

# Corporate Governance Learning Center

## Glossary of Corporate Governance Terms

### A

#### **Adjourning, or continuing, a shareholder meeting:**

Extending the voting period past the meeting date, usually so the company can continue to solicit proxies to pass a management proposal or kill a shareholder initiative. A recent Delaware Chancery Court opinion (State of Wisconsin Investment Board v. Peerless Systems) put companies on notice that they will have to meet a tougher standard of review if they adjourn a meeting in order to interfere with the results of a shareholder vote.

#### **Advance notice provisions:**

To prevent surprises at the annual meeting, many companies have adopted provisions specifying a precise time period (usually well before the meeting) during which shareholders must provide notice of their intention to nominate directors or present other business from the floor. If they do not meet the advance notice requirements, the company can bar them from nominating their candidates or bringing up their business at the meeting.

### B

#### **Blank check preferred stock:**

Preferred stock for which the board of directors has broad discretion to establish voting, dividend, conversion and other rights when the stock is issued. It gives the board flexibility to meet changing financial conditions, but it also could be used for defensive purposes, such as for a poison pill or for placement with a friendly investor to block a takeover attempt. The Council's policy is that authorized unissued common shares that have voting rights to be set by the board should not be issued without shareholder approval.

#### **Board diversity:**

Generally, having minorities and women represented on corporate boards. Some shareholder proposals also urge diversity of experience and age.

#### **Board evaluation:**

It is the Council's position that boards should conduct evaluations of themselves and their individual members on a regular basis-including whether the board has the necessary diversity of skills, backgrounds, experiences, ages, races and genders appropriate to the company's ongoing needs.

#### **Broker votes:**

Proxy votes that can be cast by brokers when no voting instructions are received from the beneficial owner within a specified period before a company's annual meeting (usually 10-15 days, under stock exchange rules). Broker votes are allowed on issues that are not "contested," as defined by the exchange, or that do not fall in one of 18 specified areas. (When no voting instructions are received and the issue is one that may not be voted on by brokers, brokers deliver so-called broker non-votes. Companies often say they need these votes to get a quorum.)

Opponents of broker votes say they amount to "stuffing the ballot box" for management, allowing some stock option plans to pass that might not otherwise do so and gutting "just vote no" campaigns against directors, which the exchanges don't consider "contests." The Council opposes the use of broker votes for anything except achieving a quorum for a shareholder meeting, and has urged the SEC to prohibit broker voting without client instructions.

## C

### **Change-in-control provisions:**

Provisions in executive compensation plans that allow plan participants to cash out options or accelerate benefits in the event of a change in control (sometimes called golden parachutes). The provisions may be explicitly written into a plan when it is adopted, or may simply give the board or compensation committee broad discretion to adjust awards when faced with a change in control. Some executive severance agreements provide payments in the event of the executive's departure regardless of the reason. The U.S. Internal Revenue Code considers such payments "excessive" if they exceed 2.99 times an executive's average annual compensation package.

### **Class action:**

A civil lawsuit brought against a company by a group of persons (the class) similarly affected by the alleged misconduct of corporate officers and directors. Any recovery, less legal fees, is divided among all members of the class in proportion to their losses. Class action suits often allege false and misleading corporate statements, securities fraud or other breaches of directors' duties to the shareholders.

### **Classified board:**

On a classified, or staggered, board, directors are divided into separate classes, usually three, with each class serving overlapping three-year terms. Companies say this provides stability and continuity of leadership, but it also makes it harder for dissidents to win control of a target company, even if they win a proxy fight, since only a third of the directors are up for election in any one year. (Classification also reduces the effectiveness of cumulative voting by requiring a greater shareholder vote to elect a single director.) Aside from the antitakeover aspect, many shareholders believe that, as a matter of accountability, all directors should have to stand for election every year; indeed, that is the Council's No. 1 core corporate governance policy. Classified board provisions often are adopted along with supermajority vote requirements to amend or repeal the provisions; these are known as lock-in provisions; and they may make it difficult for a company to get enough voting support to repeal a classified board even when it wants to.

### **Confidential voting:**

Use of a secret ballot for shareholder votes, with results tabulated by an independent tabulator. Supporters say secret ballots reduce pressures and potential conflicts of interest faced by fiduciaries that vote shares on behalf of others. The Council supports confidential voting and urges that confidentiality be permanent.

### **Counting shareholder votes:**

The way a company tallies proxy votes. Companies historically have counted votes in varying ways. Most specify in the proxy statement the vote required for passage of management proposals (majority of

outstanding shares, majority of shares voting, or supermajority vote). The method is often murkier on shareholder proposals, with some firms requiring a majority or supermajority of the outstanding shares for passage, or including abstentions and broker non-votes in the total votes cast, thus reducing the vote in favor of the resolution. The Council's policy is that broker votes and abstentions should be counted only for purposes of obtaining a quorum, and not as "yes" or "no" votes on voting items.

