

Compensation committees and boards that do not adhere to good compensation practices will increasingly find themselves subject to shareholder "withhold the vote" campaigns. Institutional Shareholder Services (ISS) has adopted a policy that recommends withholding votes from compensation committee members if a company has what ISS considers to be "poor" compensation practices. ISS will also extend its withhold recommendation to include the CEO where it determines it is appropriate and to the entire board if the whole board was involved in and contributed to egregious compensation problems. When crafting compensation, compensation committees may wish to consider what ISS considers to be "poor" and "good" executive pay practices.[34]

Another pay practice drawing fire is the use by compensation committees of pay consultants who perform other work for the company. In October 2006 a coalition of pension funds sent letters to the 25 largest U.S. companies asking for disclosure on their compensation consultant practices and whether the company was willing to adopt a formal policy to assure the independence of pay consultants. Boards of 11 of these companies now ban their compensation consultants from performing any other work for the company.[35] More companies will likely follow their lead. A congressional committee investigating the issue released a report in December 2007 showing that nearly half of the 250 largest public companies receive advice from compensation consultants who also provide other services to the company and that median CEO pay was 67 percent higher at companies with the largest conflicts compared to companies whose consultants had no conflicts.[36]

7. Say on Pay

Say on pay proposals, which call for an annual shareholder advisory vote on executive compensation, are expected to be the hottest topic on corporate ballots in 2008. These proposals received support averaging 43 percent at 46 meetings in 2007, compared to an average of 40 percent support at seven meetings in 2006.[37] At eight companies, say on pay proposals garnered a majority of votes cast.[38] The say on pay movement has enjoyed such strong shareholder support that its proponents predict that the movement will eclipse the success of the campaign for majority voting for directors, which has resulted in two-thirds of S&P 500 companies implementing the majority vote standard.

Despite its success at the ballot box, say on pay has yet to be embraced by Corporate America. Of the eight companies where the proposal passed, only one (Verizon) has actually adopted a say on pay policy. Most of the other companies have responded by acknowledging that their boards will take the resolution under advisement, although Ingersoll-Rand went a step further in its response by inviting its top 20 shareholders, representing approximately 50 percent of the company's outstanding shares, to meet with the board to share their views on executive compensation. Only one other public company (Aflac) has adopted an advisory vote on executive compensation.

Companies that have received say on pay proposals have responded in a variety of ways. Rather than following the more typical approach of stonewalling proponents of shareholder proposals, many companies have entered into a dialogue with say on pay advocates in an attempt to reach a compromise short of the proposal being placed on the company ballot. Obviously, a company with good compensation practices has a greater chance of persuading activists to withdraw their proposal. Several large companies targeted by say on pay proponents have attempted to appease them by joining a working group that includes Pfizer, Intel, Bristol-Myers Squibb, AIG, Schering-Plough Corp., AFSCME, CalPERS and Walden Asset Management. This working group, which has held roundtable discussions on whether shareholders should have an advisory vote on executive compensation packages and on how such a proposal should be crafted, has yet to publish any consensus view.

If companies do not respond to say on pay, it is possible that Congress will respond. In April 2007 the House of Representatives passed a bill that would give shareholders an annual, nonbinding vote on executive compensation packages disclosed in proxy statements, as well as a nonbinding advisory vote on golden parachute packages in certain circumstances involving negotiations to buy or sell a company. Similar legislation has been introduced in the Senate, although its prospects are unclear. Even if such a bill finds its way through Congress, it is unlikely to become law during 2008. While acknowledging that some executive compensation is excessive, President Bush believes that Congress should not mandate the process by which executive compensation is approved. If say on pay legislation is enacted, the United States will join the United Kingdom, Australia, the Netherlands, Sweden and Norway in mandating shareholder votes on executive pay.

DISCLOSURE MATTERS

8. Softening Economy – Do you know where your risk factors are?

With signs of a softening economy and even talk about a possible recession, directors should ensure that their company's public disclosure documents adequately address the risks the company may face in the event of an economic slowdown. Litigation typically bears an inverse relationship to the economy, and plaintiffs' lawyers will be quick to pounce on companies that surprise the marketplace with poor performance. The fallout from the subprime mortgage crisis has already led to at least 32 class action lawsuits being filed against lenders, REITs and financial institutions, as well as their officers and directors, for alleged failures to adequately disclose credit risks.[39] The total number of securities fraud class action suits filed in 2007 jumped 43 percent from the prior year, with 100 of the 166 suits filed in 2007 being brought in the second half of the year as the subprime mortgage crisis unfolded and the stock market experienced increased volatility.[40] In December 2007 the SEC took the unusual step of sending letters to more than two dozen financial institutions and insurance companies reminding them of their upcoming Form 10-K disclosure obligations relating to investments in off-balance sheet entities.[41] As the consequences of the housing slump and subprime mortgage crisis ripple through the broader market, all companies should be assessing their exposure to credit risks in particular and to an economic downturn in general and revising their public disclosures accordingly.

