



SECURITIES AND CORPORATE GOVERNANCE NEWSLETTER

January 2010

To our Clients and Friends:

Below is the January 2010 issue of our Securities and Corporate Governance Newsletter, a quarterly newsletter summarizing recent legal and regulatory developments of interest to publicly-traded U.S. companies. The Newsletter is intended to inform you about issues that may affect you. Please contact us if you would like to discuss these issues in greater depth, or if there are other matters you would like to see addressed in the future.

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Amendments to Executive Compensation Disclosure Rules

In December, the SEC adopted [amendments](#) to its executive compensation disclosure rules requiring companies to make new or revised disclosures regarding (a) compensation policies and practices that present material risks to the company, (b) stock and option awards of executives and directors, (c) director and nominee qualifications and legal proceedings, (d) board leadership structure, (e) the board's role in risk oversight, and (f) potential conflicts of interest of compensation consultants that advise companies and their boards of directors. The amendments are effective on February 28, 2010.

Narrative Disclosure of Compensation Policies and Practices as They Relate to the Company's Risk Management. Companies will be required to discuss and analyze their compensation policies and practices for all employees, including non-officers, if those policies or practices create risks that are reasonably likely to have a material adverse effect on the company. Smaller reporting companies (generally, companies whose public float is less than \$75 million) are exempt from this requirement.

Reporting of Stock and Option Awards in Summary Compensation Table. Under the present rules, Companies reporting stock or option awards in their Summary Compensation Table or Director Compensation Table must report the dollar amount recognized for financial statement reporting purposes. Under the amended rules, Companies must report the aggregate grant date fair value of each award granted during the most recently completed fiscal year. Thus, the SEC has restored the reporting requirement to its original form as adopted in 2006. In the SEC's view, the grant date fair value is more meaningful to investors as an indication of the

company's compensation decisions. Disclosure must address awards *granted* during the fiscal year, as opposed to awards *earned* during the year but granted in the following year. The revised rule applies to compensation tables for fiscal years ending on or after December 20, 2009.

To facilitate year-to-year comparisons, the SEC is requiring companies to present recomputed disclosure for preceding fiscal years so that the stock and option awards columns present the applicable full grant date fair values, and the Total Compensation column is correspondingly recomputed. If a named executive officer in 2009 was also a named executive officer in 2007 but not in 2008, that officer's compensation for each of those three fiscal years must be reported pursuant to the amendments. However, companies are not required to include different named executive officers for any preceding fiscal year based on recomputing total compensation for those years, or to amend prior years' Item 402 disclosure in previously-filed Form 10-K reports.

The staff of the SEC's Division of Corporation Finance has issued [Compliance and Disclosure Interpretations](#) regarding the transition to the revised rules. Among these interpretations are the following:

- If an issuer files a preliminary proxy statement prior to February 28, 2010 with the expectation that the definitive proxy statement will be filed on or after that date, the preliminary proxy statement must comply with the amended rules.
- A reporting issuer with a 2009 fiscal year that ends before December 20, 2009 will not become subject to the amended rules until the filing of its Form 10-K for fiscal year 2010. Accordingly, any Securities Act or Exchange Act registration statements filed before the filing deadline for the issuer's 2010 Form 10-K would not be subject to the amendments.
- A company with a fiscal year ending on or after December 20, 2009 that files a registration statement after that date generally will be required to comply with the amended rules if its registration statement is declared effective on or after February 28, 2010. However, a registration statement on Form S-3, which incorporates the company's 2009 Form 10-K by reference, need not comply if the 10-K was filed prior to February 28 (even if the registration statement is declared effective on or after that date).

Enhanced Director and Nominee Disclosure. The SEC is expanding the disclosure requirements regarding the qualification of directors and nominees, their past directorships, and the time period for disclosure of legal proceedings involving directors, nominees and executive officers. A company must disclose the particular experience, qualifications, attributes or skills that qualify a director or nominee to serve as a director in light of the company's business. In addition, a company must disclose any directorships held by each director or nominee at any time during the past five years at public companies and registered investment companies. The new disclosure will be required for all nominees and all directors, including members of a staggered board who are not up for reelection in a particular year.

The amendments also lengthen the time period covered by disclosure of certain legal proceedings from five years to ten years and expand the list of proceedings covered by the disclosure. In addition to bankruptcy proceedings, criminal convictions, judicial or administrative orders restricting certain business or financial activities, and judgments regarding violations of securities laws or federal commodities laws, companies must now provide disclosure regarding:

- any judicial or administrative proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity;
- any judicial or administrative proceedings based on violations of federal or state securities, commodities, banking or insurance laws or regulations, or any settlement of such actions; and
- any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization.

Finally, companies must disclose whether, and if so how, the nominating committee considers diversity in identifying nominees for director. If the nominating committee has a policy with regard to the consideration of diversity, the company must disclose how this policy is implemented and how the nominating committee assesses the effectiveness of its policy. In its adopting release, the SEC emphasizes that companies may define diversity in ways they consider appropriate. For example, some companies may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill and other individual qualities and attributes that contribute to board heterogeneity.

Board Leadership Structure and the Board's Role in Risk Oversight. Under the amendments, a company must disclose whether and why it has chosen to combine or separate the CEO and board chairman positions and the reasons why it believes that this board leadership structure is the most appropriate structure for the company. In addition, in some companies the role of CEO and chairman are combined, and a lead independent director is designated to chair meetings of the independent directors; in these circumstances, the company must disclose whether and why it has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. The amendments will also require companies to describe the board's role in risk oversight. As with disclosure about the leadership structure, the SEC believes that disclosure about the board's involvement in risk oversight should provide important information about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company.