**Cumulative voting:**

If cumulative voting is allowed at a company, shareholders can allocate the total number of votes they are entitled to cast in the election of directors in any fashion they wish—all for one candidate, split among two or three, or divided evenly among all director nominees. (The total number is equal to the number of directors to be elected at the meeting multiplied by the number of shares eligible to be voted.) This may enable holders of a minority stake to elect one or more directors if they vote all their shares for a single nominee or small, select number of nominees. It has been touted as a way for institutional investors to improve corporate governance by electing qualified, independent, accountable directors to boards, although companies say it could lead to a "constituency" representation and a divided board. While nearly half the states once mandated cumulative voting in corporate elections, most now leave it up to companies, and most companies have eliminated it.

**Cyber meetings:**

Delaware recently changed its corporate law to permit companies to hold their annual meetings by "remote communication" rather than at a specific site. Some observers now worry that the traditional face-to-face shareholder meeting may become an endangered species. While many agree that annual meetings are inconvenient, time-consuming and antiquated, shareholder activists want to be able to see and address questions to the directors they elect to represent them.

D

**Derivative suit:**

A lawsuit brought by a shareholder on behalf of the corporation to remedy an alleged wrong to the corporation. Any settlement goes to the company, not to specific shareholders. Corporate governance or board changes, designed to help prevent the recurrence of the alleged breaches of directors' duties, are sometimes included in the settlement of class action and derivative suits.

**Dilution:**

When stock options are exercised, a company's profits and assets are spread over a larger number of shares, thus reducing, or "diluting," the value and voting power of existing stockholders' shares. Shareholders often consider the total potential dilution from all of the company's option plans, including outstanding options and shares available for future grant, when voting on a new option plan proposal.

**Dual class stock:**

Some companies have two or more classes of common stock, whose voting rights may vary. One class may have super voting rights (five or 10 votes per share), or a fraction of a vote, or no vote. Sometimes one class has special rights, such as the right to elect a certain percentage of the directors. One class is often held by a founding family or controlling shareholder to retain control of the company even though

they don't own a majority of the stock. Dual class capitalization plans are not antitakeover measures per se, but they may help management (or another insider group) deter a takeover when they control the class of stock with higher or special voting rights.

## **E**

### **Equal access to the proxy statement:**

Giving shareholders access to corporate proxy statements for the purpose of nominating directors or commenting on the performance of the incumbent board, as some shareholder proposals have called for over the years.

### **Executive compensation packages:**

Executive compensation packages, including base salary, bonuses and stock awards, are governed by the compensation committee of the board, which approves them initially and has the discretion to change them. Shareholders' only say in the matter usually has been in voting on proposed stock option plans or on requests to increase the number of authorized shares (which may be needed to implement option plans, among other things). Under federal law, companies can get a tax deduction for compensation packages of over \$1 million paid to their top five executive officers only if the stock and cash bonus plans are "performance-based." Companies set their own criteria for that.

Although many shareholders feel executive compensation has gotten out of control, most shareholder proposals on the subject don't receive very high votes. Shareholders say they favor "pay for performance," but defining that term is sometimes difficult, and even when performance is demonstrably poor, shareholders have little recourse if executives continue to be rewarded with generous pay or severance packages. It is a Council policy that the annual approval of at least a majority of a company's independent directors should be required for the CEO's compensation, including any bonus, severance, equity-based and/or extraordinary payment.

## **I**

### **Independent board chair:**

A board chairman who meets the criteria for independent directors. This definition goes beyond simply separating the positions of chair and CEO. It means that not only should the CEO not be the board chair, but neither should the former CEO, another company employee or anyone else with ties to the company.

### **Independent directors:**

Directors whose only nontrivial professional, familial or financial connection to the corporation or its CEO is their directorship. Directors who are not considered independent under the Council's definition are: executives of the company; paid advisers or consultants of the company such as lawyers, accountants and bankers; employees of a significant customer or supplier; anyone with a personal services contract with the company or the CEO; anyone affiliated with a foundation, university or other non-profit organization that receives significant grants or endowments from the company; relatives of the CEO or other executives of the company; and those who are part of an interlocking directorate (where the CEO or other executive serves on the board of the company that employs the director).

Various groups apply lookback criteria under which they continue to define directors as non-independent for a specified period (usually two, three or five years) after the director's affiliation with the company ceased. Under the Council's definition, a person in any of the above categories would not be considered independent for a period of five years after the relationship ended.

