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PREPARING FOR 2009 FISCAL YEAR SEC FILINGS AND 2010 ANNUAL SHAREHOLDER MEETINGS

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Preparing for 2009 Fiscal Year SEC Filings and 2010 Annual Shareholder Meetings

Recent Changes to Executive Compensation and Governance Rules: In Effect for 2010 Proxy Season

On December 16, 2009, the SEC adopted new disclosure rules primarily concerning the areas of risk, governance and director qualifications, and compensation (the “Proxy Disclosure Enhancements Release”).¹ On January 20, 2010, the SEC released a Compliance and Disclosure Interpretation that clarified the timing for transition to the new rules.² For companies with fiscal years ended on or after December 20, 2009, the Form 10-K and proxy statement must be in compliance with the rules set forth in the Proxy Disclosure Enhancements Release if filed on or after February 28, 2010, including if a company files its 2009 Form 10-K before February 28, 2010 but files its proxy statement on or after February 28, 2010. In addition, if a company with a fiscal year ended on or after December 20, 2009 is required to file a preliminary proxy statement and expects to file its definitive proxy statement on or after February 28, 2010, then the preliminary proxy statement must be in compliance with the Proxy Disclosure Enhancements Release, even if filed before February 28, 2010. For all companies with fiscal years ended before December 20, 2009, their 2009 Form 10-K and related proxy statement filings are not required to be in compliance with the Proxy Disclosure Enhancements Release, even if filed on or after February 28, 2010.³ A company that is not required to comply with the Proxy Disclosure Enhancements Release this year may voluntarily comply with the Summary Compensation Table and Director Compensation Table amendments only if it also complies with all other Regulation S-K amendments adopted in the Proxy Disclosure Enhancements Release that apply to the form filed. However, a company may provide the other new disclosures without having to comply with all of the new requirements.

¹ *Proxy Disclosure Enhancements*, Release No. 34-61175, dated December 16, 2009.

² *Compliance and Disclosure Interpretations: Proxy Disclosure Enhancements Transition*, <http://www.sec.gov/divisions/corpfin/guidance/pdetinterp.htm>

³ In addition, a company with a 2009 fiscal year that ends before December 20, 2009 will not be required to comply with the Regulation S-K amendments until the filing of its Form 10-K for fiscal year 2010. As a result, any Securities Act or Exchange Act registration statements for such registrant filed before the 2010 Form 10-K is required to be filed would not be subject to the Regulation S-K amendments.

New Narrative Disclosure of Compensation Practices and Policies Relating to Risk Management

New Item 402(s) of Regulation S-K requires a company to describe its compensation policies and practices for *all* of its employees, including non-executive officers, if those compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company. In response to comments on the proposed rules, the SEC changed the standard that would trigger disclosure from policies and practices that “may have a material effect on the company” to those that “are reasonably likely to have a material *adverse* effect on the company” [emphasis added]. The SEC intends the “reasonably likely” disclosure threshold for this purpose to be the same as that which is applied in the Management’s Discussion and Analysis (MD&A) context, requiring risk-oriented disclosure of known material trends and uncertainties relating to the company as a whole. This disclosure will not be required within the CD&A section, but rather will form a separate narrative within a company’s other Item 402 disclosures⁴.

Item 402(s) contains a non-exclusive list of the following compensation policies and practices that may trigger disclosure:

- at a business unit that carries a significant portion of the company’s risk profile;
- at a business unit with compensation structured significantly differently from the other units within the company;
- at a business unit that is significantly more profitable than others within the company;
- at a business unit where compensation expenses are a significant percentage of the unit’s revenues; and
- 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 a company concludes that it does have compensation policies or practices that create risks that are reasonably likely to have a material adverse effect on the company, the SEC has provided a non-exclusive list of issues that the company may need to address regarding its compensation policies or practices:

⁴ Note that the SEC stated in the release that under the current CD&A disclosure rules, to the extent that risk considerations are a material aspect of the company’s compensation policies or decisions for its named executive officers, the company is required to discuss them as part of the CD&A and will continue to be required to discuss them in the CD&A after the adoption of these amendments.

- 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 those policies relate to or affect risk-taking by those employees on behalf of the company, and the manner of their 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 and practices relate to the realization of risks resulting from the actions of employees in both the short term and the long term (for example, policies requiring clawbacks or imposing holding periods);
- the company’s policies regarding adjustments to its compensation policies to address changes in its risk profile, and any material adjustments made as a result of those policies; 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.

If a company concludes that its compensation policies and practices are not reasonably likely to have a material adverse effect on the company, the rule does not require companies to make an affirmative statement to that effect. This disclosure is not required to be provided by smaller reporting companies.

We would expect that, as is the case with MD&A disclosure, the analysis as to whether any disclosure would be required would initially be determined through an internal assessment by either the individuals who perform the internal risk function at a company or the individuals who administer a company’s compensation policies, such as the head of the human resources department or general counsel’s office. Once that initial assessment is completed, we would expect a company to present its findings to its compensation committee for final review and discussion. We have added a new requirement to our form of compensation committee charter requiring the compensation committee to assess these risks.

Revisions to Equity Award Disclosure in Summary Compensation Table and Director Compensation Table

The SEC has revised the disclosure tables set forth in the Summary Compensation Table and the Director Compensation Table regarding stock awards and option awards to require disclosure of the *aggregate grant date fair value* of these awards in the year of grant. The fair value amount to be reported in the table would be computed in accordance with FASB ASC Topic 718 (“Stock Compensation;” formerly FASB Statement 123R). This disclosure replaces the current requirement to disclose the *dollar amount recognized for financial statement reporting purposes* for the fiscal year of these awards.

