

## BRAZIL

The CVM changes its disclosure rules...6

## CHINA

New Guidelines on Executive Pay...3

## JAPAN

Major Airline Carrier JAL files for bankruptcy protection...5

TSE Revises Rules...4

## SWEDEN

Corporate Governance Code Improvements...2

## UNITED STATES

Trouble over Shareholder Proposals at Apache...1

New SEC Guidance on Proxy Disclosure...4

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## Apache Sues Chevedden over Eligibility to Submit a Shareholder Proposal

Long-time shareholder activist John Chevedden hit an unexpected roadblock this month in his efforts to initiate governance reforms at the oil and gas giant, Apache Corporation. On January 8, the Texas-based company **sued Mr. Chevedden in federal court** for his alleged failure to provide proof of ownership, as required under SEC Rule 14a-8 (b), in submitting a shareholder proposal for inclusion at the 2010 annual meeting. The Com-



Apache Corporation Headquarters in Houston, TX

pany seeks both a declaration by the Court to properly exclude the proposal and to recover court costs from Mr. Chevedden. Unless the Court rules otherwise, Apache intends to omit Mr. Chevedden's proposal from its upcoming meeting.

Mr. Chevedden submitted his proposal to eliminate supermajority vote requirements on November 8, 2009, with a statement that he intended to meet minimum ownership requirements. On November 27, Mr. Chevedden submitted

another letter from RAM Trust Services, an introducing broker, which claimed that ownership requirements had been met. Apache responded on December 3, stating that neither RAM Trust Services, nor Mr. Chevedden, were record holders according to Apache's list of record. A week later, Mr. Chevedden forwarded another letter from RAM Trust stating that Mr. Chevedden's ownership was held by custodian Northern Trust. Apache states in its complaint against Mr. Chevedden that Northern Trust is also not specified in its list of record.

In an unusual move, Apache did not request a no-action letter from the SEC; rather, the Company **filed notice** with the SEC that it intends to omit the proposal. Apache acknowledges in its correspondence that the agency's staff had previously declined to allow the exclusion of a shareholder proposal under similar circumstances in an October 2008 ruling related to Hain Celestial Group's no action request. In the Hain decision, the SEC staff took the view that a statement from the proponent's broker-

dealer constituted a written statement from the record holder of the securities, and thereby satisfies the proof-of-ownership requirements under the federal proxy rules. However, this informal decision by the Commission regarding no-action relief is non-binding in a federal court.

The federal district court will now decide what constitutes sufficient proof of ownership, and a ruling

unfavorable to Mr. Chevedden may substantially increase the burden on shareholders when submitting proposals. If Apache is able to receive a declaratory judgment, other companies may adopt a similar tactic of bypassing the SEC and going directly to federal court to exclude proposals akin to the one submitted by Mr. Chevedden. Furthermore, if proving ownership becomes too opaque or costly, it

will likely curtail individual shareholders from submitting proposals that are often broadly considered within the purview of shareholder rights, such as the ability to call a special meeting, vote annually on director nominees, and to be represented by an independent chairman. Given the potential chilling effect on the shareholder franchise, we will closely monitor this developing situation.

## Sweden: Improvements to the Corporate Governance Code

On February 1, 2010, the revised Swedish Code of Corporate Governance comes into effect. The revisions contain several positive developments for the governance of Swedish companies. The new Code has an impact on executive compensation, company disclosure, and provides several clarifications due to changes in the law.

The most significant change is the inclusion of guidelines published in the EU Commission's recommendation on directors' remuneration (2009/3177/EC). Shareholders of Swedish companies already have the ability to vote on the compensation guidelines for executives. With the new Code, there are several recommendations regarding the structure of compensation for directors and executives. One new recommendation proscribes a minimum 3-year vesting period for share-related compensation, which should also be tied to performance criteria, and severance pay should be maximized at the equivalent of 2 years' base salary. Variable cash compensation—whether performance related or tied to synthetic options—should be maximized at either an absolute amount or as a percentage of base salary. Non-executive directors should not receive options, and

should not participate in incentive programs designed for executive management. The impact on actual practices will be limited; these recommendations are already followed in practice by most Swedish issuers. However, with the formalization of the recommendations it will be easier for shareholders to identify those companies whose practices divert from the local best practices.



The NASDAQ OMX Stockholm exchange

In addition, the Code now more clearly states that the compensation committee prepares matters regarding executive pay that are decided upon by the whole board, thereby specifying that all board

members can be held accountable for a company's compensation practices. The committee is responsible for monitoring any ongoing or terminated compensation plans, and for evaluating the application of the compensation guidelines approved by shareholders.

