January 14, 2008

Preparing for the 2008 Proxy Season

Introduction

As our public company clients turn their attention to the preparation of their annual reports and proxy materials, we want to highlight several important issues for the 2008 season. Most notably, as part of the SEC's new e-proxy rules, large accelerated filers must begin posting all proxy materials on the internet. And in light of the recent rounds of SEC comment letters and then new published guidelines, companies will be expected to improve their executive compensation disclosures, particularly with regard to CD&A.

E-Proxy Rules

As a result of amended proxy rules adopted by the SEC last July, large accelerated filers must now post all proxy materials on the internet.[1] All other filers may elect to post their proxy materials online, but are not required to do so until next year. Please click here to view our August 2007 Corporate Finance Bulletin for a more detailed discussion of the new e-proxy rules.

Since last July, issuers have had two options for the delivery of their proxy materials: (i) the *full set delivery option*, which allows issuers to continue to furnish paper copies of their proxy materials; and (ii) the *notice and access option*, which allows issuers to provide their proxy materials on the internet rather than in paper form.[2] Issuers are generally free to choose either option.[3] Issuers may also use a different option for different groups of shareholders.

The rule amendments require issuers to post their proxy materials on a publicly-available website (other than the SEC's Edgar site) and provide a notice of the internet availability regardless of which delivery option they choose. Large accelerated filers (other than investment companies)

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[1] Proxy materials are defined to include proxy or information statements, proxy cards, the "glossy" annual shareholder reports, notices of shareholder meetings, additional soliciting materials and any amendments to such materials.

[2] These rules also apply to other soliciting persons, and in some respects, treats them differently than issuers.

[3] Issuers seeking proxy solicitations in the context of a business combination are required to use the full set delivery option.

must begin these postings for solicitations commencing after January 1, 2008. All other issuers (including investment companies) must comply with the internet postings beginning in 2009.

As for the proxy delivery options, the requirements are as follows:

Full set delivery option

- *Delivery of notice with proxy materials* – when mailing proxy materials, the issuer must provide a notice of the internet posting, either as a separate notice or as part of the proxy statement and proxy card
- *Timing* – the notice must be sent at the same time as the proxy materials
- *Content of the notice* – the notice must provide: (i) a legend in bold-face type; (ii) information concerning the date, time and location of the shareholders meeting; (iii) a description of the matters to be acted on at the meeting and the issuer's recommendations, if any, with regard to such matters; (iv) control/identification numbers needed to access the proxy card; (v) the web address where the proxy materials are available; (vi) a list of materials being made available on the specified website; and (vii) information about attending the meeting and voting in person

Notice and access option

- *Delivery of notice only* – the issuer may not provide any other documents with the notice and the issuer may not send a paper copy of the proxy card unless the proxy card is sent ten days after the notice or is accompanied by a paper proxy statement
- *Timing* – the issuer must send a paper copy of the notice at least 40 calendar days prior to the shareholders meeting and the proxy material must be made available on or before the date the notice is sent
- *Content of the notice* – the notice must contain the information required by the full set delivery option notice, plus: (i) enhanced legends; (ii) a toll-free telephone number, an e-mail address and an internet address where shareholders may request paper or email copies of the proxy materials; and (iii) instructions on how to access the proxy card
- *Requests for copies* – if a shareholder requests paper or electronic copies of the proxy materials, the issuer must send the copies within three days of the request by U.S. first class mail or by other prompt means for a period of one year after the date of the meeting and allow the shareholder to make a permanent election to receive paper or electronic copies for future solicitations

When setting up the website for proxy purposes, issuers must comply with the following requirements:

- Protect users' confidentiality – this may require the issuer to disable cookies, segregate the proxy webpage from the company's regular website or use a

completely separate website (independently created or using a third party service provider)
- Post all materials in a format convenient for reading both online and printing on paper
- Limit the use of shareholders' e-mail addresses to the purposes of sending paper or electronic copies of proxy materials
- Limit the disclosure of shareholders' email addresses to issuers' employees and agents
- Provide on the website a method of voting – acceptable methods include electronic-voting platforms, a toll-free telephone number and access to a printable or downloadable proxy card

Executive Compensation Disclosure

In October, the SEC issued guidance based on its review of 350 public company filings under the executive compensation and related-party disclosure rules that went into effect at the end of 2006. The report, entitled "Staff Observations in the Review of Executive Compensation Disclosure," can be viewed here. The SEC identified three areas of improvement for disclosures under the new rules: (1) presentation; (2) clarity; and (3) substance.