To facilitate year-to-year comparisons, companies will be required to present recomputed disclosure of stock and option awards for each preceding fiscal year that is required to be included in the table, so that the stock awards and option awards columns present the applicable full grant date fair values, and the total compensation column will also correspondingly need to be recomputed. The stock awards and option awards columns should be recomputed based on the individual award grant date fair values reported in the applicable year's Grant of Plan-Based Awards Table, except that awards with performance conditions should be recomputed to report grant date fair value based on the probable outcome of the grant date, consistent with FASB ASC Topic 718, as further discussed below. In addition, if a person who would be a named executive officer for the most recent fiscal year (2009) also was disclosed as a named executive officer two years ago (2007) but not last year (2008), the named executive officer's compensation for all 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 the recomputed total compensation amounts or to amend any prior years' Item 402 disclosure in any other filing to reflect these changes. For smaller reporting companies that are only required to disclose compensation information for the two most recent fiscal years, 2008 disclosure is not required to be added for an individual who first appears in the summary compensation table in 2009.

The SEC has also clarified that the grant date fair value disclosure relates to awards that are granted during an applicable fiscal year, as opposed to grants that are made for services rendered during the fiscal year, but where the awards are granted after the fiscal year has ended. However, the SEC also noted that companies should disclose such post-fiscal-year-end grants in their CD&A narratives, and should consider whether tabular disclosure of such awards should be included as a supplemental matter, particularly where the information would help in an understanding of the disclosure in their CD&As.

With respect to awards that are tied to a particular measure of performance (referred to as "performance awards"), the value of such awards must be computed based upon the probable outcome of the performance conditions as of the grant date. The SEC notes that such value "better reflects how compensation committees take performance-contingent vesting conditions into account in granting such awards." This amount will be consistent with the company's estimate of the compensation cost on the grant date to be recognized over the service period, excluding the effect of forfeitures. Companies will also be required to provide footnote disclosure in the Summary Compensation Table and the

Director Compensation Table of the maximum potential value of a performance award, assuming that the highest level of performance associated with the award is probable.

Enhanced Director and Nominee Disclosure

The SEC has revised Item 401 of Regulation S-K to require disclosure of the particular experience, qualifications, attributes, or skills that led a company's board to conclude that each director and director nominee should serve as a director of the company, as of the time that the proxy statement is filed with the SEC. This disclosure will be required for all nominees and all directors, even those who are not standing for reelection at a particular meeting. Companies are not required to disclose specific experience, qualifications, or skills for individual directors relating to *committee* service. However, if particular skills or attributes that are relevant to service on a specific committee form the basis for the reason that an individual was selected to serve on the board, then those skills or attributes should be identified in the disclosure. Note that this disclosure may not be provided on an aggregate or group basis; each director's or nominee's experience, qualifications, attributes, or skills must be described individually.

This new disclosure requirement does not specify the particular information that should be disclosed about a nominee or director, and thus companies are free to describe their directors' and nominees' qualifications in any manner that they believe is responsive. We have added a new requirement to our form of nominating and governance committee charter to require a company's nominating and governance committee to determine for each director the qualifications, attributes, or skills that led the committee to determine that the individual should serve as a director. The nominating and governance committee should consider how to obtain the information they need from each director, whether by questionnaire or in an interview, in order to have full and current information regarding each director, especially if a director has been on the a company's board for some time and has not been evaluated in the recent past. Once the nominating and governance committee has completed its assessment of each director, this information will need to be presented to the full board at a meeting prior to the filing of a company's proxy statement in order for the full board to conclude, as required by the new rule, that each director should serve on the board.

In addition, instead of solely describing public company directorships held at the time of filing of the proxy statement, as has been the required disclosure for many years, companies must now disclose any public company directorships held by their directors and nominees during the *five years preceding* the date of the filing, even if the director or nominee no longer serves on a particular board.

Companies now must also disclose legal proceedings in which their directors, nominees, and executive officers have been involved during the past *ten* years (expanded from five years). Additionally, the kinds of legal proceedings requiring disclosure have been expanded to include proceedings involving mail fraud, wire fraud or fraud involving any business entity; proceedings based on violations of securities, commodities, banking or insurance laws; and sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization.

Lastly, in response to comments requesting the SEC to require expanded disclosure about board diversity, the SEC has adopted an amendment to Item 407(c) of Regulation S-K to require disclosure of whether, and if so how, a board's nominating committee considers issues of diversity in identifying nominees for director. The SEC deliberately did not define "diversity" for these purposes, noting that "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, while others may focus on diversity concepts such as race, gender and national origin," and that "for purposes of this disclosure requirement, companies should be allowed to define diversity in ways that they consider appropriate." If a nominating and governance committee does have a policy with respect to consideration of diversity in identifying director nominees, the company must disclose how the policy is implemented and how the committee, or the full board, assesses the effectiveness of the policy. For companies that do not currently have a diversity policy in place, the nominating and governance committee should consider whether to add a diversity policy and how diversity should be defined. Any new or revised diversity requirement should be added to the company's policy regarding qualification of directors and proxy disclosure of these requirements.

New Disclosure about Board Leadership Structure and the Board's Role in Risk Oversight

The SEC has also adopted amendments that will require companies to provide additional disclosure about the leadership structure of their boards of directors, and the role of their boards in the risk management process.

The new rules require companies to explain why they believe that the board leadership structure they have chosen is the most appropriate structure as of the time of filing the disclosure, and whether and why they have chosen to combine or separate the principal executive officer and board chair positions. Companies that have a single person serving as both principal executive officer and chairman of the board will be required to disclose whether and why they have a lead independent director and describe

the specific role played by the lead independent director in the leadership of the company. The additional disclosure is intended to provide investors with insights about why a company has chosen a particular leadership structure and is also intended to increase transparency into how boards function. The nominating and governance committee should discuss the leadership structure of the board and determine whether any changes are necessary in light of the SEC's new disclosure requirements.

