

SEC Proposal on Executive Compensation and Corporate Governance Disclosure Requirements and Proxy Solicitation Rules

July 21, 2009

On July 10, the Securities and Exchange Commission (SEC) issued a release proposing various rule amendments that would add or revise executive compensation and corporate governance disclosures in proxy and information statements, and address certain issues relating to proxy solicitations (Proposal Release).¹ Comments on the proposed amendments must be submitted by September 15, 2009. If the proposed amendments are adopted, the SEC expects that they will be effective for the 2010 proxy season. The proposed amendments are discussed in more detail below:

- 1. Disclosures about risks relating to compensation policies and practices.** The SEC proposes to amend Item 402 of Regulation S-K to require a company to expand its Compensation Discussion and Analysis (CD&A), if the company's compensation policies and practices for employees generally (including nonexecutive officers) create risks that could have a material adverse effect on the company. A company would be required to discuss the causes of such risks and how it manages them.

At this point, it is unclear how much of an effect this amendment would have on companies' CD&As. While all companies will have to analyze their compensation policies and practices from a risk-assessment perspective, not all companies will conclude that their policies and practices "create" risks that may have "material" adverse effects. Moreover, footnote 31 of the Proposal Release reminds companies that the current CD&A disclosure requirements already contemplate a discussion of any risk implications of their executive compensation policies.²

Noting that the current economic conditions, as well as the long-term well-being of certain companies, may have been affected by the misalignment of short-term incentives created by the design of compensation plans, the Proposal Release states that "well-designed compensation policies may enhance a company's business interests by encouraging innovation and appropriate

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1. SEC Release Nos. 33-9052, 34-61280, IC-28817; File No. S7-13-09, Proxy Disclosure and Solicitation Enhancements (July 10, 2009), available at <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>.
 2. See also "Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009," by John R. White, Director, SEC Division of Corporation Finance (October 21, 2008) (stating that a company is required to discuss in the CD&A the compensation committee's considerations of the risks that an executive officer might be incentivized to take to meet performance targets, to the extent that such considerations become a material part of the company's compensation policies and practices), available at <http://www.sec.gov/news/speech/2008/spch102108jww.htm>.

levels of risk taking.”³

Proposed amended Item 402(b)(2) identifies the following situations, among others, that may require expanded disclosure about risks relating to compensation policies and practices:

- When a business unit:
 - Accounts for a significant portion of the company’s risk profile;
 - Structures compensation for its employees in a significantly different manner than other business units do;
 - Is significantly more profitable than the company’s other business units; or
 - Has compensation expense that represents a significant percentage of the business unit’s revenues; or
- Certain compensation policies and practices vary significantly from the company’s overall risk and reward structure, “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.”⁴

Proposed amended Item 401(b)(2) lists the following examples of issues that companies may need to address in the expanded CD&A:

- The general design philosophy and implementation of the company’s compensation policies for employees whose behavior may be most affected by the incentives established by the policies, as such policies relate to or affect risk-taking by employees on behalf of the company;
- The company’s risk assessment or incentive considerations, if any, used 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 those 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 in connection with incentivizing its employees.⁵

The proposed amendments might be easier for companies to implement and more effective if the SEC also listed, in the examples of situations that may require risk-related disclosure, features of

3. Proposal Release at 8. (Page references are to the PDF version of the release posted on the SEC’s website and not to the Federal Register version, issued July 17, 2009.)

4. *Id.* at 10.

5. Proposed Item 402(b)(2)(i)–(vii).

compensation awards that might cause material risks to the company and its business, such as short-term performance targets, high cash incentive award opportunities, and uncapped and overly formulaic bonus awards. The SEC could also explain that companies should disclose whether they assess risk with respect to these specific features, and provide concrete examples of steps that they might take in designing and implementing awards to ameliorate the risks, such as:

- Setting multiyear (weighted) average targets;
- Using rolling or overlapping performance periods;
- Providing for a delay between the close of the performance period and the calculation and payout of the award;
- Implementing an earnout, tail, or trailing feature to adjust a lower initial award upward only if specified future conditions are met;
- Reserving management or compensation committee discretion to increase or decrease award payouts;
- Imposing clawbacks and holding period (including post-retirement) requirements; and
- Requiring performance-based payouts to be in restricted stock or deferred with an additional time-vested feature.

