

**CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM**

BILL ANALYSIS

Bill Number: Assembly Bill 2752 – Chu (As amended 7-19-04)

SUMMARY:

Assembly Bill 2752 requires all publicly traded corporations doing business in California to make their corporate election procedures available to shareholders upon request, and file copies of those procedures with the Secretary of State.

RECENT AMENDMENTS:

Recent amendments correct a reference to the definition/characteristics of a corporation that would be affected by AB 2752, which had been changed by the amendments of 6/29/04.

PURPOSE OF THE BILL:

According to the sponsor, disclosure of corporate election procedures provide vital information to existing and potential shareholders, allowing them to judge the risks of investing in corporations that unreasonably restrict shareholder access to the proxy to promote change.

RECOMMENDATION AND SUPPORTING ARGUMENTS:

Support. This measure provides minor improvements in the ability of shareholders and the public to obtain information on the nomination procedures associated with the election of directors to corporate boards. It would also substantially conform state law to what is already part of federal rulemaking. The California State Teachers' Retirement System's (CalSTRS) Corporate Governance Program works to provide long-term enhanced shareholder value by promoting corporate disclosure and accountability. Improving transparency in the board election process will add value to the continued efforts of the Teachers' Retirement Board (Board).

SUMMARY OF SUGGESTED AMENDMENTS:

None

ANALYSIS:

Existing law requires domestic and foreign corporations (defined as incorporated in California or doing business in California, respectively) to file annual disclosure statements with the Secretary of State concerning their operations, and makes these records open for public inspection. Among other things, Chapter 1015, Statutes of 2002 (AB 55–Shelly) the California Corporate Disclosure Act of 2002, requires additional corporate disclosures concerning a corporation's auditors, board member compensation, and securities law violations. AB 2752 requires domestic and foreign corporations to also submit copies of their corporate election procedures to the

**CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM**

BILL ANALYSIS

Secretary of State within 120 days after the end of their 2004-05 fiscal year, or the bill's effective date, whichever is later. It would also require the affected corporations to resubmit copies of their election corporate procedures whenever they are changed or amended.

If a company's election procedures are not submitted to the Secretary of State within 120 days of the close of its 2004-05 fiscal year, and again whenever its election procedures are changed, it would be subject to penalties currently applied to corporations that fail to file the required Statement of Information or Corporate Disclosure Statement. The penalty for late submission under current California law for domestic stock and foreign corporations is \$250, assessed by the Franchise Tax Board. A corporation's total failure to file the required information would ultimately result in its inability to conduct business in California.

While existing state law provides for the election of a corporation's directors at its annual shareholders' meeting, it does not prevent these companies from prohibiting shareholder nominations in its corporate charter or bylaws. An earlier amended version of the bill contained a provision that specifically required publicly traded companies incorporated in California to establish corporate election procedures that allow shareholders to recommend candidates for election as directors, thereby ensuring that the proposed federal Securities and Exchange Commission (SEC) rules would have been fully implemented in California. However, that provision has been deleted. Given the SEC proposal is stalled and the SEC required compliance with its new corporate election procedure disclosure rule by January 1, 2004 (see background information following), conforming more of the Secretary of State's corporate filing and disclosure procedures and requirements to federal practices would add value to shareholders and the corporations themselves, with little, if any, additional cost.

LEGISLATIVE HISTORY:

Resolution Chapter 92, Statutes of 2004 (AJR 79—Chu) urges the Securities and Exchange Commission (SEC) to adopt its proposed shareholder participation rules in order to improve corporate accountability, restore investor confidence, and to provide shareholders with increased access to proxy to promote greater board oversight of corporate operations and responsiveness to shareholder concerns.

Chapter 1015, Statutes of 2002 (AB 55—Shelly) the California Corporate Disclosure Act of 2002, requires publicly-traded companies to provide disclosures concerning its auditors, board member compensation, and securities law violations.

PROGRAM BACKGROUND:

Following the enactment of the Sarbanes-Oxley Act of 2002, the SEC has proposed and implemented a series of reforms associated with the governance of publicly-traded corporations. Last year, the SEC amended its rules to enhance disclosure requirements related to the transparency of operations of board nominating committees, and establish a new disclosure requirement regarding the method by which security holders may

**CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM**

BILL ANALYSIS

communicate with corporate directors. Specifically, the SEC rules require companies to disclose whether a current copy of its nominating committee's charter is available to shareholders on the company's Web site. When that is not available, the company would be required to include a copy of the charter as an appendix to its proxy statement at least once every three fiscal years. While the SEC briefly considered establishing additional rules to allow shareholders to nominate corporate directors at the same time, it chose to delay further action.

AB 2752 is a companion measure to Resolution Chapter 92, Statutes of 2004 (AJR 79 – Chu), which was supported by the Board and urges the SEC to adopt its proposed "shareholder access" Rule 14a-11, which would allow shareholders to place nominees for director in company proxy materials when certain events suggest that the company has been unresponsive to shareholder concerns. Under SEC's proposed rule, a company would be required to include a maximum of one, two or three security holder nominees, depending on the size of its board of directors.

The proposed SEC nomination procedures would not be available where a shareholder seeks either control of a board of directors or the election of a director having a financial relationship with the shareholder. In addition, the rule would not apply to companies incorporated in states that: 1) prohibit shareholders holders from nominating director candidates; or 2) allow corporations to prohibit shareholder nominations through its corporate charter or bylaws, and the corporation has properly adopted these prohibitions. CalSTRS has written the SEC in support of this proposed rule, and continues to promote several additional reforms as part of its corporate governance strategy.

According to reporting in the Wall Street Journal and Washington Post from June 8, 2004, SEC Chairman Donaldson has attempted to broker a compromise to the proposed rule in order to satisfy opposition from the business community. Under his proposal, when more that 50 percent of votes cast are withheld from a board member facing election, the board's nominating committee would be allowed to name a replacement. It is, however, unclear whether the board would be required to consult with shareholders about the replacement. Another possible feature of the proposal would require companies to allow a shareholder-backed candidate to stand for nomination at a subsequent shareholder meeting if 50 percent of votes cast are withheld from the board's replacement nominee, essentially delaying the election of a shareholder-backed candidate for three years.

Another article in the July 1st New York Times reports that Chairman Donaldson has backed away from his earlier efforts to broker a compromise due to a deadlock between the four other SEC commissioners and building pressure from the business community. While the article quoted Chairman Donaldson as being unconcerned about being able to eventually find common ground for a final rule, or meeting a specific deadline for final action, it also cited undisclosed SEC officials who indicate that any further delays will jeopardize an earlier goal that the new corporate board election rules be in place for the 2005 proxy season.

**CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM**

BILL ANALYSIS

OTHER STATES' INFORMATION:

NA

FISCAL IMPACT:

Benefit Program Costs – None

Administrative Costs – None

ECONOMIC IMPACT:

AB 2752 places the collection burden on the Secretary of State, with the filing of this information being only a nominal incremental cost to the companies as they file their corporate information already required by Chapter 1015.

LEGAL IMPACT:

NONE

SUPPORT/OPPOSITION

Support: California Secretary of State (Sponsor); American Federation of State, County, and Municipal Employees (AFSCME); California Labor Federation, AFL-CIO, CalPERS

Opposition: California Department of Corporations

BILL LANGUAGE

None