PROSKAUER ROSE LLP®

Client Alert

A report for clients and friends of the Firm

August 2009

SEC Proposes Proxy Disclosure and Solicitation Enhancements

The Securities and Exchange Commission (the "SEC") recently issued Release No. 33-9052 in response to "the turmoil in the market during the past 18 months" which has "reinforced the importance of enhancing transparency, especially with regard to activities that materially contribute to a company's risk profile." The proposed rules would require additional disclosures in annual reports and proxy statements regarding certain executive compensation and corporate governance matters, including disclosures regarding: (i) the relationship between the company's compensation policies and practices and risk; (ii) director and nominee qualifications; (iii) the company's leadership structure and the board's role in the risk management process; and (iv) potential conflicts of interest of compensation consultants who advise companies. In addition, the proposed amendments provide for accelerated reporting of shareholder voting results on Form 8-K and certain clarifications with respect to the proxy solicitation rules. The comment period on these proposed rules ends on September 15, 2009, and it is expected that some form of the proposed rules will be effective for the 2010 proxy season.

Executive Compensation and Corporate Governance Disclosures

Enhanced Disclosure in the Compensation Discussion and Analysis

Under existing proxy disclosure rules, companies are required to discuss in the Compensation Discussion and Analysis (the "CD&A") an overview of the compensation for the principal executive officer, principal financial officer, and the three most highly compensated executive officers other than the principal executive officer and the principal financial officer (the "NEOs"). The SEC has proposed to broaden the scope of the CD&A to include new risk disclosures to help investors identify whether the company has established a system of incentives for employees generally that can lead to excessive or inappropriate risk taking.

The SEC has proposed to amend the CD&A requirements to require companies to include a discussion and analysis of the broader compensation policies and overall compensation practices for NEOs as well as non-executive officers if the risks arising from those practices or policies would have a material effect on the company. These new disclosures focus on how a company's compensation policies and practices create incentives that can create risks to the company, and the management of that risk; and disclosure is required solely to the extent that the risks would have a material effect on the company. While disclosure generally will depend on the particular facts and circumstances, the SEC provided a non-exclusive list of the following compensation programs that may create material risks to the company:

- compensation policies and practices at a business unit of a company that carries a significant portion of the company's risk profile;
- compensation policies and practices at a business unit with compensation structured significantly differently than other units within the company;
- compensation policies and practices at business units that are significantly more profitable than others within the company;
- compensation policies and practices at business units where the compensation expense is a significant percentage of the unit's revenues; or

- compensation policies and practices that vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time.

If risk disclosure is required, then some examples of items that should be discussed in the CD&A include:

- 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 by those employees on behalf of the company, and the manner of its implementation;

- the company's risk assessment or incentive considerations, if any, in structuring its compensation policies or in awarding and paying compensation;

- how the company's compensation policies relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring clawbacks or imposing holding periods;

- 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 incentivizing its employees.

Revised Stock and Option Award Disclosure

Stock and option awards currently are reported in the Summary Compensation Table and Director Compensation Table in a proxy statement on the basis of their dollar amounts determined for financial statement reporting purposes in accordance with FAS 123R.

The proposed amendment would require companies to disclose stock and option awards granted during the fiscal year based on the aggregate grant date fair value computed in accordance with FAS 123R. The SEC believes that investors may consider compensation decisions made during the fiscal year important in voting and investment decisions. These decisions generally are reflected in the full grant date fair value measure, but not the financial statement recognition measure. If a company does not believe that the full grant date fair value is an accurate reflection of an executive officer's compensation, it can provide a written disclosure to such effect. The SEC also notes that the financial statement recognition measure sometimes resulted in the disclosure of a negative number, which was confusing to investors and caused the list of NEOs to change more frequently due to factors unrelated to the company's compensation decisions.

If this amendment becomes effective and the aggregate grant date fair value of stock and option awards is required to be reported in the Summary Compensation Table for the 2010 proxy season, it is currently unclear whether companies will have to re-calculate the values of stock and option awards for 2007 and 2008.

To avoid duplicative disclosures, the proposed amendment would rescind the requirement to report the grant date fair value of each individual equity award in the Grants of Plan-Based Award Table and footnote disclosure to the Director Compensation Table. In addition, registrants would not be required to report the salary or bonus foregone at an executive officer's election; rather, non-cash awards received in lieu of salary or bonus would be reported in the column applicable to the form of award elected in order to reflect the form of compensation ultimately received by an executive officer.

