

To: Our Clients and Friends

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SEC Publishes Proposed New Rules Regarding Compensation and Corporate Governance Disclosure and the Proxy Solicitation Process

On July 10, 2009, the Securities and Exchange Commission (the "SEC" or the "Commission") published the proposed new rules to enhance compensation and corporate governance disclosure in Items 401, 402 and 407 of Regulation S-K, which we reported earlier in our July 2, 2009 bulletin (available [here](#)). The proposals relate to:

- the effect of compensation policies and practices on company risk;
- the reporting of stock and option award values;
- the qualifications of incumbent directors and nominees;
- the board's leadership structure and its role in risk management; and
- potential conflicts of interest involving compensation consultants.

The SEC also published proposed new rules to accelerate the reporting of shareholder voting results by means of a new item on Form 8-K and to clarify and expand on the proxy solicitation rules.

The complete text of the proposals can be found [here](#). If the proposed amendments are adopted, the SEC anticipates they will be effective for the 2010 proxy season.

Compensation and Corporate Governance

Compensation Practices and Company Risk

The SEC is proposing to expand Compensation Discussion and Analysis ("CD&A") disclosure to require a broader discussion of compensation policies and arrangements with respect to employees generally,

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including non-executive officers, and how such practices relate to risk management practices and/or risk-taking incentives. The SEC noted that some critics believe that certain compensation practices, such as incentive compensation arrangements, encourage management and employees to make decisions that might increase company risk and that such practices promote short-term interests of management and employees that may not be properly aligned with the long-term interests of the company and its shareholders.

The proposed rules provide that disclosure would be required if these risks “may” have a material effect on the company. By way of example, the proposed rules identify several scenarios in which disclosure of compensation policies and practices may be required:

- At a business unit that represents a significant portion of the company’s risk profile;
- At a business unit where compensation is structured significantly differently than other company units;
- At business units that are significantly more profitable than others;
- At business units where the compensation expense is a significant percentage of the unit’s revenues; and
- That vary significantly from the overall risk and reward structure of the company.

If disclosure is required, the proposed rules identify some of the issues companies may need to address, including:

- The general design philosophy of the company’s compensation policies for employees whose behavior would be most affected by the incentives established by the policies, as such policies relate to or affect risk taking and the manner of its implementation;
- The company’s risk assessment or incentive considerations in structuring its compensation policies or in awarding and paying compensation;
- How the company’s policies relate to the realization of risks resulting from actions of employees in both the short term and long term;
- The company’s policies regarding adjustments to its compensation policies to address changes in its risk profile;
- Material adjustments the company has made to its compensation policies or practices as a result of changes in its risk profile; and
- The extent to which the company monitors its compensation policies to determine whether its risk management objectives are being met with respect to providing incentives to employees.

The SEC believes that, if risk considerations are a material aspect of compensation policies or decisions for named executive officers (“NEOs”), CD&A requires companies to discuss them under the current rules. It appears the SEC views this as independent of the proposed new requirement.

Stock and Option Awards

Currently, companies report the dollar amount recognized for financial statement reporting purposes in the stock and option awards columns in the Summary Compensation Table (“SCT”) and Director Compensation Table (“DCT”). The SEC is proposing that companies report instead the aggregate grant date fair value of stock and option awards made during the fiscal year computed in accordance with SFAS No. 123R. Similar to the current rules in effect, the revised rules would require companies to include a footnote to the stock and option awards columns disclosing assumptions made in the valuation or, alternatively, a cross reference in the footnote to the financial statements, notes to the financial statements or Management’s Discussion and Analysis section in its periodic reports.

The SEC acknowledged that, in 2006, it adopted this identical requirement but, before effectiveness, reconsidered the issue and adopted the current disclosure approach. Since then, the SEC has noted that a number of commentators have criticized the current rules, with some companies disclosing an “alternative” SCT and some analysts substituting grant date fair value information from other tables. The SEC recognizes that the proposal has limitations, such as distortion of the list of NEOs due to a single large grant; however, it believes the proposed approach would result in benefits, including:

- a more informative reflection of compensation decisions and intentions of companies and compensation committees;
- a more concise CD&A, which could omit a complex discussion of the FAS 123R recognition model, and a clearer discussion of the effect of any option repricing (which, under the proposed revised rules, would be reflected in the grant date fair value for the year when the repricing occurs);
- reducing the likelihood that companies report a negative number for the value of awards, which under the current recognition approach is possible if, for example, the company’s stock price has declined; and
- the potential for more consistency in the list of NEOs reported year to year, since the current rules may cause the list to change due to factors unrelated to the company’s compensation decisions.