For example, performance-based awards may cause excessive risk-taking because they may incentivize employees to simply achieve the stated target during a stated performance period, such as a one-year loan production or sales volume goal, without regard to longer-term credit risk, or the impact of current period “channel stuffing” on future periods. A performance target based on a non-GAAP financial measure, that is, one calculated without regard to specific requirements of generally accepted accounting principles (GAAP), might reduce the importance to employees of GAAP results or GAAP amounts that are not relevant to the non-GAAP financial measure. A compensation arrangement that involves a significant amount of cash compensation dependent upon achieving a short-term performance goal may cause undue risk to the company unless the long-term effect of the performance can be measured or predicted in the short term, or at least by the time the award is fully paid. An incentive award that does not limit the maximum amount of the payout may cause employees to take undue risk to achieve the highest possible payout for the immediate period, willingly forgoing a possible payment in future periods. An overly formulaic performance award that does not permit reduction or increase at the discretion of management or the compensation committee would not permit the company to assess the quality of the performance and its effect on longer-term results, or to take into account evolving economic conditions that may only be apparent with the passage of time, and may make full payment of the award impractical or unwise.⁶

In addition to asking whether the proposed amendments would elicit meaningful disclosure, the Proposal Release requests comment on the following:

6. In all events, company compensation policies should require that these conditions and reservations of discretion be built into the award from the outset, so as to put employees on fair notice and avoid any later claim by them that the company is unilaterally amending or renegeing on its contractual obligations. In addition, companies will have to consider and disclose under current CD&A requirements the effects, if any, of tax law provisions, such as Sections 409A and 162(m) of the Internal Revenue Code, on the types of award conditions and reservation of discretion, including features designed to ameliorate risk, that they employ, and the Congress, the Treasury, and the Internal Revenue Service may have to review the unintended effects of these tax provisions on the grant and payout of risky performance-based awards.

- Whether any amendments should apply only to compensation policies and practices applicable to specific groups of employees, such as executive officers, or companies of specified sizes or in specific industries, such as the financial services industry; and
- Whether any amendments should require a company to affirmatively state that it has determined that the risks arising from the broader compensation policies are not reasonably expected to have a material effect on the company.

Interestingly, the SEC did not ask for comments on what specific roles directors, especially the members of the compensation committee, and outside professionals, including compensation consultants, can play in designing and implementing appropriately risk-based performance awards in given companies or industries, or on the science or cost-effectiveness of risk assessment and risk management as applied to compensation decisions. As discussed below, the SEC is proposing amendments to require greater compensation- and governance-related disclosures generally with respect to the qualifications, including risk assessment skills, of directors, including compensation committee members, and their expertise; the role of the board in the company's risk assessment processes; and the independence of compensation consultants.

However, the SEC has not focused specifically on whether and how that general skill, expertise, and independence translate into sound risk-based compensation decisions, especially given the facts that most compensation consultants have little or no background or experience in the field of risk assessment and management or in its application to incentive compensation policies and practices in specific companies or industries; that any effort to carefully tailor a given company's compensation policies and practices to its specific risks is likely to be a time-consuming and costly process; and that any meaningful risk assessment and management process has to start with the risks faced by the business itself and then work its way down through appropriately tailored compensation policies and practices.

Nor did the SEC ask whether it should require disclosure about the role of the audit committee or any other board committee in overseeing the risks that may be influenced by incentive compensation plans or in interacting with the compensation committee. We expect that the request for greater disclosure with respect to the risk assessment mandate, if adopted, will likely lead to greater interaction between the compensation committee and the audit committee or the board committee that oversees risk. This committee could provide valuable insight with respect to the overall risk profile of the company, the assessment of the individual business units in terms of the factors outlined above, and the impact of performance goals and incentive compensation levels upon the company's finances.

