

To: Our Clients and Friends

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## SEC Approves Elimination of Broker Discretionary Voting in Director Elections and Announces Proposed Rule Changes Regarding Executive Compensation and Corporate Governance and “Say on Pay” for TARP Recipients

Yesterday the SEC approved an NYSE proposal that will eliminate broker discretionary voting in director elections. Additionally, the SEC is proposing rule changes that would (1) increase certain proxy statement disclosures relating to executive compensation and corporate governance and changes to certain proxy solicitation rules and (2) require recipients of Troubled Asset Relief Program (“TARP”) funds to implement “say-on-pay” practices through the proxy solicitation process.

The text of the TARP proposal can be found at [TARP Say on Pay Proposal](#). However, the adopting release for the NYSE proposal and the text of the executive compensation proposal have not yet been publicly released. Accordingly, the description below with respect to those matters are based on the statements made at the SEC’s open meeting and are subject to change upon review of the SEC releases. We expect to supplement this memorandum with further details after the SEC publishes the complete text of the releases.

### **Elimination of Broker Discretionary Voting**

In a divided 3-2 vote, the SEC approved a proposal submitted by the New York Stock Exchange that will eliminate broker discretionary voting for shares held in street name in director elections, whether contested or not. The NYSE’s Rule 452 currently allows brokers holding shares in street name to vote on behalf of beneficial owners on certain “routine” matters if the broker has not received voting instructions from the beneficial owner at least 10 days before the meeting. Currently, Rule 452 treats uncontested director elections as a “routine” matter. This change will eliminate the ability of all NYSE

member firms to exercise discretionary voting authority in director elections at any public company, including companies not listed on the NYSE.

Commissioners Casey and Paredes objected to the proposal, noting that the NYSE proxy working group had recommended the proposal in the context of other proxy reforms. In particular, the two Commissioners believed the change should only take place as part of a comprehensive review that addressed other systemic issues, including OBO/NOBO, so-called “over-voting” and “empty voting,” proxy, the influence of proxy advisory firms and similar matters. Commissioner Paredes noted that 93 of the 137 distinct commenters on the NYSE proposal had recommended that the SEC defer action to allow time for such a review. Chairman Schapiro stated that the SEC would look at these matters later this year.

Commissioners Casey and Paredes also expressed concern that the proposal would increase the influence of institutional shareholders and proxy advisory firms. Accordingly, several Commissioners, including Chairman Schapiro, noted that the changes would require focused efforts on shareholder education.

As a result of the rule change, vote “no” or “withhold” campaigns will no longer be “diluted” by a block (often in excess of 20% of votes cast) of broker discretionary votes in favor of management’s slate. Companies with majority-voting bylaws or policies may find it more difficult to ensure election of management’s slate. Members of the SEC staff observed that companies may need to consider proposing another “routine” item or otherwise increasing their proxy solicitation efforts in order to ensure the presence of a quorum.

The rule change will apply to director elections occurring after January 1, 2010. Companies registered under the Investment Company Act of 1940 will be exempt under the new rules.

## **Enhanced Proxy Statement Disclosure and Proxy Rule Changes**

The SEC is proposing a number of wide-ranging rules addressing topics such as:

- *Broadened Compensation and Discussion and Analysis (“CD&A”)* - The SEC proposes to expand CD&A disclosure to require disclosure of the relationship between compensation policies and overall actual practices for employees generally (including non-executive officers), if the risks arising from those policies or practice “may have” a material effect on the company, including whether such practices encourage excessive risk-taking.
- *Director Qualifications* - The SEC proposes to expand Item 401 of Regulation S-K to require disclosure of the qualifications of directors and nominees for board and committee service in light of the company’s business, including such persons’ skills, experience and other attributes. The SEC also proposes to require disclosure of board positions held by directors and nominees during the previous five years, not just current directorships.
- *Director Involvement in Legal Proceedings* - The SEC proposes to amend Item 401 of Regulation S-K to require companies to disclose the involvement of directors and nominees in certain legal proceedings during the preceding ten years, instead of just the preceding five years.