Potential Conflicts of Interest of Compensation Consultants

Under the current disclosure rules, companies are not required to disclose fees paid to compensation consultants or their affiliates for executive compensation consulting or other services, or to describe services unrelated to executive or director compensation. The SEC believes that compensation consultants who make recommendations on executive compensation may have a conflict of interest if they (or their affiliates) receive fees for additional services, especially where fees generated by the additional services exceed fees for executive or director compensation consulting services. Accordingly, the SEC has proposed to amend Item 407 to Regulation S-K to require additional disclosures if a compensation consultant or its affiliates played a role in determining or recommending the amount or form of executive or director compensation and also provided additional services. Such additional disclosures include a discussion of:

- the nature and extent of all additional services provided to the company or its affiliates during the last fiscal year by the compensation consultant and any affiliates of the consultant;

- 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 and director compensation;

- whether the decision to engage the compensation consultant or its affiliates for non-executive compensation services was made subject to screening, or recommended or reviewed by management; and

- whether the board of directors or the compensation committee has approved all of these services in addition to executive compensation services.

Disclosure would not be required, however, where a compensation consultant only advised on broad-based plans that do not discriminate in favor of executive officers or directors, such as 401(k) plans or health insurance plans, even though NEOs or directors may enroll in them.

Director and Nominee Qualifications and Legal Proceedings

Item 401 of Regulation S-K currently requires only a brief section detailing the biographical information about directors and nominees for the past five years. The proposed amendments would expand the information required for individual directors. Specifically, this would require a company to detail for each director and nominee for director the particular experience, qualifications, attributes or skills that qualify that person to serve as a director of the company and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the company's business and structure. The disclosure applies to incumbent directors, and nominees for directors by the company's nominating committee or any other proponent.

Item 401 also currently requires the disclosure of current director positions held by each director and nominee at public companies. The proposed amendment would require companies to include disclosures of directorships at public companies for the past five years to allow investors to assess a director's or nominee's previous board memberships and professional relationships and determine if there could be a conflict of interest.

The amendment to Item 401 also proposes to lengthen the time for which disclosure of legal proceedings involving directors, executive officers and persons nominated to be directors is required from 5 to 10 years.

The SEC further proposes to apply these Item 401 disclosure amendments to management investment companies registered under the Investment Company Act.

Company Leadership Structure and the Board's Role in Risk Management

The SEC has proposed a new disclosure requirement to Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A that would require disclosure of the company's leadership structure and why the company believes it is the best structure. A company also would be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions. Where the two positions are combined, the proposed amendment requires a company to disclose whether and why the company has a lead independent director and the role that such lead director plays in the leadership of the company.

The SEC also has proposed greater disclosure in proxy and information statements regarding the board's role in the company's risk management process, including:

- how a board implements and manages its risk management function, whether through the board as a whole or through a committee, such as the audit committee;

- whether the persons who oversee risk management report directly to the board as whole, to a committee, such as the audit committee, or to one of the other standing committees of the board; and

- whether and how the board, or board committee, monitors risk.

The SEC has proposed to apply the Item 407 disclosure amendments regarding leadership structure and the board's role in the risk management process to registered management investment companies. It has tailored the disclosure requirements according to the management structure of funds. The amendments propose that a registered investment company require a fund to disclose whether the board chair is an "interested person" (as defined in Section 2(a)(19) of the Investment Company Act of 1940). If the chair is determined to be an "interested person," the fund would be required to disclose whether it has a lead independent director and, if so, his or her role in the leadership of the fund.

Reporting of Shareholder Voting Results

The SEC has proposed to transfer the requirement to disclose shareholder voting results from the quarterly (Form 10-Q) and annual (Form 10-K) reports to Form 8-K to allow more timely disclosure of voting results. The proposal would amend Form 8-K by adding a new Item 5.07 to require a company to disclose the results of a shareholder vote and file this within four business days after the meeting at which the vote occurred.

Recognizing that in the case of contested elections companies may not have final voting results within the required period, the SEC has provided an exception. Where the vote pertains to a contested election of directors and results are not conclusive, companies would be required to disclose the preliminary results on Form 8-K within four business days and file an amended report within four days after the final votes are certified.

Proxy Solicitation Process

The SEC also has proposed clarifications regarding several rules governing the proxy solicitation process.