- 2. Disclosure of grant date fair value rather than annual accrued expenses for equity-based awards.** The SEC is proposing to require disclosure in the Summary Compensation Table and the Director Compensation Table of the aggregate fair value of stock and equity-based awards granted during the fiscal year, rather than the amounts of expense accrued in the financial statements in the fiscal year for all outstanding stock or equity-based awards, in compliance with Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (FAS 123R).⁷

7. When the SEC adopts final amendments to Item 402 of Regulation S-K, it expects to change the reference to FAS 123R in various provisions of Item 402 to use the corresponding section reference of the Financial Accounting Standards Board's (FASB) Financial Accounting Standard Codification (Codification). Proposal Release at note 32. The Codification will supersede all references to previous FASB standards for interim or annual periods ending on or after September 15, 2009. FAS 123R is codified at Topic 718 of the Codification.

Adoption of this proposal would reinstate the compensation disclosure requirements initially adopted in August 2006,⁸ which required separate disclosure in the Summary Compensation Table and the Director Compensation Table of the grant date fair value of stock or equity-based awards, and did not require the grant date fair value column in the Grants of Plan-Based Awards table or disclosure of the grant date fair value of stock or equity-based awards in a footnote in the Director Compensation Table.⁹ In addition, the proposed amendments would permit companies to present any salary or bonus amounts that the executive elects to receive as stock, an equity-based award or another form of noncash compensation in the applicable stock, option, or “all other compensation” column.

In order to implement the transition to the new rules, the SEC is proposing to require disclosure for all three years of the grant date fair value of stock and stock-based awards in the Summary Compensation Table to facilitate year-to-year comparisons. The SEC is considering requiring the three-year information for each named executive officer (NEO) identified for 2009 even if the NEO was not an NEO in 2008 as long as the executive was an NEO in 2007.

The Proposal Release notes that the SEC has received comments that the use of the grant date fair value would be more useful “because investors may consider compensation decisions made during the fiscal year—which usually are reflected in the full grant date fair value measure, but not the financial statement recognition measure—to be material to voting and investment decisions.”¹⁰ In addition, the Proposal Release identifies the following deficiencies in the current approach to stock and stock-based awards:

- The Summary Compensation Table may include executive officers who were not among the executives who received the largest awards in the most recent fiscal year;
- It may require more complicated CD&A disclosure to explain the effect of the FAS 123R accrued expenses;¹¹
- It may result in a negative number in the stock or stock-based award column because of the accounting for awards classified as liabilities under FAS 123R, and the need for reversals of compensation if performance-based targets are determined to be no longer likely to be achieved; and
- It does not require smaller reporting companies to provide the grant date fair value of stock and stock-based awards because smaller reporting companies do not present the Grants of Plan-Based Awards table.

Among the SEC’s specific requests for comments are the following:

- Whether the SEC should require disclosure of the grant date fair values of stock and stock-

8. See SEC Release Nos. 33-8732A; 34-54302A; IC-27444A; File No. S7-03-06, “Executive Compensation and Related Party Disclosures” (Aug. 29, 2006), available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>.

9. Presentation of the FAS 123R expense amounts in the Summary Compensation Table and the Director Compensation Table and the grant date fair value in the Grants of Plan-Based Awards table and a footnote to the Director Compensation Table was later required by SEC Release Nos. 33-8765; 34-55009; File No. S7-03-06, “Executive Compensation Disclosure” (Dec. 22, 2006), available at <http://www.sec.gov/rules/final/2006/33-8765.pdf>.

10. Proposal Release at 15.

11. In this regard, the SEC noted that a number of companies included in the CD&A an alternate Summary Compensation Table that presents the grant date fair value of stock and stock-based awards.

based awards made after the end of the fiscal year but for services in the relevant fiscal year rather than, as proposed, only for awards made during the fiscal year;¹²

- Whether companies often grant multiyear awards, which would result in significant year-to-year variability under the proposed amendments;
- Whether the proposal would discourage companies from granting performance-based stock or option awards because of the need for disclosure of the full grant date fair value, irrespective of the likelihood of achievement of the targets; and
- Whether the ability to report stock and stock-based awards in the applicable columns of the Summary Compensation Table when salary or bonus amounts are forgone should be limited to those situations for which the election right is within the terms of the applicable compensatory arrangement.