9. Climate Change Disclosure Issues Heating Up

Investors are turning up the heat on companies to provide more disclosure about global warming risks and liabilities. More than 40 climate-related shareholder proposals were filed with public companies in 2007, compared to 27 the prior year.[42] Nineteen of these proposals were withdrawn after proponents reached agreements with companies on additional disclosure or other actions.[43] Of the 17 proposals that were voted on, support averaged 21 percent, with five climate proposals receiving more than 30 percent of the vote.[44] These results are noteworthy because social and environmental proposals historically have received less than 15 percent support.[45]

Several of the climate-related proposals went beyond disclosure issues and asked companies to set quantitative goals for reducing greenhouse gas emissions. These proposals won a surprising 31 percent of the vote at Exxon's annual meeting and 29 percent at General Motors. The shareholder proposals were not just targeted at energy and auto companies. Several retailers and home builders were asked to disclose their corporate strategies and performance on energy efficiency.

Government agencies are also turning their attention to corporate disclosure about climate risks. In September 2007 New York Attorney General Andrew Cuomo subpoenaed five major energy companies demanding information regarding their "analyses of climate risks" and their "disclosure of such risks to investors," inferring that the companies may be withholding material information from investors.[46] Also, in September 2007 a coalition of institutional investors and public interest groups petitioned the SEC to issue interpretive guidance clarifying that companies must carefully review the implications of climate change on their financial condition and operations and disclose any material climate risks in their periodic reports.[47]

Although it does not appear that the SEC will provide formal guidance on the issue in the near future, companies should evaluate their exposure to climate change risks in light of existing SEC reporting requirements to ensure that they are adequately disclosing any material risks. As part of that assessment, companies may also wish to evaluate whether it is prudent to take a more active role in addressing climate change issues, which are becoming more important to the general public. Over half of S&P 500 companies now respond to an annual questionnaire on climate change distributed by the Carbon Disclosure Project, a coalition of more than 315 institutional investors with over $41 trillion in assets under management. Although participation is voluntary, companies that choose not to respond to the questionnaire are often the target of climate-related shareholder proposals. In January 2007 the CEOs of 10 major U.S. corporations urged the Bush administration to support mandatory reductions in industrial greenhouse gas emissions,[48] and in November 2007, more than 150 of the world's largest companies petitioned a U.N. conference to craft measures to cut greenhouse gas emissions.[49] Companies are also increasingly incorporating their positions on the environment and global warming into "green" advertising and marketing campaigns.[50]

Climate change is only one aspect of the broader corporate social responsibility initiative, which has grown exponentially in recent years. [51] More and more companies are integrating corporate social responsibility into their businesses, as shareholders are asking companies to conduct their business in a socially and environmentally responsible manner. Several companies, including Coca-Cola, General Electric, Starbucks, Exxon and Nike, have published corporate social responsibility annual reports to, among other things, help shareholders understand what the company is doing to be a good corporate citizen environmentally, socially and ethically. Although social responsibility is of growing importance with many shareholders, in addition to the benefits of being socially responsible, boards must also weigh the consequences that could arise if corporate assets are deployed for social causes rather than profit as well as the potential liability if the company does not live up to the social responsibilities that it discloses to shareholders.

10. Increased Focus on Insider Trading

The SEC is devoting more attention to insider trading these days, and directors of public companies need to make sure that their company's insider trading policies and procedures are up-to-date and that all directors, officers and employees understand the consequences of violating such policies. Aside from the civil and criminal penalties that an individual may face, an insider trading scandal can seriously damage a company's reputation.

The SEC brought 47 insider trading cases last year and more can be expected in 2008. While many of the SEC enforcement actions involved insider trading by investment banking and hedge fund personnel, the SEC has also stepped up its scrutiny of trading pursuant to Rule 10b5-1 trading plans and trading by relatives of insiders.

