



## SECURITIES AND CORPORATE GOVERNANCE NEWSLETTER

July 2009

To our Clients and Friends:

We are publishing our inaugural Securities and Corporate Governance Newsletter, a quarterly newsletter summarizing recent legal and regulatory developments that affect publicly-traded U.S. companies.

### Summary

***Interactive Data.*** A new SEC rule will require that periodic reports and registration statements include interactive data in XBRL format that is mapped to their financial statement items. The rule will initially apply only to the largest public companies and then will be phased in with respect to other companies over the next two years.

***Broker Votes in Director Elections.*** Beginning in 2010, brokerage firms will no longer be authorized to vote their customers' shares in director elections without instructions from the customer.

***NASDAQ Bid Price and Market Value Requirements.*** NASDAQ's temporary suspension of its continued listing requirements regarding minimum bid price and minimum market value is set to expire on July 20, 2009. However, NASDAQ has proposed that it be extended to July 31, 2009.

***Changes in Delaware Law Regarding Director Nominations and Reimbursement Bylaws.*** Effective August 1, 2009, the Delaware General Corporation Law will expressly permit the adoption of bylaws that permit stockholders to submit director nominations for inclusion in the corporation's proxy materials and that entitle stockholders to reimbursement of expenses incurred in soliciting proxies relating to director elections.

***SEC Rule Proposal Regarding Shareholder Access.*** The SEC has once again proposed rules permitting qualifying shareholders to include director nominations in the issuer's proxy materials.

***Proposed SEC Rule Regarding Executive Compensation Disclosure.*** The SEC has proposed further revisions to its executive compensation disclosure rules, including additional Compensation Discussion and Analysis disclosures, a change in the method for reporting equity

awards in the Summary Compensation Table and additional disclosure regarding fees earned by compensation consultants or their affiliates, qualifications of directors, nominees and executive officers, and the company's leadership structure.

***Pending Congressional Legislation.*** Bills have been introduced in Congress proposing corporate governance and disclosure reforms such as shareholder votes on executive compensation, limitations on deductibility of excess compensation, shareholder access to the proxy process in director elections, majority voting in director elections, independence requirements for compensation consultants, stronger clawbacks of unearned incentive compensation, and prohibition of severance payments to executives terminated for poor performance.

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## **Interactive Data**

Beginning this year, the SEC will begin phasing in its rule, adopted in a [release](#) issued in January 2009, requiring that periodic reports and most registration statements include interactive data in XBRL format that is mapped to the issuer's financial statement items. XBRL, which stands for eXtensible Business Reporting Language, is a system for embedding standard tags within financial statements to permit users to engage in quantitative analysis using software that recognizes such tags and automates the process of extracting financial data from companies' SEC filings.

The rule covers:

- Forms 10-K and 10-Q;
- any Form 8-K that includes financial statements; and
- any non-IPO registration statement that specifies the price or price range for the offering. (According to the adopting release, the inclusion of the price or price range typically marks the point at which any significant issues raised in the SEC review process have been resolved.)

XBRL data must be filed in an exhibit and must also be posted on the issuer's website for at least 12 months. The cover pages for Form 10-K and Form 10-Q have been amended to include a check box indicating whether the company has complied with the interactive data requirements. (Companies that are not yet subject to the interactive data rule are instructed to leave the box unchecked.)

The interactive data must cover all financial periods reported in the filing, including any comparative periods that predate the time when the issuer became subject to the interactive data requirement. Issuers are not required to provide interactive data for their Management's Discussion and Analysis, executive compensation disclosures or other financial, statistical or narrative disclosure. XBRL exhibits will not be covered by CEO/CFO certifications or audit reports.

For U.S. issuers, the rule takes effect in three phases between 2009 and 2011, beginning with issuers with a public float in excess of \$5 billion, as detailed in the following table:

<i>Type of Issuer</i>	<i>Rule takes effect beginning with Form 10-Q for period ending on or after:</i>
Company with public float greater than \$5 billion	June 15, 2009
Other large accelerated filers	June 15, 2010
All other filers	June 15, 2011

Each group will be given an additional year following the applicable phase-in date to begin providing detailed XBRL data from financial statement footnotes. Each company will also be afforded a 30-day grace period with respect to the filing of its first exhibit containing interactive data, and a similar grace period with respect to the filing of its first exhibit containing interactive footnote data.