Following amendments to relevant legislation— primarily the Swedish Companies Act and Annual Accounts Act—several minor changes have been made to the recommendations. The Code rule that an issuer has to produce a corporate governance report has been removed, as that is now a requirement in the Annual Accounts Act. Companies are now required to state the code rules with which they don't comply, and clearly state the reasons for each case of noncompliance and describe the alternative solution. While the comply-or-explain principle is already required by law, companies are not required to present the alternative solution chosen. Also, the Code now specifies that it is the reason for noncompliance, and not the reason for the alternative solution, that is to be explained.

New rules regarding disclosure are also being introduced. The cor-

porate governance section of an issuer's website must now contain a corporate governance report for the last three fiscal years, including the auditor's statements on its audit of the reports. The website must contain updated information regarding any changes to the board, the CEO, the auditor, or the compensation policy or active share-related programs. Such changes must be reflected in the information on the website within seven days of a change. In addition, the board must publish its (or the compensation committee's) evaluation of active incentive plans and ones terminated in the last fiscal year.

One additional change, that should have little effect on issuers' actual practices, and on shareholder value, is the reincorporation of

director independence criteria in the Code. The first version of the Code, published in 2005, contained criteria for assessing a director's independence. However, following the inclusion of the criteria in the listing rules of the NASDAQ OMX Stockholm stock exchange, they were removed from the Code in its subsequent versions. However, the latest version of the listing rules does not contain independence criteria, and so the new Code entails a return to the rule on independence that was included in the original Code.

The new changes are, we believe, a positive development in the Swedish corporate governance framework. Incorporating the EU Recommendation on directors' remuneration will serve to provide shareholders and companies with

a more solid framework with which to evaluate compensation plans and practices. Improving and clarifying the rules regarding oversight and disclosure for compensation will allow for more transparency, and further the development toward more standardized practices and improved shareholder awareness. Clearer references to legislation, and separation between comply-or-explain recommendations and rules mandated by legislation should serve to more easily outline requirements for smaller issuers and shareholders. All in all, Swedish corporate governance regulations and disclosure are already at a very high international level. The new Code should serve to continue this trend, and help further integrate local practices with regional and international standards.

## New Guidance for Executive Compensation in China

State-owned enterprise executives in China have been facing the public scrutiny over so-called "astronomical salaries." The Department of Human Resources and Social Security along with six other departments, recently jointly issued a regulation entitled "Guidance on Further Standardization of the Compensation of Executives in State-owned Enterprises." This is the first time that the central government has addressed compensation regulation aimed at all state-owned enterprise executives.

Although no concrete regulation like the United States' \$500,000 cap on executive compensation exists, this Chinese version of limited compensation regulation is the first document to clarify certain standards for executive pay. Namely, that state-owned enterprises executives' basic annual salary and the previous year's average wage of

state-owned enterprise employees are linked, and that performance-based salary is determined by an annual business performance evaluation.

According to the new regulation, corporate executive compensation is divided into three parts: basic salary, performance-based annual salary, and long-term incentive benefits. While corporate executives receive a basic monthly salary, the performance incentive annual salary is based on an "evaluate first, pay later" principle.

Long-term incentive benefits, recently the subject of controversy, received a more cautious approach, and were labelled "prudent to explore" as a principle.

The income gap between state-owned enterprise executives and other employees has long been a hot topic. In 2002, China began

to regulate salaries to a level not over 12 times the average wage of other employees. Since then, however, this figure has been tested by executives in state-owned finance, telecommunications, petroleum, tobacco, and other enterprises, who are often paid far more.

With the goal of establishing a performance-based compensation system, this "limited salary regulation" aims to create an effective mechanism that closely links executive performance-based annual salaries to business performance.

In the future, new tax laws to control compensation will likely be put in place, similar to those which exist in the United States.

As China continues to grow, executive compensation will likely remain a topic of heated debate. How regulators cope with the changing global milieu remains to be seen.

## The SEC's Interpretative Guidance Regarding its Proxy Disclosure Enhancements

On December 16, 2009, the Securities and Exchange Commission approved amendments to the proxy disclosure rules to enhance public company disclosures regarding risk, compensation and corporate governance. The new disclosure requirements include the following key items:

- A discussion of the risks associated with compensation policies and programs if the risks are "reasonably likely to have a material adverse effect" on the company;
- Reporting the "fair value" of stock and option awards granted during the fiscal year;
- Director and nominee qualifications, background and diversity;
- The board leadership structure;
- The board's role in risk oversight;
- Compensation consultant independence; and
- Reporting vote results on Form 8-K.