The SEC is soliciting comments regarding transitioning to the proposed rule change and is considering requiring recalculation of values for stock and option awards for 2008 and 2007 for the 2010 proxy season.

The SEC is also seeking comments with respect to an alternative method for reporting stock and option awards proposed by a compensation consulting firm. Under this approach, the reported amount would instead reflect the annual change in the value of the awards.

In a related rule change, the SEC is proposing to eliminate the requirement to report the grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table and the corresponding footnote disclosure to the DCT, as such values would be duplicative if the rule changes discussed above are adopted.

Non-Cash Compensation Received in Lieu of Annual Cash Compensation

The SEC is proposing to amend the SCT rules to allow companies to omit from the salary and bonus columns any amount of salary or bonus foregone at an NEO's election pursuant to a program under which stock, equity based or other forms of non-cash compensation may be received by an NEO instead. Under the proposed revised rules, the company would report the non-cash compensation received in lieu of the annual compensation in the appropriate column in the SCT. If the award is made pursuant to a non-equity incentive plan, the company must include a footnote to the salary or bonus column referring to the Grants of Plan-Based Awards Table where the award is reported.

Qualifications of Directors and Nominees for Director

Current rules focus on general biographical information for directors and nominees and do not require specific discussion of their qualifications. The SEC is proposing that:

- Companies include a narrative discussion of the "specific experience, qualifications, attributes or skills" that qualify an individual to serve as director and as a member of any committee (as relevant) in light of the company's business and structure. The SEC is proposing that this discussion span beyond five years if material and that it include information about risk assessment skills, particular areas of expertise and other relevant qualifications.
- Companies disclose all directorships held by directors and nominees for director at any time during the past five years at public companies, including directorships no longer held at the time of disclosure. The current rules require disclosure of only current board positions. The Commission believes this requirement would better reveal potential conflicts of interest.
- The time period for disclosure of prior legal proceedings involving directors, nominees and executive officers would be lengthened from five to ten years. The Commission believes this additional disclosure would provide investors more insight regarding the competence and character of directors and nominees.

The SEC is also requesting comment on whether diversity in the boardroom is viewed as a significant issue and whether additional disclosure on this topic should be required.

Board Leadership Structure

The Commission is proposing to require discussion of a company's board's leadership structure and why the company believes it is appropriate given the specific characteristics and circumstances of the company. Further, companies would also be required to indicate whether and why they have chosen to combine or separate the principal executive officer and chairman positions. If one person serves as both chairman and principal executive officer, the company would disclose whether it has a lead

independent director and what specific role the lead independent director plays in the leadership of the company.

Citing the role that risk and the adequacy of risk oversight has played in the recent market turmoil, the Commission is also proposing to require discussion of the board's role in the company's risk management process and its effect on the leadership structure. The SEC anticipates this disclosure will focus on topics such as: (1) whether the persons who oversee risk management report directly to the board as a whole or a board committee; and (2) whether and how the board or board committee monitors risk.

Role of Compensation Consultants

Concerned about potential conflicts of interest, the SEC proposes to require increased disclosure of additional services provided by compensation consultants. Under the proposed revised rules, if compensation consultants or their affiliates play "a role in determining or recommending the amount or form of executive and director compensation" and provided other services to the company or its affiliates in the last fiscal year, companies must disclose:

- The nature and extent of all additional services provided to the company or its affiliates during the last fiscal year by the compensation consultant or its affiliates;
- The aggregate fees paid for all additional services, and the aggregate fees paid for work related to determining or recommending the amount or form of executive or director compensation;
- Whether the decision to engage the compensation consultant or its affiliates for those other services was made, subject to screening or recommended by management; and
- Whether the board of directors or its compensation committee approved the non-compensation services.