Compensation Consultants. Under the amendments, in addition to the current requirement that companies describe the role of the compensation consultant, fee disclosure related to the retention of a compensation consultant will be required in certain circumstances:

- If the compensation committee has engaged its own consultant and the consultant provided other consulting services to the company in excess of \$120,000 during the fiscal year, the company must make fee disclosures regarding fees and related

information. The company must also disclose whether the decision to engage the consultant or its affiliates for other consulting services was made or recommended by management, and whether the compensation committee has approved these consulting services.

- If the committee has not engaged its own consultant, but a consultant is providing executive compensation consulting services and other consulting services, where the latter services exceed \$120,000 during the fiscal year, the company must make fee disclosures.
- Services involving only broad-based non-discriminatory plans or the provision of information, such as surveys, that are not customized for the company, or are customized based on parameters that are not developed by the consultant, are not treated as executive compensation consulting services.

Reporting of Voting Results on Form 8-K. The SEC is adopting a new Item 5.07 to Form 8-K requiring companies to report the results of a shareholder vote within four business days after the end of the meeting at which the vote was held. The SEC is eliminating the requirement that such vote results be disclosed on Form 10-Q or 10-K. According to the staff's [Compliance and Disclosure Interpretations](#), such disclosure must be made regarding any vote held on or after February 28, 2010, even if the proxy statement was mailed prior to that date. On the other hand, if the vote occurs prior to that date but the company's next Form 10-K or 10-Q is due after that date, the results of the meeting should be reported under "Other Information," rather than in the "Submission of Matters to a Vote of Security Holders" item, which is being rescinded.

Change in Nasdaq Rule Regarding Material Disclosures

Nasdaq has adopted an [amendment](#) to its rule regarding notification of the exchange prior to material disclosures by a listed company. Under the amended Rule 5250(b)(1), companies are now required (rather than merely urged) to notify Nasdaq's Market Watch Department at least 10 minutes prior to disclosure of material information by a means that complies with Regulation FD (e.g., press release or Form 8-K).

Pending Financial Reform Bills

In response to last year's crisis in the financial industry, Congress is considering several bills designed to address some of the systemic risks that led to the crisis. While most of the provisions of these bills are directed at financial institutions, some key provisions affect publicly-traded companies in general, including new requirements regarding compensation practices, executive compensation disclosure and corporate governance.

In December, the House of Representatives passed the [Wall Street Reform and Consumer Protection Act](#). (The Senate has not yet taken up this bill for consideration but is considering similar legislation, as discussed below.) The House bill includes wide-ranging reforms relating to oversight of financial institutions, credit rating agencies and the insurance industry, trading in derivatives, consumer financial protection, broker-dealer regulation, investor protection, and

asset-backed securities, among other areas. The bill also includes the following provisions that would apply to public companies generally:

- *Shareholder Approval of Executive Compensation.* At their annual meetings, companies would be required to seek a non-binding shareholder vote to approve the executive compensation disclosed in their proxy statements.
- *Shareholder Approval of Golden Parachutes.* Should a company seek shareholder approval of a merger, acquisition, sale or similar transaction, it would also be required to obtain non-binding shareholder approval of any arrangements providing for payments to any named executive officers in connection with such a transaction.
- *Compensation Committee Independence.* Any exchange-listed company would be required to have a compensation committee consisting of independent directors. Such committees would be subject to requirements similar to those affecting audit committees: they must have the authority to engage consultants and advisors, and must be directly responsible for the appointment, compensation and oversight of their compensation consultants and other advisors. The company would be required to disclose whether its compensation committee had retained a consultant.

Similar legislation is under consideration in the Senate. Most recently, in November, Senator Christopher Dodd introduced the [Restoring American Financial Stability Act of 2009](#). Senator Dodd's bill includes provisions relating to executive compensation and corporate governance similar to the provisions of the House bill, as well as the following additional compensation-related provisions:

- *Pay-for-Performance Disclosure.* Companies would be required to disclose the relationship between executive compensation and financial performance and provide a graphic or pictorial comparison of the compensation earned and the company's financial performance or investor return over a five-year period.
- *Clawback Policies.* Companies would be required to adopt "clawback" policies for current and former executives, under which, in the event of a financial restatement due to material noncompliance with financial reporting requirements, such executives' incentive compensation from the previous three years could be recovered to the extent it exceeded what would have been paid based on the restated results.
- *Disclosure Regarding Employee Hedging.* Companies would be required to disclose whether their employees are permitted to hedge the value of their equity compensation grants.

Senator Dodd's Bill also includes the following provisions regarding corporate governance:

- *Majority Voting in Director Elections.* Directors of listed companies elected in uncontested elections would be required to receive a majority of the votes cast (rather than a plurality as generally provided by state law).
- *Proxy Access.* Shareholders would be permitted, under specified conditions, to nominate director candidates through the company's proxy statement.
- *Disclosures Regarding Chairman and CEO Structures.* Companies would be required to disclose in their proxy statements why they have combined or separate board chairman and CEO roles.
- *Shareholder Vote on Boards with Staggered Terms.* Listed companies would be required to obtain shareholder approval or ratification of classified boards.

Possible SOX 404 Relief for Smaller Companies

The [Wall Street Reform and Consumer Protection Act](#), discussed above, includes a provision amending Section 404 of the Sarbanes-Oxley Act to permanently exempt non-accelerated filers from the audit requirements of Section 404.

The provision also directs the SEC and the Comptroller General to conduct a joint study to determine ways to reduce the burden of this audit requirement for accelerated filers whose market capitalization is less than \$250 million, while maintaining investor protections. (The bill specifically refers to "market capitalization" but may be intended to refer to public float, the measure generally used in securities regulations that categorize companies by size.) The study must also consider whether a reduction in such burden or a complete exemption from the audit requirement would encourage companies to list on U.S. exchanges in connection with their IPOs.

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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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