The SEC began devoting more attention to Rule 10b5-1 trading plans after a December 2006 study revealed that trades made under these plans beat trades made outside of such plans by nearly 6 percent.[52] This study raised eyebrows at the SEC, with the director of the SEC's Division of Enforcement announcing that the Commission would take a "hard look" at whether these plans are being abused to facilitate trading based on inside information.[53] In the past year, the former CEO of Qwest was convicted of insider trading even though some of the questionable trades were made under Rule 10b5-1 trading plans and the CEO of Countrywide is under investigation for sales following amendments to his Rule 10b5-1 plan.[54] Although the safe harbor of Rule 10b5-1 is still available, the comfort level that directors and officers previously enjoyed when making trades pursuant to Rule 10b5-1 trading plans may be slipping away. Companies and insiders should carefully review any existing and proposed Rule 10b5-1 trading plans to ensure the plans follow "best" practices and that insiders are not able to manipulate them based on inside information.

An increasing number of SEC enforcement actions highlight the perils of "pillow talk." The SEC filed eight cases involving married couples in 2007, up from only one case in 2006.[55] In some of these cases, the spouse traded directly based on confidential information obtained from his or her spouse; in other cases, the spouse used offshore accounts or the accounts of other family members to buy or sell, or tipped off a family member or acquaintance. Insiders (or their spouses) often think they may be able to fly beneath the radar because the trade is small, or they have used the account of a relative or friend. However, the surveillance programs used by the stock exchanges and the SEC are so sophisticated that they can signal any unusual trading no matter how small or remote. Last year, the SEC was able to detect suspicious trading by a wife who had a different last name than her husband, and in another case, trading by a husband that netted only $15,000 in profit.[56]

[1] Edward Iwata, "Boardrooms Open Up to Investors' Input," *USA Today*, Sept. 6, 2007.

2 John Laide, "Shareholder Activism Continues to Increase While Takeover Defenses Decline," Jan. 7, 2008. Available at http://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs_20080107.html&rnd=267580. According to John Laide, product manager of FactSet SharkWatch, the activist campaigns considered in the study relate to any agitation for change, including proxy fights and efforts to have corporations sell divisions, complete stock buybacks or issue special dividends, among many other tactics. Some less high-profile activist efforts may also be included as an activist campaign, such as reports by activist hedge funds in government filings that they have had discussions with management about potential ideas to improve shareholder value. Posting of "More activists were circling prey in 2007" to Dealscape, Jan. 8, 2008. Available at http://www.thedeal.com/dealscape/2008/01/more_activists_were_circling_p.php.

3 Based on results reported in 101 proxy fights that had been announced as of January 4, 2008. An additional 9 proxy fights were pending as of such date. SharkWatch – Proxy Fights 2007 at http://www.Sharkrepellent.net (Jan. 4, 2008).

4 An independent shareholder forum was credited with helping secure a shareholder victory on a say on pay proposal at Verizon in 2007. Posting of "Verizon's Say on Pay: A Take-Away" to TheCorporateCounsel.net Blog, Nov. 5, 2007. Available at http://www.thecorporatecounsel.net/blog/archive/001505.html.

5 Ashwini K. Agrawal, "Corporate Governance Objectives of Labor Union Shareholders," Job Market Paper, Dec. 11, 2007.

6 Helen Avery, Hedge Fund Activism Debate: *The Real Face of Active Investing*?, EUROMONEY, February 2007.

7 "Hedge Funds and Shareholder Activism," *The Altman Group Advisor* (The Altman Group, New York, N.Y.), December 2006, at 1-2. (The Altman Group reports that of 75 instances of threatened or actual proxy contests by hedge funds tracked in 2006, the hedge funds were successful 60 percent of the time either through an actual contest or in a negotiated settlement.) April Klein & Emanuel Zur, "Hedge Fund Activism" (European Corporate Governance Inst., Finance Working Paper 140/2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstractid=913362. (Klein and Zur report that in a study of Schedule 13D filings by hedge funds from January 2003 through December 2005, hedge funds had a 72 percent success rate (30 of 41) when they stated a demand for board representation, and a 60 percent success rate with respect to achieving some or all of their demands made in the initial Schedule 13D filings.)

8 John Laide, *supra*.

9 Sharkrepellent.net, *supra*.

10 Sharkrepellent.net, *supra*.

11 Posting of Chris Young, "2007 Review: M&A, Proxy Fights," to Risk Metrics Group blog, Nov. 12, 2007. Available at http://blog.riskmetrics.com/2007/11/2007_review_ma_proxy_fightssub.html.

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