These disclosures would not be required if:

- a compensation consultant's services were rendered with respect to broad-based plans that do not discriminate in scope, terms or operation in favor of executive officers or directors of the company and such plans are generally available to all salaried employees; and
- the consultant did not provide any other services relating to executive or director compensation.

Accelerated Reporting of Shareholder Voting Results

Companies are presently required to disclose the voting results of any matter submitted to shareholders (whether in an annual or special meeting) either on Form 10-Q or on Form 10-K for the quarterly period in which the matter was submitted to the shareholders. In the proposing release, the Commission expressed concern that this approach can delay the posting of results for up to several months.

Accordingly, the SEC is proposing to add a new Item 5.07 to Form 8-K to require companies to disclose the results of any shareholder vote within four business days after the end of the shareholder meeting. The Commission recognizes that, in the case of contested elections, voting results may not be available within four business days and proposes that, if they are not definitely determined by the end of the meeting, the company must disclose the preliminary voting results within four business days and subsequently file an amended 8-K upon certification of the final results.

Clarifying Proxy Solicitation Rules

The Commission is also proposing revisions to the proxy solicitation rules to “provide greater certainty to soliciting parties, help shareholders receive timely and complete information and facilitate shareholder voting.” These revisions address the following:

- Communications by Non-Management Parties. The SEC believes that confusion has arisen as to whether the act of providing an unmarked copy of management’s proxy card and requesting the card be returned directly to management constitutes a form of revocation that would subject the shareholder to the proxy solicitation rules. The Commission believes this clarifying Rule 14a-2(b)(1) to provide that an unmarked copy of management’s proxy card does not constitute a “form of revocation” will facilitate shareholder access to information by enabling shareholders to more easily share their views with other shareholders and also allow the recasting of votes without having to seek a new proxy card from management.
- Substantial Interest of Non-Shareholders. The proxy solicitation rules apply to “[a]ny person who, because of a substantial interest in the subject matter of the solicitation, is likely to receive a benefit from a successful solicitation that would not be shared pro rata by all other holders of the same class of securities, other than a benefit arising from the person’s employment” with the company. Seeking to expand the amount of information available to investors for their voting decisions, the SEC is proposing to clarify Rule 14a-2(b)(1)(ix) that one does not need to own shares in or derive a benefit from the class of shares whose proxies are being solicited in order to have a substantial interest. For example, the Commission notes that “a soliciting party could have a significant financial interest in the subject matter of a solicitation without owning any shares of the company whose shareholders are solicited if the solicitation relates to a merger with a company that the soliciting party wishes to acquire.”
- Rounding Out Nominee Slates. In “short slate” election contests, current rules do not allow non-management groups to seek authority to vote for nominees named in third party proxy statements other than the company’s. The Commission is proposing to amend Rule 14a-4(d)(4)

to allow them to round out short slates by seeking proxies for nominees named in both the company's and other groups' proxy statements.

- This would be available only when non-management parties are not acting together. When seeking to round out their slates with nominees from other proxy statements, the proponents would be required to represent that they have not agreed to, and will not agree to act, as a "group" with the other non-management group. Further, they would also be required to represent that they will not be a participant in the other group's solicitation.
- Requiring Objectively Determinable Conditions. Current Rule 14a-4(e) requires that a proxy statement or form of proxy provide that the shares represented by the proxy be voted "subject to reasonable specified conditions." The Commission proposes to clarify that any conditions upon which a soliciting party may or may not vote the shares to which it has received authority be "objectively determinable." It expects that the proposed change will enable shareholders to better understand what they are being asked to grant proxy authority for and to evaluate the propriety of any subsequent withholding of shares from voting.
- Availability of Disclosures. Under the current proxy solicitation rules, a solicitation may be made prior to furnishing a proxy statement if, among other things, each written communication contains required certain information such as the identity of the participants and a description of their interests in the solicitation or legend indicating where such information can be obtained. The SEC is seeking to clarify Rule 14a-12(a)(1)(i) that, for all communications made to shareholders before distribution of a proxy statement, the information referenced in the legend must be available at the time the legend is provided to shareholders.

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