Second, the SEC has adopted amendments that will require companies to provide additional disclosure about the board's role in a company's risk management process, such as how the board administers its oversight function and the effect it has on the board's leadership structure. The intended purpose of the additional disclosure is to provide investors with 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. Many companies already require the audit committee to oversee general risk management. The nominating and governance committee and the full board should determine whether any changes to its processes should be made in light of the SEC's new disclosure requirements.

New Disclosure Regarding Compensation Consultants

Companies often engage compensation consultants to make recommendations on the appropriate levels of executive compensation, to design and implement incentive plans and policies, and to provide information on industry compensation practices. However, compensation consultants and their affiliates also provide additional services, such as benefits administration, human resources consulting, and actuarial services. Because the fees generated by these additional services may be greater than the fees for the executive compensation services, the SEC has raised a concern of a potential conflict of interest that may call into question the objectivity of the consultants' executive pay recommendations. For example, in the SEC's view, compensation consultants may face incentives to cater to management preferences in recommending executive compensation packages so that they may retain an engagement for additional services, providing larger fees.

Prior to the revisions, Item 407 required companies to disclose the identity of a compensation consultant, whether the consultant was engaged directly by the compensation committee of a board or by any other person, the nature and scope of the consultant's assignment, and the material elements of the instructions or directions given to the consultant with respect to the performance of its duties. However, Item 407 did not previously require companies to disclose the fees paid to compensation consultants and their affiliates for executive compensation consulting or additional services. In order to address the concern over the potential conflict of interest in this area, the SEC has amended Item 407 to

require disclosure, under specified circumstances, about the fees paid to compensation consultants and their affiliates when they take part in determining or recommending the amount or form of executive or director compensation and also provide additional services to the company, such as benefits administration, human resources consulting, or actuarial services.

Under these rules:

- If a company's compensation committee has engaged its own compensation consultant to advise it on the amount or form of executive and director compensation, and the consultant provides other services to the company that are not related to executive compensation in an amount exceeding \$120,000 during the company's last completed fiscal year, the company must disclose the aggregate fees paid both for the executive and director compensation-related services and the additional services. The company would also have to disclose whether the decision to engage the compensation consultant or its affiliates for these other services was made or recommended by the company's management, and whether the compensation committee or the board has approved these other services.
- If the company's compensation committee has not engaged its own compensation consultant, the company would still be required to disclose the aggregate fees paid to a consultant if the consultant provides both executive and director compensation-related services and other services to the company, if the fees for the additional services exceed \$120,000 during the company's last completed fiscal year.
- A company will not be required to disclose fees for compensation consultants that work with management, whether the services provided are compensation-related or non-compensation-related or both, if the board has retained its own compensation consultant that advises it on executive compensation issues.
- A company will not be required to disclose fees for compensation consultants where the compensation consultant's only role is limited to consulting on broad-based plans that do not discriminate, in scope, terms, or operation, in favor of executive officers or directors and that are generally available to all employees, such as 401(k) plans or certain health insurance plans; or to provide information that is not customized for the company or that is customized based on criteria that were not provided by the consultant and about which the consultant does not provide advice.

The new rule does not require disclosure of the nature of the non-compensation-related services that are provided to a company by a compensation consultant. However, companies are free to provide such information if it would be helpful to investors in understanding the disclosure.

Reporting of Shareholder Voting Results on Form 8-K

Under the new rules, companies will be required to disclose the results of voting at shareholder meetings in Form 8-Ks, rather than in Form 10-Qs and 10-Ks. The rules add a new Item 5.07 to Form

8-K, which requires companies to disclose results of a shareholder vote within four business days after the end of the meeting at which the vote was held.

The change is intended to provide investors with more timely information about the results of voting at meetings, as technological advances in shareholder communications and the use of third-party proxy services have increased the ability of companies to tabulate and disseminate vote results on a more expedited basis. The SEC recognized in the new rules that it may not be possible in all situations for companies to tabulate final voting results within the four-business-day window provided by Form 8-K. Accordingly, the requirement is to report preliminary results of the votes within four business days, and to file an amended report on Form 8-K within four business days after the final results are known. However, if the final results are known within four business days after the end of the meeting, the final results should be reported on the original Form 8-K.

Reporting of the results of annual meetings under Item 5.07 of Form 8-K will take effect for any shareholder meeting that occurs **on or after February 28, 2010**, even if the proxy statement for that meeting was mailed out before that date. However, if the meeting takes place before February 28, 2010, a Form 8-K will not be required. If the Form 10-K or Form 10-Q is due on or after February 28, 2010, the results of the meeting should be reported in the "Other Information" Item of each form, rather than in the "Submission of Matters to a Vote of Security Holders" Item, which will be removed from Form 10-K and Form 10-Q on February 28, 2010.

Compensation Disclosures Continue to Take Center Stage

The Staff of the SEC's Division of Corporation Finance continues to emphasize the importance of clear and comprehensive executive compensation disclosures, with the CD&A as the focal point of the SEC's ongoing scrutiny. The Staff continues to note, in speeches, at conferences, and in comment letters, that issuers' efforts must be redoubled in this area in order to provide disclosure that is responsive to the requirements.

Compensation Discussion and Analysis

Most companies are required to provide a CD&A in their proxy statements or Form 10-Ks, discussing a company's philosophy on executive compensation for their named executive officers (NEOs).⁵ Comparable to the MD&A, the CD&A is viewed as the centerpiece of the SEC's principles-based reporting approach to executive compensation.

The CD&A must discuss the six explicit items set forth below, and must also discuss and analyze other information which a company's directors considered in determining the amounts and types of compensation paid to the NEOs during the most recently completed fiscal year.

- What are the objectives of the company's compensation programs?
- What is the compensation program designed to reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount (and, where applicable, the formula) for each element?
- How do each element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements?