These new requirements were discussed in detail in our 2010 Proxy Season Preview published in January.

On December 22, 2009, the SEC's Division of Corporation Finance

issued new **Compliance and Disclosure Interpretations** regarding transitioning to the new disclosure rules. These enhanced disclosure requirements will apply to proxy statements, as well as annual reports on Form 10-K, that are filed on or after February 28, 2010 for companies with fiscal years ending on or after December 20, 2009. A company may elect to voluntarily comply with the new disclosure requirements before it is required to do so, but if it elects to comply with the new disclosure requirements relating to the reporting of stock and option awards, it must also comply with all of the other Regulation S-K amendments that apply to the form being filed.

On January 20, 2010, the SEC's Division of Corporation Finance issued nine more **Compliance and Disclosure Interpretations** related to the new disclosure rules.

Among other things, the SEC provided the following guidance regarding the new rules:

- The disclosure of each director or nominee's experience, qualifications, attributes or skills must be provided on an individual basis, with regard to each person's particular and specific experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company;
- The informational requirements related to directors and nominees apply to all directors on the board, including any director who is not up for re-election due to the classification of the board, stating why the director should continue serving on the board; and
- The types of additional fees paid to the compensation consultant that must be disclosed under the new rules depend on the facts and circumstances of each service. Fees for consulting on broad-based, nondiscriminatory plans in which executive officers or directors participate and for providing information relating to executive and director compensation, such as survey data is not subject to disclosure if they are the only services provided. However, fees for benefits administration, human resources services, actuarial services and merger integration services are "additional services" subject to the disclosure requirements.

## Tokyo Stock Exchange Revises its Listing Rules

The TSE revised its listing rules in December (the TSE announced the revision on 12/22 and the revised rules were effected on 12/30), and **will now require TSE-listed companies to appoint at least one independent board member to either the board of directors or the board of statutory auditors beginning in June 2010**. The TSE will give issuers a one-year grace period, only enforcing the rule beginning in June 2011. Under the new rule, a board member with a certain affiliation to the company will not be considered 'independent,' or the company must explain why it considers him/her independent despite conflicting interests.

A number of parties, including the new DPJ administration, as well as the Ministry of Economy, Trade, and Industry and the Financial Services Agency have pushed for greater independence as a road to attracting capital to Japan's markets. The Japan Pension Fund Association, the Japan Association of Corporate Directors, and the Asian Corporate Governance Association, too, are just some of the groups joining the chorus of demand for directorial independence on Japanese boards. Until now, there has been no definition of 'independence' for directors or statutory auditors, and affiliates often serve as so-called 'external' directors and

auditors. This traditional lack of true independence has led critics and investors to question whether there are sufficient systems in place in Japan to serve as a check on management.

The concerns over the absence of the definition of independence and independence requirements have sparked much discussion in recent years, and have perhaps led to the TSE's latest step of adopting the new rule on board structure. While there is still much distance to be covered in Japanese governance practices, this step will surely change the conversation on insider-friendly practices in the country.

## Inside the JAL Bankruptcy: a Revealing Look at Corporate Governance in Japan

On January 19, 2010, Japan Airlines Corporation filed for bankruptcy protection, giving it the dubious distinction of being the largest non-financial company to ever file for bankruptcy in Japan, and prompting heated discussion about the role of government in publicly traded companies.

JAL was privatized in 1987, but the government retained close ties to the company throughout the years. Pork barrel policies under the LDP whereby government transportation officials forced the Company to fly money-losing routes and to build airports in sparsely populated areas simply to boost construction, along with the practice of placing retired government bureaucrats within the Company management structure allowed the government to remain deeply involved in Company affairs. The state-owned Development Bank of Japan is a main creditor for JAL, as well.

The Company's financials are dire. It carried ¥2.3 trillion in debt as of September 30, 2009, its share price has fallen from around ¥90 on January 5th to a recent all-time low of ¥2, breaking stock market trading records. The market value of this group, known until now as the largest carrier in Asia, is now approximately only 150 million dollars. It had more than 446,000 shareholders as of last March, and retail shareholders comprised over 60% of that number.