3. Expanded disclosure about qualifications and backgrounds of directors and nominees and about legal proceedings involving directors, nominees, and executive officers. The SEC is proposing to amend Item 401 of Regulation S-K to expand disclosure requirements for directors and director nominees about their particular experience, qualifications, attributes, or skills that qualify them to serve as directors of the company and as members of the respective committees on which the directors serve, or that directors or nominees are expected to serve, in light of the company's business and structure. The type of disclosure that may be appropriate includes details concerning a director's or nominee's risk-assessment skills and particular areas of expertise, and may cover a period of more than the prior five years. The Proposal Release explains that the proposed amendments are designed to enable investors to determine whether a director or nominee is a "good fit" for the company and to provide the company with the flexibility to craft appropriate disclosures.

In addition, the proposed amendments would require companies to disclose the directorships at other public companies that the directors and director nominees have held at any time during the prior five years (rather than only currently held directorships). The expanded disclosures are intended to enable "investors to better evaluate the relevance of a director's or nominee's past board memberships, or professional or financial relationships that might pose potential conflicts of interest (such as membership on boards of major suppliers, customers, or competitors)."¹³

Finally, the proposed amendments would expand the time period for which legal proceedings involving directors, director nominees, and executive officers must be disclosed to the prior 10 years (rather than just the prior five years). The SEC explained that this disclosure would enhance an investor's ability to assess a director's, director nominee's, or executive officer's competence and character because the legal proceedings required to be disclosed "reflect upon an individual's competence and character."¹⁴

Among the SEC's specific requests for comments are the following:

- Whether the requirement in Item 407 of Regulation S-K to disclose minimum qualifications that a nominating committee believes must be met by a nominee for director

12. This would reflect current practice with respect to bonuses, nonequity incentive compensation, and all other compensation.

13. Proposal Release at 28.

14. See Proposal Release at 29.

should be retained if Item 401 is amended as proposed;

- Whether the SEC should require disclosure of any additional factors that a nominating committee considers when selecting a nominee for director, such as diversity;
- Whether the director qualification disclosure should be required for all board committees or just for certain key committees, such as audit, compensation, and nominating/governance;
- Whether the expanded qualification disclosure should be required for all nominees or all directors and nominees when a company has a staggered board, only for nominees or only when the director is first nominated or periodically, such as every three years;
- Whether the SEC should require disclosure about each of the committees of the board similar to the current disclosures required for the audit, compensation, and nominating/governance committees;
- Whether directorship and legal proceedings disclosure should be required for periods longer than the proposed five and 10 years, respectively;
- Whether there are additional legal proceedings for which disclosure should be required; and
- Whether the SEC should retain the exception from the legal proceedings disclosure requirement for information that the company concludes would not be material to an evaluation of the ability or integrity of the director, director nominee, or executive officer.

4. Disclosures about leadership structure. The SEC is proposing to amend Item 407 of Regulation S-K and Schedule 14A to require additional disclosure about a company's leadership structure, including why the company has chosen to combine or separate the chief executive officer and board chair positions, and whether the company has a lead independent director.¹⁵

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15. Members of Congress also have been concerned about the leadership structure of public companies. Bills are under consideration that would, among other things, require the SEC to direct the national securities exchanges to require listed companies to have an independent chair. *See* Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. § 5 (2009), introduced by Senators Charles Schumer and Maria Cantwell on May 19, 2009; and Shareholder Empowerment Act, H.R. 2861, 111th Cong. § 2(d) (2009), introduced by Representatives Gary Peters, Maxine Waters, John Dingell, Peter Welch, Rush Holt, Peter DeFazio, and Michael Capuano on June 12, 2009. The Shareholder Bill of Rights Act would also require boards of directors to have a separate committee of independent members of the board to be responsible for the establishment and evaluation of the risk management practices of the company. *See* S. 1074 § 5.

Other provisions of S. 1074 and H.R. 2861 would require nonbinding votes of shareholders on the executive compensation disclosed in the proxy or information statement (say-on-pay) and on any golden parachute payments to be made to executive officers as a result of a merger or similar transaction subject to shareholder approval; the inclusion of shareholders' director nominees in companies' proxy statements; the election of each member of the board of directors on an annual basis and by a majority vote of the shareholders in uncontested elections, to the extent permitted by applicable state corporate law; the independence of compensation consultants; clawbacks of compensation; the prohibition of providing for severance agreements upon a termination for poor performance; and improved disclosure about specific performance targets. H.R. 2861 also provides that, in determining the independence of the compensation consultant, the SEC shall consider the extent to which the consulting firm provides other services to the company or its executives and if the individual consultant is permitted to own the company's equity and receives compensation linked to the provision by the consulting firm of other services.