The Staff has emphasized repeatedly that CD&A disclosure needs to be focused on *how* and *why* a company arrives at specific compensation decisions and policies, including discussions of:

- *how* the company determined the amounts of specific compensation elements
- *how* the company arrived at the particular levels and forms of compensation paid to their NEOs
- *why* the company pays that compensation

⁵ The CD&A is not required for smaller reporting companies and foreign private issuers.

- *how* and *why* the determinations the company made with regard to one compensation element for a particular NEO may or may not have influenced decisions it made with respect to other compensation elements that were awarded to that NEO.

As you prepare the CD&A to analyze compensation decisions made during 2009, we encourage you to read the following documents, which are available on the SEC’s website: a speech by Shelley Parratt, Deputy Director of the Division of Corporation Finance, called “Executive Compensation Disclosure: Observations on the 2009 Proxy Season and Expectations for 2010”; “Staff Observations in the Review of Compensation Disclosure,” by the Staff of the Division of Corporation Finance; and two speeches by John W. White, former Director of the SEC’s Division of Corporation Finance, in which he discussed the Staff’s observations and expounded upon his own thoughts and reactions to the first and second years of the CD&A disclosure regime.⁶

In Ms. Parratt’s speech, she emphasized the Staff’s position with regard to the CD&A, which is that it “. . . is essential to providing investors with meaningful insight into the compensation policies and decisions of the companies in which they choose to invest. The CD&A is where a company tells its story about why it made the decisions it made.” She also observed that the Staff had undertaken a review of the comments that it had issued to companies regarding their compensation disclosures, and noted that there appeared to be a marked difference between the quality and detail of the disclosure provided by companies whose disclosures had been the subject of a Staff review, and those whose disclosures had not yet been reviewed by the Staff. This led to the Staff’s conclusion that companies that had not been reviewed were likely waiting to provide disclosure that was fully compliant with the rules until their filings were selected for review, even though ample guidance is available to all companies with regard to the compensation disclosure requirements and the Staff’s expectations regarding those requirements. As a result, in order to encourage companies strongly to avoid this practice of waiting for a Staff review to provide fully compliant disclosure, Ms. Parratt notes that companies need to “take a proactive approach” to their CD&A disclosure. If they do not, they may be required to amend their proxy statements **before** the annual meeting takes place in order to address comments on the disclosure, instead of simply agreeing to provide responsive disclosure in their future proxy statements. The need to respond to comments and provide such an amendment could result in a delay to the stockholder meeting, if the comments are not resolved with sufficient time to spare before the meeting is scheduled to occur.

⁶ The text of the speech by Ms. Parratt is available [here](#). The Staff Observations are available [here](#). The text of the 2007 speech by Mr. White is available [here](#), and the text of his 2008 speech is available [here](#).

Ms. Parratt also noted two areas in particular on which companies should concentrate when preparing their CD&As for this year: the level of *analysis* in their disclosure, and the use of and disclosure surrounding *performance targets*.

1. *Analysis*. Ms. Parratt noted that many CD&A disclosures have become extremely lengthy and full of detail, but that this does not by itself satisfy the requirement to analyze *how* and *why* compensation decisions were made. She noted that

A company's analysis of its compensation decisions should present shareholders with meaningful insight into its compensation policies and decisions, including the reasons behind them....Factual statements about what the company or compensation committee did or did not do are not enough. It isn't sufficient for a company to state that its compensation committee used tally sheets, wealth accumulation analyses, or internal pay equity analyses in making compensation decisions. The company should discuss how the committee used these tools to determine compensation amounts and structures, and explain why it reached its decisions.

This theme of insufficient analysis has been touched upon by several other SEC Staff members, including in the speeches referenced above. We encourage you to take a fresh look this year at the amount of analysis in your CD&A disclosure, and consider whether your compensation information has not merely been presented in great detail, but most importantly has been thoughtfully analyzed.

2. *Performance Targets*. Ms. Parratt observed that the Staff has issued more comments in the area of performance targets than in any other part of the CD&A. She noted that each company must determine whether corporate or individual performance targets are material to its compensation policies and decisions. Given recent negative economic conditions, many companies set performance targets that were not achieved. Even if this is the case, the Staff believes that disclosure of performance targets in the CD&A may still be material, in that the targets indicate how a company intended to incentivize its management. If the performance targets are deemed by a company to be material, they must be disclosed, with one exception. If a company believes that disclosure of those performance targets will result in competitive harm, and seeks to omit those targets as a result, the company will be asked to provide a justification for the omission, using the same standard as that which would be required in a confidential treatment request. The company's rationale for claiming such an exception

should be developed prior to making a filing that excludes specific performance targets, so that the analysis can be sent promptly to the Staff in the event the filing is reviewed.

Please refer to our 2009 year-end kickoff memo for a further description of the specific requirements of the CD&A.

Elimination of Broker Discretionary Voting on Director Elections

On July 1, 2009, the SEC voted to approve a change to NYSE Rule 452 to eliminate broker discretionary voting in uncontested election of directors, beginning on January 1, 2010. This means that brokers are no longer allowed to vote their clients' shares with regard to the election of directors unless they have been directed by their clients as to how the clients wish their shares to be voted.

This change will mean that it may be harder for some companies to achieve a quorum for the transaction of all business at stockholder meetings because, previously, shares that were represented by broker votes on the election of directors were eligible to be counted towards the achievement of a quorum. With the election of directors now treated as a "non-routine" matter, companies should consider placing a matter on the ballot that will be considered "routine" under Rule 452 in order to preserve the ability of brokers to vote uninstructed shares on at least one matter at the meeting, and thereby contribute to the quorum. The most common stockholder meeting matter that is still considered "routine" for this purpose is the ratification of a company's independent registered public accounting firm. Our recommendation for any company that is concerned about achieving a quorum at a meeting is to include a proposal for stockholders to ratify the company's accounting firm. Many companies already do this as a matter of course. Companies may also want to consider hiring a proxy solicitor in order to help ensure that a quorum and necessary votes are achieved.

