



## NEWS

### For Immediate Release

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### **IRRC INSTITUTE AND STANFORD'S ROCK CENTER SUBMIT REPORT TO SEC THAT RAISES QUESTIONS ABOUT FUNDAMENTAL UNDERPINNINGS OF CORPORATE GOVERNANCE**

***Corporate and Bankruptcy Laws Lag Behind Market Reality With Regard to Shareholder/Creditor Ability to Vote and Exert Influence Despite Having No Economic Interest; Potentially Damaging Implications for Companies and Markets***

**NEW YORK, NY, October 19, 2010**—A report commissioned by the Investor Responsibility Research Center Institute (IRRC) and conducted by the Rock Center for Corporate Governance at Stanford University raises concerns that the financial markets' ability to divorce economic interests from ownership rights – via derivatives and other means – has outpaced the existing corporate governance and bankruptcy legal framework. The report provides an analysis of the decoupling phenomenon – also known as “empty voting” – that occurs when shareholder voting rights substantially exceed economic interest in a company.

The report, *“Identifying The Legal Contours Of The Separation Of Economic Rights And Voting Rights In Publicly Held Corporations,”* was submitted today to the Securities and Exchange Commission (SEC) as part of the agency's request for comments (“Concept Release on the U.S. Proxy System”) to examine aspects of the proxy system including ways empty voting can occur, its nature, extent, and effects on shareowner voting and the proxy process.

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Joseph A. Grundfest, former SEC Commissioner and co-director of Stanford University's Rock Center for Corporate Governance said, "The study's findings raise important questions about the very foundations on which corporate governance is based. Modern financial markets make it very easy for sophisticated shareholders to cast important votes in corporate elections even if they have no financial exposure to the company's stock price performance." Grundfest added, "It's a bit like voting in a country's election even though you are no longer a citizen. Yet, we have no clear idea about how frequently this problem arises or its actual implications for corporate governance."

"Ironically, we just enacted a massive reform of the financial system. The underlying presumption, however, was that economic and ownership interests are inseparable. We know this is not true," said Jon Lukomnik, IRRRC Institute program director. He added, "We commissioned the report because we are increasingly concerned that the fundamental philosophic basis of corporate governance – that the owners of the company who can determine its fundamental fate are incented to want it to thrive – is eroding. As worrisome, if those who control ownership rights can be incentivized towards value destruction rather than value creation, it is only a matter of time until the real economy is affected due to a large-scale impact on corporations. Our study suggests that the law, unfortunately, has not kept pace with financial market reality."

The key research findings in the report include:

- The potential for and reality of decoupling transactions that can generate empty or negative voting can present significant challenges to existing shareowner and creditor governance practices.
- Existing disclosure provisions in federal securities law and federal bankruptcy law assume that the economic rights and voting rights associated with share or debt ownership are inseparable. Because these rights may be freely decoupled, existing law fails to provide necessary transparency as to the existence of hedging transactions that can affect the economic rights and voting incentives of shareholders and creditors. This, in turn, can mean that others, including regulators, corporate directors, other shareowners and creditors, are made on a less than informed basis.
- It is unclear that disclosure alone is sufficient to address the problems that can be created by empty and/or negative voting. Policy makers may therefore wish to consider substantive measures that might address the rights of shareowners or creditors to cast votes without regard to their participation in decoupling transactions that can give rise to empty or negative voting\_

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The report is a comprehensive review that identifies the different manifestations of the decoupling issue in the corporate governance, securities regulation, and bankruptcy arenas. More specifically, it summarizes 19 research studies; analyzes relevant provisions of federal securities law; critiques policy-relevant proposals; discussed the Dodd-Frank Act reporting swap contracts; considers opportunities within SEC's "Proxy Plumbing;" catalogues implications of decoupling and of empty or negative voting in the context of the federal bankruptcy process; and summarizes several key judicial opinions indicating in growing concerns in litigated transactions.

The full report is available at [www.irrcinstitute.org](http://www.irrcinstitute.org) and [www.law.stanford.edu/program/centers/rcfcg/](http://www.law.stanford.edu/program/centers/rcfcg/). It also is included in the IRRC sponsored Social Science Research Network Corporate Governance Network at <http://www.ssrn.com/cgn/index.html>.

#### **About IRRC Institute**

The IRRC Institute is a not-for-profit organization headquartered in New York, N.Y. Its mission is to provide thought leadership at the intersection of corporate responsibility and the informational needs of investors. More information is available at [www.irrcinstitute.org](http://www.irrcinstitute.org).

#### **About the Arthur and Toni Rembe Rock Center for Corporate Governance**

The Arthur and Toni Rembe Rock Center for Corporate Governance, a joint initiative of Stanford Law School and the Stanford Graduate School of Business, was founded in 2006 to advance the practice and study of corporate governance and become an important voice in the debate over governance policy, both domestically and internationally. The Rock Center's home page is located at [rockcenter.stanford.edu](http://rockcenter.stanford.edu).

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