In addition, on July 16, 2009, the Department of the Treasury delivered to Congress draft legislation that would require the SEC to adopt rules that would require all public companies to provide shareholders the right to vote on nonbinding resolutions on the compensation of executive officers disclosed pursuant to the SEC's rules at annual meetings (or special meetings in lieu of annual meetings) occurring on or after December 15, 2009, and on clearly disclosed golden parachute payments that executives will receive if the shareholders approve a merger or acquisition. *See* "FACT SHEET: Administration's Regulatory Reform Agenda Moves Forward: Say-on-Pay" (July 16, 2009), *available at*

(continued).

The Proposal Release states that the proposed disclosure is intended to provide investors with insights about why the company has chosen its particular leadership structure, and to increase the transparency for investors into how boards function. The Proposal Release notes that different leadership structures may be appropriate for companies of different sizes, or having different types of businesses, or for other reasons.¹⁶

In addition, the proposed amendments would require disclosure about the role of the board in the company's risk-management processes. The Proposal Release states that investors need to understand the role of the board or board committees in risk management processes because of the roles that risk and the adequacy of risk oversight have played in the recent market crisis. Possible disclosures suggested by the SEC to enable investors to understand how a company's board perceives and manages a company's risks include whether the persons who oversee risk management report directly to the full board as a whole or to a board committee, and whether and how the board or board committee monitors risk.

Among the SEC's specific requests for comments are the following:

- Whether disclosure should be required of the specific duties performed by the board's chair or independent lead director;
- Whether disclosure should be required about other board structure matters, such as how the company determines the number of independent directors to have on its board, or the size of the board;
- Whether there are competitive or proprietary concerns about the level of detail that the proposal would require about the risk management structure and function; and
- Whether additional disclosure about a company's risk management processes should be required.¹⁷

5. Disclosures about fees paid to and services provided by compensation consultants. The SEC is proposing to expand the disclosures required by Item 407 of Regulation S-K about compensation consultants if they play a role in the determination or recommendation of executive or director compensation and also provide other services. If the expanded disclosure requirement is adopted, a company would be required to describe the additional services provided, state whether the decision to engage the consultants was made "subject to screening" or recommended by management, and whether the board or compensation committee approved the additional services.

<http://www.ustreas.gov/press/releases/tg219.htm>, and draft legislation, available at <http://www.ustreas.gov/press/releases/reports/titleixsubtdexcomp%20.pdf>. As discussed below, the draft legislation also includes provisions relating to compensation committees and consultants and advisors to compensation committees. See *infra* at note 19.

16. Proposal Release at 35.

17. The Proposal Release states that, in addition to the proposal to address risk-management oversight as a part of the corporate governance disclosures required in proxy and information standards, the SEC is considering whether to revise existing disclosure requirements, such as in Items 303 and 305 of Regulation S-K, to require additional disclosure regarding a company's risk management practices in other filings, such as annual and quarterly reports. Proposal Release at 37–38. The SEC has not commented, however, on the need for the board's risk-assessment oversight to include the consideration of appropriate disclosures in the Management's Discussion and Analysis about trends and uncertainties, including any risks resulting from compensation policies or practices.

In addition, the company would be required to disclose the aggregate fees paid for determining or recommending executive or director compensation and the aggregate fees for the additional services. Expanded disclosure would not be required for compensation consultants whose “only role in recommending the amount or form of executive or director compensation is in connection with consulting on broad-based plans that do not discriminate in favor of executive officers or directors of the company and are available to all salaried employees, such as 401(k) plans or health insurance plans.”¹⁸

Among the SEC’s specific requests for comments on its proposed amendments are the following:

- Whether the proposed disclosure will “help investors better assess the role of compensation consultants and potential conflicts of interest, and thereby better assess the compensation decisions made by the board;”
- Whether the proposed disclosure would adversely affect a company’s ability to receive compensation-related consulting services;
- Whether the proposed disclosures would raise competitive or proprietary concerns;
- Whether other disclosures should be required regarding potential conflicts of interest of compensation consultants, such as ownership interests in the company or the provision of compensation-related services in other years;
- Whether the disclosure about fees should be limited to those exceeding a certain amount or a specified percentage of income or revenues of the consulting firm, or should be disclosed for each service; and
- Whether there are other categories of consultants or advisors whose activities on behalf of companies should be disclosed to shareholders.