This change to Rule 452 is more likely to create issues with the re-election of directors in companies with (1) large numbers of retail, as opposed to institutional, stockholders, and (2) a majority, as opposed to a plurality, voting standard for the election of directors. Companies with large retail holdings that previously had been able to rely on the broker discretionary vote to ensure both a quorum and the re-election of their directors may now see their voting levels drop precipitously. Additionally, this effect will be more pronounced for companies with a majority voting standard for the election of directors, since the director nominees must achieve the favorable vote of shares representing a majority of the votes cast at the meeting or represented by proxy in order to be elected. By contrast, in companies with a plurality voting standard for the election of directors, the nominees receiving the most votes will be

elected as directors, regardless of whether the shares voted for an individual nominee represent a majority of the votes cast or represented by proxy. Thus, in companies with a plurality vote standard for director elections, a drop-off in the number of votes cast for individual directors will not adversely impact a director's ability to be elected, although it may be concerning to the company as evidence of a lack of stockholder involvement and participation.

Electronic Delivery of Proxy Materials

2010 is the second year that all public companies, regardless of size, are required to comply with the SEC's "e-proxy" rules, which require that all annual meeting materials be posted electronically on a publicly available Internet site, which must be different from the SEC's website.⁷ The annual meeting materials to be posted include the proxy statement, the proxy card, and the annual report to shareholders required by Rule 14a-3 under the Securities Exchange Act of 1934, as amended (the Exchange Act)—sometimes referred to as the "glossy" annual report, as distinct from the Annual Report on Form 10-K. These rules took effect for all proxy solicitations, other than those relating to a business combination transaction, commencing on or after January 1, 2009. While all proxy materials must now be made available electronically, issuers have a choice as to the means of delivery of those materials. As the SEC notes in its release adopting these rules, these changes "are intended to provide all shareholders with the ability to choose the means by which they access proxy materials, to expand use of the Internet potentially to lower the costs of proxy solicitations, and to improve the efficiency of the proxy process and shareholder communications." Also, issuers will still be required to have a supply of proxy materials available in paper copies for those shareholders who request them.

Under the e-proxy rules, issuers can either elect the "notice only" option, under which the issuer will send a notice to its shareholders that the annual meeting materials are available on the Internet, and not deliver paper copies of those materials unless requested to do so by shareholders, or the "full set delivery" option, under which the issuer will continue to deliver paper copies of all proxy materials to shareholders, but must still post those same materials on an Internet site and tell shareholders how they can access the materials on the Internet. Issuers do not need to choose only one of the options for all of their shareholders and may choose different delivery options for different groups of shareholders.

⁷ *Shareholder Choice Regarding Proxy Materials*, Release No. 34-56135, dated July 26, 2007. See also *Internet Availability of Proxy Materials*, Release No. 34-55146, dated January 22, 2007.

Notice Only Option

An issuer that chooses the notice only delivery model will be required to send a Notice of Internet Availability of Proxy Materials (a Notice) to all shareholders *at least 40 calendar days* before the meeting date or, if no proxies are being solicited, before the date on which votes will be used to take a corporate action. This timing requirement will mean, for most issuers choosing to rely on this option, that they will need to prepare and distribute the Notice well in advance of 40 days prior to the meeting date, because the rules also provide that issuers must provide *intermediaries* (such as brokers who hold securities on behalf of their clients) with information necessary for the intermediary to prepare and distribute its own notice at least 40 calendar days before the meeting date (or shareholder action date). The notice only delivery option may not be used for proxies related to business combination transactions.

A company may only send the Notice to stockholders by electronic delivery instead of mail if the stockholder has previously consented to receiving proxy materials by e-mail (or the individual is an employee and the employee uses the e-mail system in the normal course of his or her employment and routinely logs on to a computer to receive e-mail and other communications, or does not routinely log on to a computer but has access to alternative ways of receiving e-mail messages, such as printouts from a secretary or access to a computer kiosk.) A company's transfer agent should be able to confirm how many stockholders have signed up for electronic delivery; in our experience, this number is usually small.

In addition, the Notice must also satisfy the company's stockholder notice obligations under its by-laws and state corporate law, as the company may not be allowed to rely upon the notice set forth in the proxy statement to satisfy its corporate law requirements as such notice will only be posted electronically. For example, Section 232 of the Delaware General Corporation Law (DGCL) prohibits the mailing of the Notice to stockholders electronically without the stockholder's prior consent to receive notices electronically.

The Notice must be written in plain English and must contain the following information:

- A prominent legend in bold-face type that states:

Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].

This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.

The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].

If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery.

- The date, time, and location of the meeting or the earliest date on which the corporate action may be effected
- A “clear and impartial” identification of each separate matter to be acted on, and any recommendations of the issuer regarding those matters (only if the issuer chooses to make a recommendation, which is not required), without any supporting statements
- A list of the proxy materials that are being made available at the specified website
- A toll-free telephone number, an e-mail address, and a website address where shareholders can request a copy of the proxy materials, both for all meetings of the issuer and for the particular meeting to which the Notice relates
- Any identification numbers that the shareholder needs to use to access his or her proxy card on the website
- Instructions on how to access the proxy card, which may not enable a shareholder to execute a proxy without having access to the proxy statement
- Information about attending the shareholder meeting and voting in person.

The Notice must also be filed with the SEC, as additional soliciting material, on the first date that the issuer sends the Notice to its shareholders, and no other proxy materials may be sent along with the Notice. If a shareholder who receives the Notice requests delivery of a paper copy of the proxy materials before the meeting has occurred, the issuer must respond to the request by sending a copy of the materials by first class mail within three business days of receipt of the request.⁸ A shareholder’s request for delivery of a paper copy of the proxy materials shall continue with respect to subsequent proxy materials, unless it is revoked by the shareholder.