The Japanese government has been critical of shareholders, with the prime minister taking a hard-line stance, stating that shareholders should take general responsibility for the situation at JAL, and in so doing, implying that some of the blame for the Company's failure rests with shareholders and retir-

ees with pensions. Many, however, cite government intrusion into Company affairs as a main reason for recent troubles.



Established in 1951, JAL remains Asia's largest carrier by revenue despite losses.

JAL has already been bailed out by the LDP government three times in ten years. Until recent events, JAL was the prototypical example of corporate behemoths that accrued monstrous debt, failed to strategically manage resources, and yet could still count on a government bailout. Not only did the Company lack strong governance, but the recent economic crisis, along with unpredictable fuel costs and falling passenger numbers, hit the Company hard at a time when the new DPJ government was promising to end profligate spending.

Though the LDP put up major roadblocks for the Company to file bankruptcy protection, with the DPJ newly in power, the government has appeared both willing and able to force JAL to restructure, showing its creditors as well as smaller businesses that the government will not always bail out companies in crisis. Under the LDP, allowing the Company to file for bankruptcy would have been unimaginable.

In October of 2009, the "JAL Task Force," a group comprised of

business restructuring specialists and established by the Minister of Land, Infrastructure, Transport, and Tourism, was commissioned to ensure a restructure of the Company in line with government standards. The Company has since applied for assistance from the Enterprise Turnaround Initiative Corp of Japan ("ETIC"), a quasi-governmental group comprised of specialists that purchases the debt of troubled companies with state money.

By filing for bankruptcy protection, the Company will receive the help for which it applied, as well as \$10 billion from the government through capital injection. Its top lenders have agreed to waive ¥730 billion in debt owed them, and the ETIC will continue to head the restructuring effort. Preliminary reports from JAL state that Kyocera founder, respected business leader, and industry outsider Kazuo Inamori will take over as president. The government will also provide public funds for the Company to use to continue its operations as it undergoes these structural changes. Over 15,000 jobs are slated to be cut, international money-losing routes will be reduced, pensions will be reduced by up to 50%, and shareholders will be wiped out. Delisting will occur on February 20.

The developments at JAL have laid bare some of the most contentious issues in Japanese corporate and political governance. The relationship between major corporations and the government has always been friendly under LDP rule, but how the DPJ will balance its promise to end wasteful corporate practices with its long-term and national political self-interest remains to be seen.

## Major Changes for Brazilian Corporate Governance

The Brazilian Securities Commission (“CVM”) has recently given serious attention to the matters of information disclosure and proxy solicitation, changing the regulations that govern these areas.

The CVM released a statement of its goals, which are to improve information disclosure quality, lower costs for shareholder participation, and in so doing, facilitate the supervision of public companies. Through the CVM’s recently released “Instruction 481,” a number of major changes will be implemented around these topics.

### *Availability of information*

The director of investor relations will be responsible for more tasks under the new rules. Along with his responsibility to communicate with shareholders, he will be required to ensure disclosure of a greater amount of information than was previously required by companies.

Included in this increased disclosure is an electronic disclosure rule – all general meeting documents and information will be put on CVM’s website on the same date of the meeting notice publication.

Issuers will have to provide supplementary information for resolutions regarding amendments to bylaws; election of directors and supervisory (council) members, director and executive remuneration, stock option plans; amendments to the terms of preferred shares, reduction of mandatory dividend, and acquisition of control of another company, among others. Further,

issuers will have to disclose managerial discussion and analysis of the financial situation of the company.

### *Proxy solicitations*

Proxy solicitations are also addressed in this most recent regulation from the CVM. Proxy solicitations must be directed to all shareholders holding voting rights, must be accompanied by a power of attorney, and must identify the people who sponsored the proxy. Shareholders who hold at least 0.5% of the share capital of a company that has adopted electronic voting may request that the company include their solicitations on the company’s proxy. At companies that have not yet adopted an electronic proxy voting system, companies will reimburse shareholders for up to three newspaper announcements and for printing and shipping costs of proxy solicitations. Reimbursement rates are 100% for proposals with successful voting outcomes, and at least 50% for proposals that fail to pass. If the company adopts electronic voting, reimbursement will be waived, thus incentivizing its adoption.

Shareholders who hold at least 0.5% of the share capital of a company may request a list of shareholders ranked by number of shares held (but without disclosing actual amounts held) free of charge.

As of January 1, 2010, every company listed in Brazil is subject to these new rules, a hopeful sign that Brazilian corporate governance will assist the country’s publicly traded companies in their rise to capital market success.

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