

RECENT SEIU MASTER TRUST DEMAND LETTERS  
CONCERNING EXECUTIVE PAY RAISE KEY CONSIDERATIONS  
FOR RESPONDING BOARDS OF DIRECTORS

April 22, 2009

To Our Clients and Friends:

The Service Employees International Union Master Trust (“SEIU Master Trust”) recently announced that it has hired the law firm of Grant & Eisenhofer P.A. to send letters to the boards of 29 major companies in SEIU Master Trust’s investment portfolio, demanding that the boards “investigate a total of more than \$5 billion of incentivized executive pay that may have been tied to poorly understood derivatives and other financial instruments that are now worthless.” Grant & Eisenhofer reportedly has stated that if these issues are not resolved, SEIU Master Trust will consider filing shareholder derivative lawsuits. “Grant & Eisenhofer Goes After Exec Pay,” *The Am Law Litigation Daily*, April 21, 2009.

This development suggests that derivative demands could become a preferred course for shareholders seeking to raise issues related to executive compensation and highlights the importance of early attention to proper procedure when a board is called upon to review and respond to a shareholder derivative demand. As a general matter, the decision whether to assert claims on behalf of a corporation is entrusted to the business judgment of the company’s directors. When a shareholder demands an investigation of alleged misconduct that raises potential company claims, the board is required to review the challenged activities and respond, lest it be deemed to have acquiesced in allowing the shareholder to bring a derivative action on the company’s behalf. To preserve the board’s control over company claims, it should pay careful attention to several key considerations at the outset of the demand review and response process.

**Informing the Board.** Management, which typically receives the shareholder’s demand, needs to inform the full board that the demand has been received. The Board should meet promptly (possibly telephonically, if a regular meeting is not upcoming) to decide how to proceed with the review of the demand. The company’s directors and officers liability insurer also should be notified of the demand.

**Establishing a Demand Review Committee.** Under Delaware law, a shareholder who makes a demand concedes that a majority of the directors are sufficiently independent to investigate the issues raised by the demand and determine how to respond. (This rule may vary or be unclear in other states.) As a result, the board’s ultimate decision whether to pursue the company’s claims will be protected by the business judgment rule, unless the

shareholder can establish a reasonable doubt that the board made its decision with due care, in good faith and in the company's best interests.

Although a demanding shareholder of a Delaware corporation concedes the independence of a majority of the board, director independence is still an important consideration when deciding which directors will conduct the review in response to the demand. The participation of a director who is alleged to have directly benefited from the challenged conduct could give the shareholder an avoidable argument that the board's review was not conducted in good faith, and thus is not protected by the business judgment rule. Thus, it is typical for the board to appoint a "demand review committee" composed of directors whom it determines to be clearly independent with respect to the alleged misconduct, to review and investigate the facts related to the demand.

**Determining the Scope of the Demand Review Committee's Authority.** When structuring a committee to review potential derivative claims, the board needs to decide whether to authorize the committee to decide the company's response to the demand or only to recommend action to the full board, which retains the ultimate decision-making authority. Where a shareholder's demand constitutes a concession that a majority of the board is sufficiently independent to consider the issues raised by the demand (as is the case with a Delaware corporation), a majority of the board should be viewed as capable of making the ultimate decision whether to pursue the company's claims, based on the demand review committee's review and recommendation. In an abundance of caution, however, the derivative review committee still should examine as part of its review not only its members' independence to consider the issues raised by the demand, but also the independence of a majority of the board to act on its recommendations.

**Choosing the Right Team to Advise the Demand Review Committee.** The demand review committee should be advised not only by independent outside counsel, but also by any other independent advisors whose expertise on accounting, technical or other issues will materially assist the committee in conducting its review and formulating its conclusions.

Special care should be taken in selecting the committee's outside counsel, which typically takes an active role in conducting the review. The record should be clear that the demand review committee decided on its own counsel, preferably after considering multiple candidates. Outside counsel to the committee should not have previously advised the company or any of the potential subjects of the investigation with respect to the actions challenged by the demand. The committee's counsel also should not have such a close and substantial relationship with the company or the potential investigation subjects that counsel could be viewed as conflicted or incapable of acting in the company's best interest with respect to the matters in question.

Making an Initial Response. There is no fixed period of time within which a board must make a decision whether to pursue claims relating to a demand before the shareholder may bring a derivative action and allege that the board has failed to respond to the demand. It is generally good practice to confirm in writing to the demanding shareholder (or the shareholder's counsel) as early as practicable that the board is reviewing the demand. It is also common for this communication to invite the shareholder to provide any information that it believes supports the bringing of a claim. This initial response from the board both puts the shareholder on notice that it would be premature to file a derivative action and establishes a written record that the board is reviewing the demand in case the shareholder files an action prematurely.

\* \* \* \* \*

Please feel free to contact us with any questions.

**New York**

John S. Kiernan  
+1 212 909 6692  
jskiernan@debevoise.com

Bruce E. Yannett  
+1 212 909 6495  
beyannett@debevoise.com

Gary W. Kubek  
+1 212 909 6267  
gwkubek@debevoise.com

**Washington, D.C.**

Colby A. Smith  
+1 202 383 8095  
casmith@debevoise.com

Scott N. Auby  
+1 202 383 8053  
snauby@debevoise.com