If the issuer is providing telephone voting as a means for executing a proxy, the Notice must not include the telephone number to use for voting since the shareholders will not, as of the time of receipt of the Notice, necessarily have reviewed the proxy materials themselves.

⁸ If the request for copies of proxy materials is received after the conclusion of the meeting, the materials must still be sent, but they do not need to be sent by first class mail nor do they need to be sent within three business days.

Issuers relying on the notice only option may follow up the delivery of a Notice with a paper or e-mail mailing of a proxy card, but must wait to do so until at least ten calendar days from the mailing of the Notice, unless the proxy card is accompanied or preceded by a copy of the proxy materials.

Full Set Delivery Option

If the issuer elects to continue to deliver all proxy materials in paper form, it will nonetheless still be required to (1) post its proxy materials on a publicly available Internet site (not including the SEC's website), and (2) include information regarding access to the proxy materials that are posted on the Internet and other information regarding the meeting, either by preparing and sending a separate Notice of Internet Availability of Proxy Materials or by including the information in the proxy materials themselves. Although the full set delivery option requires the traditional printing and mailing of all of the proxy materials to stockholders, this option requires only one mailing to stockholders, and, assuming the company does not have many stockholders that have consented to receiving proxy materials via e-mail, may turn out to be similar from a cost perspective to the notice only option.

In addition, the full set delivery option does not impose the requirement on companies to deliver the Notice at least 40 calendar days before the meeting, and does not even require that companies deliver a separate Notice, as the information required to be contained in the Notice may be included in the company's proxy statement.

The information that must be provided in a Notice under the full set delivery option includes the following information:

- A prominent legend in bold-face type that states:
Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].
The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].
- The date, time, and location of the meeting or the earliest date on which the corporate action may be effected
- A "clear and impartial" identification of each separate matter to be acted on, and any recommendations of the issuer regarding those matters (only if the issuer chooses to make a recommendation, which is not required), without any supporting statements
- A list of the proxy materials that are being made available at the specified website
- Any identification numbers that the shareholder needs to use to access his or her proxy card on the website

- Information about attending the shareholder meeting and voting in person.

Because the notice only option has resulted in a significant decrease in voting by retail stockholders, many proxy solicitors are suggesting that companies considering switching to notice only delivery for the first time this proxy season may want to reconsider this decision in light of the elimination of the ability of brokers to vote in their discretion for the election of directors, as this double effect will likely have a larger negative impact on shareholder voting.

Proposed Rule Changes to Address Low Retail Stockholder Participation in E-Proxy

In light of observations that the e-proxy rules have negatively impacted the rates of voting in elections by retail stockholders, the SEC has proposed rules that would slightly revise the mechanics of the e-proxy process, with a goal of encouraging greater voting participation.⁹ These rules would, among other things, allow companies to include an explanation of the e-proxy process in the Notice that is distributed to stockholders, and provide for a format of the Notice that the Staff believes would be easier to follow. These rules have not yet been finalized for the 2010 proxy season.

Companies may find it desirable to analyze the make-up of their stockholder base, and if necessary, adopt a hybrid approach to distributing proxy materials, in which retail stockholders receive a paper distribution and institutional stockholders receive a notice only distribution. Companies considering a notice only distribution of their proxy materials this year should consult well in advance of the scheduled annual meeting date with legal counsel and with their transfer agents, in order to ensure that all applicable deadlines are being met.

Proxy Access: Not Yet a Reality, but Most Likely Will Be Soon

In June 2009, the SEC proposed controversial rules that would allow shareholders to have increased access to a company's own proxy statement in order to nominate directors.¹⁰ The proposed rules would require companies, under certain circumstances, to include shareholder nominees for director positions in the companies' proxy materials. Shareholders of public companies already have the ability to conduct "proxy contests," in which a shareholder or group of shareholders proposes a separate slate of

⁹ *Amendments to Rules Requiring Internet Availability of Proxy Materials*, Release No. 34-60825, dated October 14, 2009. Of companies adopting the notice only model from July 2007 to June 2008, only approximately 16.6% of retail stockholders voted their shares, as compared to approximately 34.3% of such retail stockholders in the year prior to the implementation of the e-proxy rules.

¹⁰ The text of these proposed rules is available at <http://www.sec.gov/rules/proposed/2009/33-9046fr.pdf>.

nominees and prints and mails a separate proxy statement, at the shareholders' own expense, and in which the dissidents' nominees are proposed for election. However, proxy contests are in most cases prohibitively expensive and frequently ineffective. Proponents of proxy access believe that providing an easier method for shareholder nominations is a fundamental right of the owners of a corporation, and should be encouraged by the SEC. Opponents of proxy access believe that this issue should be left to the corporate law of the state in which a corporation is incorporated, as are most issues of pure corporate governance.

Among the requirements in the proposed rules are share ownership thresholds, which would vary depending on the size of the company, and which shareholders would have to satisfy in order to be eligible to propose nominees. As proposed, the ownership threshold would require that the proponent have held at least 1% of a company's outstanding shares for one year if the company was a large accelerated filer, at least 3% of the outstanding shares for one year if the company was an accelerated filer, and at least 5% of the outstanding shares for one year if the company was a non-accelerated filer.

SEC Chairman Mary Schapiro, speaking at the Practising Law Institute's Annual Institute on Securities Regulation in November 2009, indicated that the Staff of the SEC is still considering these proposed rules on proxy access, and that they will not be finalized in time for the 2010 proxy season. The SEC has received over 500 comment letters on these proposed rules, and they have inspired vigorous debate on both sides of the issue. Chairman Schapiro also indicated that the passage of some form of proxy access was one of the top near-term priorities of the SEC, and we believe it is likely that the rules will be adopted during 2010.

In addition to the proposed rules on this topic from the SEC, in 2009 the State of Delaware added two new sections to the DGCL, which allow, but do not require, companies to include provisions in their bylaws relating to proxy access by shareholders.