In addition to the adopting release, the SEC has posted some secondary resources to assist issuers in their compliance with the rule. The Division of Corporation Finance has issued a set of [Compliance and Disclosure Interpretations](#) addressing a number of interpretive issues relating to the interactive data rule. The SEC has also published a [Small Entity Compliance Guide](#) setting forth a useful summary of the new requirements. Persons who are directly involved in preparing interactive data for filing may wish to consult the [FAQs](#) posted by the SEC addressing various technical issues.

Accurate mapping of financial data can require the participation of finance and accounting personnel, outside auditors, IT staff and financial printers. Accordingly, each issuer should begin preparing for compliance with the interactive data requirements well before it becomes subject to the rule.

### **Broker Votes in Director Elections**

After several years of fits and starts, on July 1 the SEC approved the New York Stock Exchange's proposed [amendment](#) to Rule 452 to eliminate brokerage firms' authority to vote their customers' shares in director elections without instructions from the customer. *This amendment affects virtually all public companies, regardless of whether they are listed on the NYSE*; Rule 452 does not apply directly to listed companies but, rather, is part of the regulations governing brokerage firms that are NYSE members. The rule change will take effect with respect to shareholders' meetings held on or after January 1, 2010.

In general, when a brokerage customer does not provide instructions as to how the customer's shares should be voted (typically given by means of a form resembling a proxy card, which is included with proxy materials forwarded by the broker) Rule 452 permits the firm to vote the customer's shares on uncontested matters that do not involve a merger or other issue that may substantially affect the rights or privileges relating to the shares, subject to an exception for certain types of matters, commonly referred to as "non-routine matters," as to which a firm may

vote only in accordance with instructions from the customer. The amendment will add director elections to this list of non-routine matters.

The most significant effect of this rule change will be on companies that employ majority voting in director elections; such companies will no longer be able to rely on brokers' discretionary votes as a bastion against a "vote no" campaign. In addition, the change may also make it more difficult for a company to achieve a quorum at annual shareholders' meetings at which only non-routine matters are being considered. For this reason, companies that have not previously opted to seek shareholder ratification of auditors may wish to consider doing so in the future to ensure that there is at least one routine matter considered at each annual meeting.

### **NASDAQ Bid Price and Market Value Requirements**

In October 2008, in light of turmoil in the financial markets, the NASDAQ Stock Market temporarily suspended its continued listing requirements regarding minimum bid price and minimum market value applicable to the NASDAQ Global Market and the NASDAQ Global Select Market. Normally, for an issuer to remain listed on these markets, the bid price of its shares must be at least \$1.00 per share, and the market value of its publicly held shares must be at least \$5 million or \$15 million (depending on which of two alternative tests the issuer is relying on). NASDAQ's suspension of these requirements has been extended twice, most recently in this [rulemaking proposal](#) issued in March 2009. The requirements regarding minimum bid price and market value are due to be reinstated as of July 20, 2009. However, on July 13, NASDAQ [proposed](#) that the suspension be extended to July 31, 2009.

### **Changes in Delaware Law Regarding Director Nominations and Reimbursement Bylaws**

Effective August 1, 2009 the Delaware General Corporation Law will expressly permit the adoption of bylaw provisions regarding shareholder access to the company's proxy materials and reimbursement of proxy solicitation expenses incurred by a stockholder in connection with the election of directors. Under the new [Section 112](#), a corporation may adopt a bylaw permitting stockholders to submit director nominations for inclusion in the corporation's proxy materials. The bylaw may subject such nominations to conditions such as minimum stock ownership, minimum duration of ownership and supplemental information to be submitted by the stockholder.

Under the new [Section 113](#), a corporation may adopt a bylaw that entitles stockholders to reimbursement of expenses incurred in soliciting proxies relating to director elections. The bylaw may impose conditions to reimbursement based on factors such as the number of persons nominated by the stockholder, the proportion of votes cast in favor of a nominee or nominees, or the amount spent by the corporation in soliciting proxies in connection with the election.