## **J**

### **Just vote no campaign:**

A solicitation urging shareholders to withhold their votes from a board as a way of "sending a message" regarding the company's performance or a specific corporate governance issue. Such efforts, usually involving letters to shareholders and press releases, call attention to the reasons for opposing the board, and often result in a substantial number of votes being withheld, at a cost far below that for conducting a full-fledged proxy contest.

## **L**

### **Lead director:**

A director elected from among the board's independent directors to serve as their leader at companies where the CEO is the board chair. The lead director would consult with the CEO/chair on the makeup of board committees, meeting agendas, board procedures, the adequacy of information given to the board and other issues, and convene executive sessions of the independent directors to assess CEO and corporate performance, conduct board evaluations, etc.

### **Lead plaintiff:**

The shareholder chosen by the court to direct class action litigation. The lead plaintiff usually selects the lead counsel. The court may appoint co-lead plaintiffs.

## **M**

### **Majority of independent directors:**

There is widespread support in both the shareholder and business communities for having a majority of independent directors on corporate boards. The Council's core policies call for at least two-thirds of the board and all members of its audit, nominating and compensation committees to be independent directors.

## **N**

### **Nomination and election of directors:**

Most director nominations are made by the company's nominating committee or full board, with the approval (or upon the recommendation) of the CEO and sometimes with the help of a search firm. Some companies say they will accept nominations from shareholders; some will not. No companies nominate more candidates than there are seats up for election, so unless there is a proxy contest, shareholders have no choice of who to vote for. Thus the "election" of directors actually is a ratification of the company slate. The Council's position is that shareholders should have "meaningful opportunities" to suggest or nominate director candidates, as well as to suggest processes and criteria for director selection and evaluation.

In 1991 the Council endorsed a shareholder proposal calling on companies to nominate two more candidates for the board than there were vacancies, to give shareholders some choice; the proposal also would have required boards to implement procedures to ensure that at least two candidates would be nominated by shareholders, unless they had some good fiduciary reason not to include them on the slate. A current shareholder proposal by the group Responsible Wealth calls on companies to nominate 50 percent more director candidates than the number of seats on the board.

## O

### **One share, one vote:**

One of the Council's bedrock principles-part of its original "Shareholder Bill of Rights"-is that each share of common stock should have one vote per share.

The New York Stock Exchange had a one share, one vote listing standard for 70 years, but proposed to abandon it in 1985 in what critics called a "race to the bottom" among the stock exchanges. The SEC then adopted a rule (Rule 19c-4) barring companies from issuing stock with super voting rights that would disenfranchise existing shareholders, but the rule was struck down in the courts. The stock exchanges subsequently adopted a "uniform voting rights policy" that barred disparately reducing or restricting the voting rights of existing common shareholders through the use of time-phased voting and other unequal voting rights schemes (see below), but allowed companies that already had unequal voting rights to keep them and allowed companies to create them in initial public offerings or if the firm is in "financial distress." The Council believes corporations should not have classes of common stock with disparate voting rights.

### **Other unequal voting rights:**

Unequal voting rights provisions limit the voting rights of certain types of shareholders or grant special rights to others. For example, time-phased voting gives shareholders who have owned their stock for a certain length of time (such as four years) more votes per share than more recent purchasers; substantial shareholder provisions reduce or cap the voting power of a large shareholder once a certain ownership threshold, such as 10 or 20 percent, has been reached.

## P

### **Poison pills:**

Also known as shareholder rights plans because, in the event of a hostile takeover attempt, they give shareholders (except for the would-be acquirer) the right to buy stock in their own company or in the acquiring company at a deep discount, usually half price, if the bidder acquires a certain percentage (usually 15 or 20 percent) of the outstanding shares. Shareholders consider pills one of the most potent antitakeover measures, but companies say they simply force a would-be acquirer to negotiate with the board. If the board approves the deal, it can redeem the pill; if not, and the potential acquirer were to proceed anyway, the pill could be triggered. With other shareholders then able to buy shares at half price, the target company would become financially unattractive and the voting power of the potential acquirer would be diluted-i.e., acquiring the company under those terms would be like swallowing a poison pill.

**Private Securities Litigation Reform Act of 1995 (PSLRA):**

The federal law aimed at reducing the number of "meritless" lawsuits brought against corporations. In passing the act, Congress sought to encourage the appointment of institutional investors as lead plaintiffs in securities fraud class action suits.

**Proxy contest:**

A solicitation by a dissident shareholder or group for seats on a company's board. (Shareholder campaigns in opposition to certain management proposals, such as a merger or a dilutive stock option plan, are also sometimes referred to as proxy contests, but generally the definition refers to a fight for seats on the board.)