New Section 112 of the DGCL allows companies to include provisions in their bylaws that specifically provide for access by shareholders to the company's proxy materials with regard to director nominations. The provisions may include conditions to the access right, such as eligibility and procedural requirements, including ownership levels, background information about the nominee, and any other conditions permitted by law. New Section 113 of the DGCL similarly allows companies to provide in their bylaws for the reimbursement by a company of expenses incurred by a shareholder in nominating director candidates. The reimbursement provision may include conditions, such as the

number or proportion of nominees proposed and whether the shareholder has requested reimbursement previously.

Internal Control Over Financial Reporting

Companies that qualify as large accelerated filers and accelerated filers have now experienced three years of compliance with the requirements of Section 404 of Sarbanes-Oxley concerning internal control over financial reporting (ICFR). As a reminder, those filers are required to include in their annual reports:

- an evaluation by management of the effectiveness of the company's ICFR
- an attestation report from the company's independent accountants with respect to the effectiveness of the company's ICFR.¹¹

Management must also evaluate any change in a company's ICFR that occurs during a fiscal quarter and that has materially affected, or is reasonably likely to materially affect, the company's ICFR.

Starting with fiscal years ending on or after December 15, 2007, non-accelerated filers are also required to include an evaluation by management of the effectiveness of ICFR. Non-accelerated filers are not, however, required to include the attestation report from their auditors on ICFR until their annual reports for fiscal years ending on or after June 15, 2010. This date represents a further extension by the SEC, for non-accelerated filers, of the filing of the auditor attestation report, and is currently expected to be the last such extension.

The SEC has also made it significantly easier for companies that have had declines in the market value of their public float to exit accelerated filer status. An accelerated filer whose public float has dropped below \$50 million as of the last business day of its second fiscal quarter may cease to report as an accelerated filer at the end of the fiscal year in which its public float fell below \$50 million, and may therefore file its Form 10-K for that year and subsequent periodic reports on a non-accelerated basis. The rules also contain similar requirements for exiting large accelerated filer status, permitting a large accelerated filer whose public float dropped below \$500 million as of the last business day of its second fiscal quarter to cease reporting as a large accelerated filer as of the end of the fiscal year in which its public float fell below \$500 million, and to file its Form 10-K for that year and subsequent periodic

¹¹ Previously, the attestation report from a company's independent accountants was required to address both the accountants' views as to the company's ICFR and also the accountants' views as to the company's evaluation of its own ICFR. The SEC has revised this requirement to provide that the attestation need only cover one topic: the accountants' views as to the effectiveness of the company's ICFR. See <http://www.sec.gov/rules/final/2007/33-8809.pdf>.

reports as an accelerated filer, or a non-accelerated filer, as appropriate. Prior to these changes, companies that had become accelerated filers could only cease to report as accelerated filers if they became eligible to report as small business issuers.

Management's annual report on ICFR and the attestation report provided by the company's auditors, which are required pursuant to Item 308 of Regulation S-K, should appear either in close proximity to the MD&A section of the Form 10-K or immediately preceding the company's financial statements. In addition, the SEC has indicated that companies should include both management's report on ICFR and the auditors' report on ICFR in the annual report to shareholders when audited financial statements are included in that report. The SEC has also noted that, if management states in the report that the company's internal controls are ineffective, or the auditors' report includes anything other than an unqualified opinion, and those reports are *not* included in the annual report to shareholders, the company would have to consider whether the failure to include those reports constitutes an omission of a material fact, rendering the annual report to shareholders misleading.

If you receive any indication from your accountants that a qualified report will be issued, or that there are material weaknesses or significant deficiencies in your internal controls, you should consult with the Mintz Levin attorney with whom you work as soon as possible to determine any disclosure ramifications.

2010 Periodic Report Filing Deadlines

For companies that qualify as large accelerated filers and have fiscal years ending on December 31, annual reports on Form 10-K are due 60 days after fiscal year-end (Monday, March 1, 2010).¹² Form 10-K reports continue to be due 75 days following fiscal year-end for accelerated filers¹³ (Tuesday, March

¹² *Large accelerated filers* are domestic companies that meet the following requirements as of their fiscal year-end:

- have a common equity public float of at least \$700 million, measured as of the last business day of their most recently completed second fiscal quarter (i.e., for calendar fiscal year-end companies, this test would be applied as of June 30, 2009)
- have been subject to the reporting requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, for at least 12 months
- have previously filed at least one Annual Report on Form 10-K
- do not qualify as small business issuers under SEC rules.

¹³ *Accelerated filers* are those that meet all of the above tests but have a common equity public float of at least \$75 million, but less than \$700 million, measured as of the last business day of their most recently completed second fiscal quarter (i.e., for calendar fiscal year-end companies, this test would be applied as of June 30, 2009).

16, 2010 for December 31 year-end companies) and 90 days after fiscal year-end for non-accelerated filers (Wednesday, March 31, 2010 for December 31 year-end companies).

In addition, Form 10-Q reports filed by accelerated filers and large accelerated filers will continue to be due 40 days after the close of the fiscal quarter. The deadline for Form 10-Q reports for non-accelerated filers continues to be 45 days after the close of the fiscal quarter.

These changes do not affect the existing proxy statement filing deadline of 120 days after fiscal year-end for companies that choose to incorporate by reference from their definitive proxy statements the disclosure required by Part III of the Form 10-K.

Board of Director and Committee Membership

Each year as part of the year-end reporting process, we recommend that companies carefully examine the membership profiles of their board and board committees. Sarbanes-Oxley, the SEC rules issued under Sarbanes-Oxley, and changes to the listing requirements of Nasdaq, NYSE and NYSE Amex relating to board and committee membership requirements all impact who may serve.¹⁴ Mintz Levin has prepared a director independence and qualification checklist to assist with this analysis, and we encourage you to evaluate each director and director nominee to ensure continued compliance with these requirements.