Rule 14a-2(b)(1)

Rule 14a-2(b)(1) exempts solicitors who are not seeking proxy authority or who do not have a substantial interest in the subject matter of the solicitation from the disclosure, filing and most other requirements of the proxy rules. The exemption is, however, unavailable to one who "furnishes or requests a form of revocation."

The SEC noted that there has been some ambiguity as to whether a person who is otherwise qualified for the exemption but provides a solicited shareholder with an unmarked copy of management's proxy card and requests its return to management is providing a "form of revocation." Accordingly, the SEC has proposed an amendment that qualifies such persons for the exemption by expressly providing that an unmarked copy of management's proxy card requested to be sent back to management is not a "form of revocation."

Rule 14a-2(b)(1)(ix) explicitly states that the Rule 14a-2(b)(1) exemption is not available 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 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 registrant."

The SEC noted that there has been some question as to whether this limitation requires both that a person is a security holder of the class being solicited and the benefit relates to such holdings, or whether the limitation applies generally to any person with a substantial interest in the subject matter of the solicitation. The proposed amendment would construe this limitation broadly, such that the exemption is unavailable to a person with a substantial interest in the subject matter of the solicitation and a substantial interest may exist even if the soliciting party is not a shareholder. In other words, a person does not have to be a security holder of the class of securities being solicited and a benefit does not have to be related to any security holdings in the class being solicited for a person to be disqualified from the exemption.

Rule 14a-4(d)(4)

Rule 14a-4(d)(1) requires that, when soliciting support for the election of a person to office, the person must be a *bona fide* nominee who agreed to being named in the solicitor's proxy statement and to serve, if elected. State law allows solicitors to exercise their right to run their own nominees independently, which could result in nominees who, if elected, would be a minority of the board (called a "short slate").

Rule 14a-4(d)(4) is an exception to the *bona fide* nominee requirement which allows a form of proxy where a person who solicits support of a "short slate" can fill the remainder of the director positions up for election with nominees from the company's proxy statement. In other words, the exception was permitted so that solicitors could exercise their state law right to run their own nominees and also vote for company nominees. While the rule permits rounding out a short slate by seeking authority to vote for nominees named in the company's proxy statement, it does not address nominees named in other non-management groups' proxy statements. The issue has arisen particularly with regard to where non-management groups soliciting support for a "short slate" have sought to fill the remaining director nominee positions with nominees named in another non-management group's proxy statement.

The SEC's proposed amendment would permit a non-management person soliciting in support of nominees who, if elected, would be part of a minority of the board to fill the remainder of the director nominee positions with both nominees named in the company's proxy statement and those named in other soliciting persons' proxy statements. This option is only available, however, when non-management parties are not acting in concert.

Rule 14a-4(e)

Rule 14a-4(e) requires that a proxy statement provide that the shares represented in a proxy be voted subject to "reasonable specified conditions."

The SEC noted that when a shareholder grants the authority for a soliciting party to vote his or her shares, the shareholder should know whether their shares will only be voted subject to some condition. The SEC has proposed to amend Rule 14a-4(e) to clarify that the "reasonable specified conditions" under which a party may not vote shares which it has received proxy authority over must be objectively determinable.

Rule 14a-12(a)(1)(i)

Rule 14a-12 allows persons to solicit support from shareholders before providing shareholders with a proxy statement that meets the requirements of Rule 14a-3(a) if, among other requirements, each written communication contains specified participant information. Rule 14a-12(a)(1)(i) further stipulates that such written information include the identity of the participants in the solicitation and a description of their direct or indirect interests or a legend directing shareholders as to where they can obtain this information.

The SEC noted that in providing the option to disclose information through a legend, it did not intend to permit participant information to be provided later than if provided in the written materials. Thus, the SEC has proposed to amend the rule to clarify that the identity and interests of participants in the solicitation must be filed under cover of Schedule 14A as part of the proxy statement or other soliciting materials no later than the time shareholders are first solicited.

Client Alert

The Employee Benefits and Executive Compensation Law Practice Group at Proskauer Rose LLP counsels clients on the full spectrum of benefit and compensation issues, communicating technical and complex legal concepts in an intelligible, pragmatic manner.

For more information, please contact:

Ira G. Bogner
212.969.3947 – ibogner@proskauer.com

James P. Gerkis
212.969.3135 – jgerkis@proskauer.com

Andrea S. Rattner
212.969.3812 – arattner@proskauer.com

Michael S. Sirkin
212.969.3840 – msirkin@proskauer.com

Ellen Czura
212.969.3816 – eczura@proskauer.com