1. *Presentation* – as part of an effort to simplify and enhance compensation disclosures, the SEC advises companies to improve the visual presentation of their disclosures. Namely, issuers should focus on (i) increasing the prominence of material information; (ii) adding the use of charts, tables and graphs (particularly with regard to change-in-control and termination payments); (iii) avoiding duplication, particularly avoiding alternative summary compensation tables; and (iv) using executive summaries whenever possible

2. *Clarity* – the SEC notes that companies often mistakenly equated lengthy discussion and boilerplate language as sufficient analysis. Instead, companies are reminded to draft their disclosures in plain English and to use simple and concise language

3. *Substance* – the SEC emphasizes that the focus of compensation discussion and analysis should shift from an abstract discussion of compensation philosophy and decision mechanics to a substantive analysis of *how* and *why* compensation is determined. In particular, companies must:

    - Strengthen Disclosure of Performance Targets – the SEC issued more comment letters on performance targets than any other issue, observing that companies were generally vague as to the nature and use of performance targets. Specific recommendations include:
        - When material to compensation policy, disclosing actual performance targets and if non-GAAP targets are used, describing the method of calculation
        - Specifically identifying how performance targets are used in setting compensation

- Assessing the difficulty of reaching target levels
- If benchmarks are used, describing to what extent qualitative factors are also considered

- Enhance Disclosure of Benchmarks – the SEC has also issued significant comments on the use of benchmarks, stressing that issuers should:
  - Provide greater detail on the use of benchmarks and how they impact compensation decisions
  - Indicate whether benchmarking is discretionary and if so, identify the extent of the discretion and whether it was actually exercised
  - Identify the companies and compensation components used in benchmarks

- Improve Disclosures of Change-In-Control and Termination Arrangements – in particular, companies are reminded to:
  - Discuss change-in-control and termination arrangements with named executive officers in the CD&A, with an emphasis on explaining why the company structured such arrangements as it did
  - Identify the amount and formula, if any, of change-in-control and termination payments

- Provide Increased Context of Disclosures – the SEC found that filers often discussed individual compensation components and decisions in isolation and so emphasizes that companies should tie these issues into an analysis of overall compensation policies, components and decisions. For example, issuers should:
  - Identify to what extent certain types of compensation (including change-in-control and termination payments) affected decisions regarding other compensation elements
  - Where applicable, describe material differences in compensation policies and decisions for named executive officers
  - Consider whether disclosure of previous years' performance targets and whether such targets were achieved is material to understanding current compensation mechanics

On a related note, this year's Summary Compensation Tables will include for the first time comparative compensation data. Issuers should consider whether to discuss any material changes in the table based on this comparative data. Issuers also should re-examine whether their named executive officers have changed in the last year. For newly determined named executive officers, the SEC has clarified that issuers only need to disclose in the Summary Compensation Table compensation data for the current year.

D&O Questionnaire Updates

Issuers should confirm that their D&O questionnaires reflect the new executive compensation and related-party disclosure rules released at the end of 2006. Additionally, issuers listed on the

NASDAQ or American Stock Exchange should revise their D&O questionnaires to reflect revisions in the exchanges' definition of an independent director. Under the new rules, which are now identical to NYSE rules, directors accepting compensation from issuers in excess of $100,000 do not constitute independent directors. Both exchanges have increased this compensation threshold from $60,000.

Shareholder Proxy Access

In July, as a result of an unusual split among the SEC's commissioners, the SEC issued two conflicting rule proposals relating to shareholder proxy access:

- The first proposal would clarify the SEC's position that companies may omit from their proxy statements shareholder proposals that could result in an election contest

- The second proposal would require companies to include in their proxy statements binding shareholder proposals to amend their bylaws regarding director nomination procedures

Please click here to view our Corporate Finance Bulletin describing these rule proposals.

In November, the SEC adopted the first proposal and revised Rule 14a-8(i)(8) to allow companies to exclude shareholder proposals "relat[ing] to a nomination or an election for membership on the company's board of directors. . . or a procedure for such nomination or election." In the adopting release, the SEC clarified that "procedures" include those that would result in a contested election either in the year in which the proposal is submitted or in any subsequent year. The rule changes effectively allow companies to exclude proposals to amend their bylaws to provide for shareholder proxy access for director nominations.

Broker Discretionary Voting

The NYSE has tabled proposed changes to its broker discretionary voting rules. NYSE Rule 452 currently allows brokers to vote uninstructed shares registered in its name on "routine" matters on behalf of beneficial owners. In June, 2006, a NYSE working group, among other things, recommended that director elections be considered "non-routine" for the purposes of Rule 452. Last September, the NYSE notified listed companies that the broker discretionary voting rules will not be revised for the upcoming proxy season.

Direct Registration

In August, the SEC approved NYSE, American Stock Exchange and NASDAQ rule changes to require all listed companies to become Direct Registration System (DRS) eligible. The SEC had originally required all listed companies to become DRS eligible by January 1, 2008, but has extended this deadline to March 31, 2008.

DRS eliminates the need for paper share certificates by allowing shareholders to electronically register their shares through transfer agents or broker-dealers. In order for an issuer's shares to become DRS eligible, the issuer must ensure that: (1) its transfer agent is DRS eligible; (2) its board of directors has authorized the issuance of uncertificated shares; (3) its bylaws permit the issuance of uncertificated shares; and (4) its transfer agent instructs the Depository Trust Company, which currently operates DRS, to designate the issuer's shares as "direct registered eligible securities."

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