**R****Repricing or replacing of options:**

The practice of repricing outstanding underwater options at new, lower exercise prices, or canceling the underwater options and replacing them with new, lower-priced options. Companies say adjustment of out-of-the-money options is necessary to retain key employees when the stock price falls, but many shareholders feel it is unfair to cushion losses for managers when the shareholders are losing money on the stock. Shareholder approval is not required for repricing, although as a result of shareholder efforts, some companies have agreed not to reprice or replace options without it. Council policies call for no repricing or replacing of underwater options unless the shareholders approve the action.

**S****Securities Litigation Uniform Standards Act of 1998:**

Federal law requiring that securities class action suits against nationally traded companies be brought only in federal courts, and setting standards for bringing the suits. It was intended to prevent the shifting of securities suits from federal to state courts, frustrating the intent of Congress in passing the PSLRA (see above).

**Shareholder approval of stock option plans:**

One of the most contentious corporate governance issues in recent years. The New York Stock Exchange in 1998 changed its listing standard on the subject, allowing many option plans to be adopted without shareholder approval. After an outpouring of shareholder opposition, it also promised to adopt a dilution standard worked out by a task force of corporate representatives and institutional investors, but to date it has not done so.

It is Council policy that shareholders should have the opportunity to vote on all equity-based compensation plans that include any director of the company and on any plan where the number of reserved shares, together with the company's outstanding equity-based awards and shares available for grant, may have a material impact on the capital structure of the company and the ownership interests of its shareholders (generally, 5 percent dilution).

Shareholders' rights to act by written consent or call a special meeting:

Some companies have adopted charter or bylaw amendments that restrict or prohibit shareholders

from taking action by written consent or calling a special meeting. They may require a high supermajority or unanimous consent to approve an action, or ban the practice outright. Council policies say shareholders' rights to call a special meeting or act by written consent should not be eliminated or abridged without shareholder approval.

**Short slate:**

The nomination of one or a few directors by dissident shareholders, allowed by an SEC rule adopted in 1992 as part of its proxy rule reform. Under the rule, the shareholders can nominate one or more directors for a board and then indicate which management nominee(s) they will withhold their votes from to make room for the new candidate(s). The rule is intended to allow shareholders to replace one or more directors without seeking control of the company.

**Stock option plans:**

Options to buy company stock in the future for a specified price, either the fair market price; a discount price (which the Council opposes); a premium price or a price indexed to company performance (which the Council supports). Stock options now make up a sizable portion of most executive pay packages. In many cases, they are given to all, or a large portion, of company employees.

**Submitting shareholder proposals:**

Resolutions submitted by shareholders for inclusion in company proxy materials to be put to a shareholder vote. Most shareholder proposals are precatory-i.e., advisory. They are merely recommendations to the board, and are not binding, although many shareholders (and the Council) take the position that the board should implement the proposals if a majority of the shares vote in favor of the proposal. Since most boards do not do so, shareholders in recent years have begun filing binding proposals, which, if passed, require the board to implement the proposal-by amending the company's bylaws to eliminate the classified board or by redeeming the poison pill, for example. Companies have fought the proposals, saying shareholders do not have legal authority to override board decisions, but the issue has not yet been decided in the courts. The Oklahoma Supreme Court upheld the legality of a binding poison pill proposal submitted to an Oklahoma company, but the issue has yet to be tested in Delaware or other states where the vast majority of companies are incorporated.

**Supermajority voting requirements:**

Some companies require the approval of two-thirds, three-fourths or even 80 percent of the outstanding shares to pass, repeal or amend a charter or bylaw provision or approve a merger. Many shareholders, and the Council, believe a simple majority vote should be sufficient to amend company bylaws or approve other corporate actions.

**U**

**Underwater options:**

Options with exercise prices above the stock's current market value-i.e., of no immediate value to the holder.

## **W**

### **Withholding votes from directors:**

Sometimes referred to as voting against the board. Unless there is a proxy contest, with competing candidates for the board, there effectively is no such thing as voting against the board, since the official board nominees will always win no matter how small a vote they get. Some shareholders withhold their votes from the entire board (or the class standing for election) to indicate general dissatisfaction with company performance; others withhold support only from specific directors, for such reasons as poor attendance, conflicts of interest, failure to own company stock, or serving on a compensation committee that awarded excessive compensation packages. Some vote against boards that do not take actions recommended in shareholder proposals that get majority votes (a Council policy). It is also a Council policy that boards should review the performance and qualifications of any director from whom at least 10 percent of the votes cast are withheld.

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