- *Board Leadership Structure* - The SEC proposes to require disclosure of the board's leadership structure and why it is believed to be the best structure for the company, including whether and why the company combined or split the chairperson and CEO positions, and whether the company has a lead independent director.
- *Board's Role in Risk Management* - The SEC proposes to require enhanced disclosure as to the board's involvement in monitoring company risk management and the effect, if any, on how the board has organized its leadership structure.
- *Conflicts of Interest of Compensation Consultants* -The SEC proposes to require increased disclosure regarding potential conflicts of interests of compensation consultants. If a compensation consultant provides consulting services related to executive or director compensation and any additional services to the company specified disclosure would be required. The proposal would require disclosure of the additional services provided by the compensation consultant and any of its affiliates; the aggregate fees paid for all additional services and the aggregate fees paid for work related to executive and director compensation consulting; whether the decision to engage the compensation consultant for any other services was recommended or made by management; and whether the board of directors or the compensation committee has approved the other services.
- *Stock and Option Values* - The SEC is proposing that companies disclose in the Summary Compensation Table and the Director Compensation Table the aggregate grant date fair value of awards computed in accordance with FAS 123R. By contrast, under current rules, companies disclose only the dollar amount recognized for financial statement reporting purposes in accordance with FAS 123R for the fiscal year.
- *Accelerated Announcement of Shareholder Voting Results* - The SEC would create a new 8-K item requiring announcement of shareholder voting results within four business days after the meeting, rather than delaying disclosure until the 10-Q for that fiscal quarter.

Additionally, the SEC is proposing amendments to the proxy rules to clarify certain matters, including with respect to the following rules:

- Rule 14a-2(b), to clarify that an unmarked copy of management's proxy card that is requested to be returned directly to management is not a "form of revocation" that would render the exemption for certain solicitations from the proxy rules unavailable;
- Rule 14a-2(b), to clarify that a soliciting person may lose the exemption from the proxy rules if the person has a substantial interest in the subject matter of the solicitation, even if such person is not a shareholder;
- Rule 14a-4(d), to provide that a soliciting person can round out its short slate with nominees named in a non-management proxy statement in the same manner as already permitted by the rule for nominees named in the company's proxy statement;
- Rule 14a-4(e), to clarify that any condition specified by a soliciting party as to when it may not vote shares over which it has received proxy authority must be objectively determinable; and

- Rule 14a-12, to require that information regarding the identity and interests of participants in a solicitation must be available and on file with the SEC no later than when shareholders are first solicited.

### **“Say-On-Pay” for TARP Recipients**

The recently adopted Emergency Economic Stabilization Act of 2008 (the “EESA”) requires shareholder approval of executive compensation during the period in which any obligation arising from TARP assistance remains outstanding. Accordingly, the SEC is proposing new proxy rules which would require recipients of TARP funds to provide for a separate non-binding shareholder vote on executive compensation packages. Companies receiving TARP funds would only be required to seek such advisory votes when soliciting proxies for the election of directors. This requirement would be effective as long as a company’s TARP obligations remain outstanding.

In an effort to provide companies with maximum flexibility, the SEC’s proposal does not require specific language in the proxy statement when submitting such matters to the shareholders. The proposal, however, would require companies to disclose in their proxy statements that a separate vote is being sought on executive compensation in order to comply with the EESA and to explain the effect of the vote, including its non-binding effect. Further, the SEC proposal clarifies that the vote must be to approve “the compensation of executives, as disclosed pursuant to [SEC rules] (which disclosure shall include the [CD&A], the compensation tables, and any related material).”

In the proposing release, the SEC clarified that the results of the advisory shareholder vote will not imply the creation of any additional fiduciary duties on directors. The SEC also emphasized that adoption of the rules would not limit or otherwise restrict the ability of shareholders to submit other proposals for inclusion in the proxy statement relating to executive compensation. Finally, the release clarifies that smaller reporting companies would not be required to include a CD&A in their proxy statements in order to comply with the new proxy rules.

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