The SEC’s proposed amendments regarding compensation consultants may be overshadowed by congressional proposals¹⁹ and the draft legislation delivered by the U.S. Department of the Treasury to Congress on July 16, 2009, which would impose more comprehensive independence requirements for compensation committee members and their independent advisors. The Treasury’s draft legislation in particular would require the SEC to adopt rules requiring the national securities exchanges and national securities associations to prohibit the listing of any security of a company if the company is not in compliance with the standards promulgated pursuant to the provisions of the legislation within 270 days after the enactment of the legislation.

These standards would prohibit each member of a company’s compensation committee from accepting any consulting, advisory, or other compensatory fee from the company, other than in his or her capacity as a member of the board or a board committee, and from being an affiliated person of the company or any subsidiary thereof. They would also require that any consultant, legal counsel, or other adviser to the compensation committee meet the independence standards promulgated by the SEC, and that the compensation committee have the necessary funding and the authority, in its sole discretion, to retain and obtain the advice of a compensation consultant and independent legal counsel, and to oversee any such persons.

18. Proposal Release at 41.

19. See note 15, *supra*.

With respect to disclosure, the required standards would mandate disclosure, in proxy or consent solicitation material for an annual meeting (or a special meeting in lieu of the annual meeting) occurring on or after the date that is one year after enactment of the legislation, as to whether the compensation committee retained and obtained the advice of a compensation consultant meeting the independence standards adopted by the SEC and if not, the reason why the committee did not do so. Finally, the draft legislation would require the SEC to issue a report to Congress within two years after enactment of the legislation based on a review of the use of compensation consultants meeting the standards for independence promulgated pursuant to the legislation and the effects of such use.

- 6. Accelerated disclosure of the results of shareholder votes.** The SEC is proposing to require companies to disclose shareholder voting results within four business days after the meeting in a Current Report on Form 8-K under proposed Item 5.07, rather than, as currently required, in a Quarterly Report on Form 10-Q or an Annual Report on Form 10-K. Companies that have a contested election of directors and do not have a final tabulation of the vote at the end of the meeting would be required to disclose on a timely filed Form 8-K the preliminary voting results, provided that the company reports the final results within four business days after certification.²⁰ Since companies generally know the voting results at the meeting or shortly thereafter and many companies now publicly disclose expeditiously the results of shareholder votes in proxy contests and on many shareholder proposals, this proposal, if adopted, should not be burdensome.

Among the SEC's specific requests for comments are the following:

- Whether reporting preliminary results could have adverse consequences, such as influencing the final vote;
- Whether any alternative method to disseminate the information about voting results would be more effective or appropriate;
- Whether any changes should be made to the information required to be disclosed about the votes;²¹ and
- Whether the SEC should amend Rule 13a-11(c) to add Item 5.07, if adopted, to the list of items of Form 8-K that are not deemed to result in a violation of Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 thereunder if the Form 8-K is not filed, and whether General Instruction I.A.3(b) of Form S-3 should be amended to add Item 5.07, if adopted, to the list of items of Form 8-K that do not result in the loss of Form S-3 eligibility if the Form 8-K is not filed on a timely basis.