Although the adoption of such bylaws is optional, bylaws may be amended by stockholders without board approval. Moreover, as discussed below (see "Shareholder Access"), the SEC has proposed an amendment to Rule 14a-8 pursuant to which stockholders proposing amendments of the type permitted by Sections 112 or 113 would be permitted to have their proposals included in the company's proxy materials, provided certain conditions are met. Although such amendments would presumably be subject to further amendment by the board,

directors who are seen as acting unreasonably could later face retaliation from activist stockholders, e.g., through an attempt to replace them with a competing slate of directors.

## **On the Horizon**

There are several pending regulatory and legislative actions focusing on shareholder access to company proxy materials and executive compensation disclosure.

### ***Shareholder Access***

SEC has issued a [rule proposal](#) resuming its efforts to open up company proxy materials to director nominations by shareholders. Under proposed Rule 14a-11, qualifying shareholders would have the right to include director nominations in the issuer's proxy materials, provided that the shareholder or group of shareholders has held a certain amount of stock continuously for the past 12 months. The required ownership threshold is 1% for large accelerated filers, 3% for other accelerated filers and 5% for all other filers. As a further condition, shareholders must certify that they do not intend to gain control of the issuer or to fill more than a limited number of board seats.

The number of nominees that an issuer would be required to include under Rule 14a-11 would be limited to a number equal to 25% of the overall size of the board at the time of the election. If the issuer had a classified board, continuing directors who were previously nominated pursuant to Rule 14a-11 would count toward the maximum. If a greater number were proposed by two or more proponents, the proposals would be given priority based on the order in which the proposals were submitted.

In connection with the proposed rule, the SEC is also proposing an amendment to Rule 14a-8 to require issuers' proxy materials to include shareholder proposals to amend bylaws or other governing documents to modify nomination procedures or related disclosure requirements, provided that certain conditions are met and that the proposal does not conflict with Rule 14a-11.

### ***Proposed Changes to Executive Compensation Disclosure Rules and Proxy Rules***

The SEC has issued a [rule proposal](#) setting forth further revisions to its executive compensation disclosure rules. Under the proposal:

- In Compensation Discussion and Analysis, companies would be required to discuss the relationship between their compensation policies and risks arising from those policies if those risks may have a material effect on the company.
- Equity awards shown in the Summary Compensation Table would be reported based on the grant date fair value, rather than the portion recognized as compensation during the fiscal year, as originally contemplated in the rule changes adopted in August 2006, prior to the modifications adopted in December 2006.
- Additional disclosure would be required regarding fees earned by compensation consultants or their affiliates if they provide any other services to the company.

- Additional disclosure would be required regarding the qualifications of directors, nominees and executive officers.
- Companies would be required to discuss matters relating to leadership structure, such as why the board chose to combine or separate the chairman and CEO positions.

The SEC has also proposed that the results of shareholder votes be disclosed currently on Form 8-K rather than in a subsequent Form 10-K or 10-Q.

### *Pending Legislation*

Several bills have been introduced in Congress during 2009 proposing to reform selected corporate governance and disclosure practices. In May, Senators Schumer and Cantwell introduced the Shareholder Bill of Rights. This bill would:

- require companies to have annual advisory “say-on-pay” votes on executive compensation;
- require advisory votes on “golden parachute” arrangements;
- enable shareholders to include director nominations in companies’ proxy statements;
- require companies to have an independent board chair;
- require annual director elections;
- require majority voting in uncontested elections; and
- require that each board of directors establish an independent risk committee.

In May, Senator Durbin introduced two bills aimed at curbing excessive compensation. The Excessive Pay Shareholder Approval Act would require shareholder approval, by a 60% vote, of any compensation structure in which an employee is paid more than 100 times the company’s average employee compensation. In soliciting such vote, the company would be required to make specific disclosures regarding its compensation structure. The Excessive Pay Capped Deduction Act would limit the federal tax deduction for compensation paid to executives in excess of 100 times average employee compensation.

In June, Congressman Peters introduced the Shareholder Empowerment Act. This bill includes many provisions similar to those contained in the Shareholder Bill of Rights, and, in addition would:

- require that compensation consultants engaged by the board or the compensation committee be independent;
- strengthen clawbacks of unearned incentive compensation;

- bar severance payments to executives terminated for poor performance; and
- require additional disclosure regarding performance targets.

*If you have any questions about any of the matters discussed in this newsletter, please contact [Paul Blumenstein](#) of our Silicon Valley Office or [William Caffee](#) of our Portland Office.*

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