Nasdaq and NYSE have amended their director independence requirements to provide that a director cannot be deemed independent if she or one of her defined family members received compensation from the company in excess of a specified amount during any 12-month period within the prior three years (with narrow exceptions) and increased the dollar threshold from \$100,000 to \$120,000. In addition, effective January 1, 2001, the NYSE approved minor amendments to its listing requirements to harmonize some of the NYSE requirements with current SEC disclosure regulations, permit companies to make some required disclosures through postings on their company websites, and provide clarification on certain listing standards¹⁵.

Stockholder Approval of Equity Compensation Plans

Nasdaq, NYSE Amex and NYSE all require shareholder approval for the adoption of equity compensation plans and arrangements for employees, directors, and consultants, and for any material

¹⁴ Please see our Client Advisory, dated November 2003, entitled “Changes to Corporate Governance Standards for Nasdaq-Listed Companies,” for a further description of these changes.

¹⁵ The amendments are described in Release No. 34-61067

modification of such plans and arrangements, including the addition of new shares to a plan.

Exemptions from the stockholder approval requirement continue to be available for inducement grants to new employees, if such grants were approved by a compensation committee or a majority of the company's independent directors, and promptly following the grant a press release is issued specifying the material terms of the award, including the name of the recipient and the number of shares issued, and in certain situations relating to an acquisition or merger. An exemption from the stockholder approval requirement is also available for certain tax-qualified, non-discriminatory employee benefit plans (such as plans that meet the requirements of Section 401(a) of the Internal Revenue Code and Employee Stock Purchase Plans meeting the requirements of Section 423 of the Internal Revenue Code), provided that such plans are approved by the issuer's compensation committee or a majority of the issuer's independent directors. Equity plans adopted prior to June 30, 2003 are unaffected under this rule, until a material modification is made to such a plan.

As noted above, companies considering option repricing programs in light of significant declines in their stock prices should note that such programs may require stockholder approval, depending on the terms of the equity compensation plan under which the options were granted. In the event that stockholder approval is required, the company will need to file a preliminary proxy statement with the SEC, which would not be required for approval of a new plan or an amendment to an existing plan.

Companies should review their existing equity compensation plans as part of their year-end reporting preparation in order to determine whether shareholder approval will need to be obtained for new plans, increases in the numbers of shares available under old plans, option repricing programs, or material plan amendments.

Other Year-End Considerations

We also recommend that companies take the opportunity while planning their year-end reporting to consider what amendments may be necessary or desirable to their corporate documents over the coming year that may require stockholder approval. Some items to consider are:

- Does the company have enough shares authorized under its certificate of incorporation to achieve all of its objectives for the year, including acquisitions for which it may want to use its stock as currency?
- Does the company have adequate shares available under its equity compensation plans to last throughout the year?

- Are there other material changes that should be made to the company's equity compensation plans that would require shareholder approval?
- Has the company reviewed its charter and by-laws to assess any anti-takeover measures in place?

To the extent that a company expects any proposal in its proxy statement to create controversy among its stockholder base, it may want to consider hiring a proxy solicitor to assist with the process of seeking the requisite stockholder vote.

In addition, in light of the new executive compensation and governance rules described above, management and directors of public companies should consider the following questions, with a view to the disclosure that would flow from each answer.

Compensation Committee:

- Consider whether the company's compensation policies and practices for *all* of the company's employees, including non-executive officers, create risks that are reasonably likely to have a material adverse effect on the company.
 - Are there business units that carry a significant portion of the company's risk profile?
 - Are there business units with compensation structured significantly differently from the other units within the company?
 - Are there business units that are significantly more profitable or risky than others within the company?
 - Are there business units where compensation expenses are a significant percentage of the unit's overall expenses?
 - Does the company have compensation policies or practices that vary significantly from the overall risk and reward structure of the company and are not in alignment with the timing of the outcome on which the award was based?
- Is the company using a compensation consultant for which disclosure would be required under the new rules?

Nominating Committee:

- Consider, for each director and nominee, the particular experience, qualifications, attributes, or skills that led the board to conclude that the person should serve as a director for the company and how the directors' skills and background enable them to function well together as a board, as of the time that a filing containing this disclosure will be made with the SEC. Review the company's current requirements regarding minimum qualifications to serve as a director that are currently set forth in the company's proxy statement to make sure that the new disclosure works with the current nominating committee policy.

- Consider whether, and if so how, the nominating committee considers diversity in assessing director nominees. Consider whether to adopt a policy regarding the consideration of diversity in identifying nominees, how to implement the policy and how to assess its effectiveness.
- Consider the current governing structure of the board. Is it still appropriate for the company? Are revisions necessary or appropriate?
- Revise the nominating committee charter, if necessary, based on the issues discussed above.

Full Board:

- Consider the board's role in managing and overseeing the material risks facing a company. Has this role been effectively managed by the board? Should the role be delegated to a committee?

Management:

- Update the company's director and officer questionnaire to elicit additional information from directors regarding legal proceedings, public company directorships, and other information that the company believes is necessary to gather the information regarding the increased disclosure that is required under the new rules.
- Ensure that disclosure controls and procedures are updated to reflect the change in reporting of stockholder meeting results from Forms 10-Q and 10-K to Form 8-K (within four business days of the end of the meeting).
- Is the company using a compensation consultant for which disclosure would be required under the new rules?
- Update disclosure controls and procedures to ensure that the reporting of stock and option awards reflects the aggregate grant date fair value as calculated in accordance with FASB ASC 718.

Mintz Levin Website: Client Publications

We would also like to call your attention to the many client advisories and alerts regarding topics of current interest that are available to you on our website, www.mintz.com. New alerts and advisories are posted frequently, and we hope that you will find the information useful.

Please contact the Mintz Levin attorney who is responsible for your corporate and securities law matters if you have any questions or comments regarding this information.