- 7. Amendments to facilitate shareholder communications and voting.** The SEC is proposing the

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20. Presumably, any election in which more nominees for director are presented to shareholders than can serve as directors would constitute a contested election eligible for this exception from the need to report final voting results within four business days after the meeting. The SEC has not issued any guidance on what makes an election of directors contested for this purpose, however. For example, if a soliciting person rounds out its short slate with the requisite number of management's nominees as permitted by Rule 14a-4(d)(4), would the election of these round-out nominees be considered not to be contested, thereby requiring disclosure of the final votes for those nominees to be disclosed within four business days after the meeting?
21. Such a review of the requirements is appropriate, particularly given that the current Instruction 3 to Item 4 of Part II of Form 10-Q and Instruction 4 to proposed Item 5.07 state that no disclosure of the names of directors elected or continuing after the meeting is required for an uncontested election, yet compliance with Item 4(c) and proposed Item 5.07(c) appear to require disclosure of the names.

following amendments to the proxy solicitation process:

- *Ability of soliciting person to deliver to solicited persons management’s proxy card.* An amendment to Rule 14a-2(b)(1) to clarify that when a shareholder or other nonissuer soliciting party provides an unmarked copy of management’s proxy card and requests that shareholders return such card directly to management, the soliciting party is not providing a “form of revocation” that would render unavailable the Rule 14a-2(b) exemptions from the rules relating to the solicitation of proxies.²²

The SEC is of the view that “a person providing a solicited shareholder with an unmarked copy of management’s proxy card requested to be returned directly to management would not be seeking [proxy] authority for itself.”²³ The Proposal Release states that this amendment would help such persons’ efforts “to facilitate voting by shareholders sharing their views on matters submitted for shareholder approval—such as in a ‘just vote no’ campaign—without having to incur the costs and efforts of conducting a fully-regulated proxy solicitation” and would make it easier for shareholders to vote after hearing such views.²⁴

Among other things, the SEC seeks comments on the following:

- Whether a soliciting person should be required to file a Notice of Exempt Solicitation;²⁵
 - Whether a soliciting person should provide to solicited persons information about itself, including its beneficial ownership of shares and any relationships it has with the company or its affiliates;²⁶ and
 - Whether the proposed relief should also apply if the soliciting person requests that solicited persons return management’s proxy card to the soliciting person.
- *Substantial interest of a nonshareholder.* An amendment to Rule 14a-2(b)(1)(ix) to clarify that a “substantial interest” in the subject matter of a solicitation can exist even if the soliciting person is not a holder of the class of securities being solicited.

22. This proposal is consistent with informal advice provided by the SEC staff that was not accepted by the Second Circuit in *MONY Group, Inc. v. Highfields Capital Management, L.P., et al.*, 368 F.3d 138, 142 (2d Cir. 2004). The court concluded that, in the particular circumstances involved, “a duplicate of management’s proxy card, when included in a mailing opposing a proposed merger, is a ‘form of revocation’ under Rule 14a-2(b)(1).”

23. Proposal Release at 49.

24. *Id.* at 50.

25. This filing currently is required by Rule 14a-6(g) in connection with a written solicitation by shareholders who hold more than \$5 million in market value of the class of securities subject to the solicitation.

26. Many companies, particularly after the Second Circuit’s decision in *CSX Corp. v. Children’s Inv. Fund Mgmt. (UK) LLP*, 292 Fed. Appx. 133 (2008) (affirming without opinion the district court’s decision, 562 F. Supp. 2d 511 (S.D.N.Y. 2008)), have adopted advance-notice bylaw provisions that already require extensive disclosure by a soliciting person of its interest in the company, including beneficial ownership of shares and derivative positions, among others. *See* F. Mark Reuter, Bryan A. Jacobs & Michael B. Hurley, *The Bylaw Groundswell: Advance Notice Provisions in the Wake of CSX*, 22 INSIGHTS: THE CORPORATE & SECURITIES LAW ADVISOR 11 (2008). The advance-notice bylaw provision would not apply, however, to a soliciting person that has not submitted a proposal for consideration at the meeting and is just trying to influence shareholders to vote in a certain way, such as in a “just say no” campaign.

- *Rounding out a short slate.* An amendment to Rule 14a-4(d)(4) to provide that a soliciting person other than the company itself can round out its short slate with nominees named in a nonmanagement proxy statement in the same manner currently permitted for nominees named in management’s proxy statement.²⁷ This proposed amendment would be available to nonmanagement persons that are not acting together as a group and are not participants in the solicitation of another person’s nominees (that is, they are not actively recommending or soliciting proxies in support of another person’s nominees).

Accordingly, the SEC has proposed that each soliciting person represent in its proxy statement that it has not agreed and will not agree with others to act as a group and that it is not a participant in another person’s solicitation.

Among other things, the SEC has requested comment regarding the following:

- Whether the proposed restrictions are appropriate, or whether other safeguards are necessary, such as a requirement that the soliciting person only be able to round out its short slate if the other soliciting person is only soliciting minority representation;
 - Whether the issues that could arise if there is a change in a majority of the board (including the triggering of change-in-control provisions) need to be addressed;
 - Whether the amendment would lead to an increase in short slates; and
 - Whether the amendment should permit a soliciting person that has no nominees itself to seek authority to vote for the nominees of the company or another soliciting person.
- *Conditions to the exercise of the vote.* An amendment to Rule 14a-4(e) to clarify that “reasonable specified conditions” that would enable a proxy holder not to vote shares for which it has received proxy authority must be “objectively determinable.”²⁸ The SEC is concerned that, “if the conditions were not objectively determinable, the recipient of the proxy could seek to exercise a degree of discretion that would be inconsistent with Rule 14a-4(c)’s limits on when a proxy can confer discretionary authority.”²⁹

If this amendment is adopted, it is unclear whether it would preclude a company from withdrawing from shareholder consideration a matter that it had voluntarily submitted for shareholder approval, or canceling a meeting altogether, after receiving proxy cards in the absence of disclosure of objectively determinable conditions under which it would be able to do so.

27. This amendment codifies *Eastbourne Capital, L.L.C.*, SEC No-Action Letter, 2009 SEC No-Act. LEXIS 289 (Mar. 30, 2009), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/2009/eastbournecapital033009-sec14.htm>; and *Icahn Associates Corp.*, SEC No-Action Letter, 2009 SEC No-Act. LEXIS 607 (Mar. 30, 2009), available at <http://www.sec.gov/divisions/corpfin/cf-noaction/2009/icahnassociates033009-sec14.htm>.

28. This proposed amendment would prohibit conduct like Motorola, Inc.’s self-imposed requirement of a “second” as a condition to the voting of proxies received with respect to a shareholder proposal. See *Motorola, Inc.*, SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2541 (Oct. 8, 1987).

29. Proposal Release at 60.

- *Timing of the identification of solicitation participants.* An amendment to Rule 14a-12(a)(1)(i) to clarify that, when written communication is used in a solicitation, information regarding the identity and interests of participants in the solicitation must be filed under cover of Schedule 14A as part of a proxy statement or other soliciting materials no later than the time the first soliciting communication is made. Thus, when soliciting material does not include participant information but instead includes a legend advising shareholders where they can obtain participant information, “the information referenced in the legend must be available when the soliciting person uses the soliciting material with the legend.”³⁰

8. Other Requests for Comments. The Proposal Release states that the SEC is considering other ways to improve proxy disclosure. In connection with that effort, the SEC has requested comment on various other matters, including:

- Whether it should require disclosure of the compensation paid to all executive officers;
- Whether it should eliminate the ability of companies to omit disclosure of performance targets based on the potential adverse competitive effect on the companies of their disclosure or whether, instead, it should only require disclosure of performance targets on an after-the-fact basis, such as three or more fiscal years later, whether or not the disclosure may result in competitive harm;
- Whether the Compensation Committee Report should be considered filed rather than furnished, and whether the CD&A should be part of the Compensation Committee Report;
- Whether the SEC should require disclosure regarding whether a member of the compensation committee has expertise in compensation matters and whether the compensation committee has the resources to hire its own independent legal counsel;
- Whether disclosure about arrangements intended to create incentives to increase long-term enterprise value should include requirements for disclosure about whether a company has “hold to retirement” or clawback provisions, and if not, why not;
- Whether the SEC should require disclosure of whether the amounts of executive compensation reflect any considerations of internal pay equity or disclosure of internal pay ratios of a company;
- Whether the SEC should require disclosure regarding the total number of compensation plans a company has and the total number of variables in all of its compensation plans to give investors a better understanding of the breadth and depth of the company’s focus on compensation;
- Whether the required disclosure about tax gross-up arrangements should include a requirement to disclose and quantify the savings to each executive; and
- Whether and the extent to which the disclosure proposals should apply to smaller reporting companies, if adopted.

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30. *Id.* at 61.

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