

SEC Proposes Amendments Likely to Impact the 2010 Proxy Season

by Jerry J. Burgdoerfer, William L. Tolbert and Elaine Wolff

With the July 1, 2009 proposed rule changes by the SEC, the 2010 proxy season is likely to see pronounced changes. The SEC's proposed rule changes are aimed at further enhancing shareholder rights. If adopted, these proposals would:

- Implement the Troubled Asset Relief Program ("TARP") by requiring registrants that received TARP funds to include a separate advisory vote on executive compensation.
- Enhance the disclosures that registrants are required to make about executive compensation and other corporate governance matters, and clarify certain of the rules governing proxy solicitations.

The SEC also approved the proposed rule change by the New York Stock Exchange ("NYSE") that would eliminate broker discretionary voting for the election of directors.

What's in store for the 2010 proxy season?

Increased "Say on Pay" Proposals.

With an increasing number of legislators calling for making non-binding shareholder votes on executive compensation mandatory for all public companies, such proposals are likely to increase in the 2010 proxy season. According to RiskMetrics Group (formerly Institutional Investor Services "ISS") about 85 "Say on Pay" proposals are expected to

be voted on in the 2009 season. Of the 85, few companies have adopted advisory votes voluntarily. Most calendar year-end companies will not be required to disclose the voting results until they file their Form 10-Q in early August. In her statement, Commissioner Walter encouraged more companies to allow "Say on Pay" on their ballots, regardless of whether or not they receive TARP funds.

Clearer Disclosures on Compensation, Equity Awards, Compensation Consultant Conflicts and Other Matters.

Voicing the concern of investors and companies that "proxy statements are in danger of becoming unreadable because there is so much information packed into them," Chairman Shapiro stressed that the new executive compensation and corporate governance disclosures are meant to provide investors with the "right information" rather than additional information. Indeed, in her remarks, she solicited comments on unnecessary items of current disclosure.

In keeping with the concept of providing investors with the "right information" one area that is likely to garner support is the reversion back to the August 2006 originally proposed disclosure on equity awards granted to named executive officers. As a result of an unexpected December 2006 amendment to the comprehensive executive compensation revisions, current disclosure does not call for the grant date fair value of equity awards

but rather amounts expensed for the fiscal year in the company's financial statements. Most will welcome the presentation of grant date fair value of equity awards as providing a clearer picture of compensation decisions.

Nevertheless, the proposals would necessitate new officer and director questionnaires and thoughtful drafting as a result of new Compensation Discussion and Analysis ("CD&A") disclosures regarding risk considerations in compensation policies for non-executives, and additional disclosures regarding director and nominee qualifications, corporate governance decisions such as separate or independent chairs, and the role, potential conflicts of interest and fees of independent compensation consultants. Immediately after the SEC announced its proposals, AFL-CIO President John Sweeney applauded the proposal to provide more information to shareholders about potential conflicts of interest with compensation consultants. He noted that a 2007 congressional report found that executive compensation was higher at companies that used compensation consultants with potential conflicts of interest, such as providing management with other services, than executive compensation at companies that used independent consultants.

Changes in Voting Dynamics.

An estimated 70 to 80 percent of all shares are held in "street name." Proponents of the NYSE Rule to eliminate broker discretionary voting argue that it will enfranchise retail shareholders as recent declines in retail voting (due in part to the electronic delivery of proxy materials) have increased broker votes. Opponents argue that declines in retail voting will mean a substantial increase in institutional shareholder influence. In any case, this rule change has the potential to profoundly change the voting dynamics in uncontested director elections and as such companies should begin to get a better handle on their stockholder base and initiate steps to increase shareholder communications. There is no doubt that even with greater participation by retail stockholders than companies are currently experiencing, in a post Rule 452 regime, institutional shareholders will end up with greater influence.

The SEC's Proposals on July 1st

"Say on Pay" for TARP Recipients.

The first proposal, otherwise known as "Say on Pay" for TARP recipients, would amend the proxy rules to require registrants that have received TARP funds pursuant to Section 111(e) of the Emergency Economic Stabilization Act of 2008 ("EESA"), to include a separate advisory shareholder vote on executive compensation.

Proposed Rule 14a-20 under the Securities Exchange Act of 1934 would mirror the language in Section 111(e) of the EESA and would apply to solicitations during the period in which any obligation arising from financial assistance under the TARP remains outstanding. Under the proposed rule, the shareholder vote would only be required in connection with an annual meeting of shareholders, or a special meeting in lieu of an annual meeting, for which proxies will be solicited for the election of directors. The proposal would add an amendment to Item 20 of Schedule 14A (information required in a proxy statement) to require TARP recipients to disclose that they are providing a vote on executive compensation pursuant to the requirements of the EESA and to briefly explain the general effect of the vote. These companies would be required to file a preliminary proxy statement under Rule 14a-6.

The proposed rule is consistent with past staff practice of not objecting to the inclusion in company proxy materials of resolutions that are non-binding and advisory.

Enhanced Proxy Disclosures and Clarifications of Proxy Solicitation Rules.

The second proposal is aimed at improving proxy related disclosures regarding a company's risk profile, executive compensation, director and nominee qualifications, and board governance. The proposal also seeks more timely disclosure of annual meeting voting results.

The proposal contains seven primary amendments:

(1) A focal point of the proposal is an expansion of the CD&A discussion to include a discussion and analysis of company risk related compensation policies influencing non-executive officers, if such risks may have a material effect on the company.

Currently, if material, a company must discuss the risk considerations of its compensation policies with respect to named executive officers. Under the proposal, this type of information would be required about a company's overall compensation policies, applicable beyond the executive officers. The proposal seeks disclosure about whether a company's compensation policies create incentives for employees to act in a way that creates risks not aligned with the risk objectives of the company. However, Commissioner Paredes expressed concern that such disclosures not unduly hinder appropriate risk taking and cause companies to become overly cautious.

(2) The proposal would revise the Summary Compensation Table and Director Compensation Table to require disclosure of the aggregate grant date fair value of awards computed in accordance with Statement of Financial Accounting Standards (FAS) No. 123R. This would replace the current requirement to disclose the dollar amount for the fiscal year of the accounting expense recognized in the company's financial statements in accordance with FAS 123R which is typically an amount recognized over an amortization schedule that corresponds to the award's vesting period.

(3) The proposal would amend Item 401 of Regulation S-K by:

- Expanding the disclosure of the qualifications of directors and nominees selected by the company to require the particular experience, qualifications, attributes or skills that qualify that person to serve as a director, and as a member of any committee on which such person serves or is chosen to serve, in light of the company's business.
- Lengthening the time for which disclosure of legal proceedings is required from five to 10 years.
- Lengthening the time for which disclosure of directorships at public companies held by each director and nominee is required from current directorships to five years.

On this issue, Commissioner Aguilar stressed the importance of diversity in the board room and highlighted the fact that the Commission is soliciting comment on whether diversity is a factor considered by the nominating committee and whether it should amend the rules to provide for additional or different disclosure related to diversity.

(4) The proposal would amend Item 407 of Regulation S-K to require a discussion of why the company believes its leadership structure is the best structure for the company. Under the proposal, companies would be required to disclose:

- Whether and why companies have chosen to separate the CEO and board chair positions.
- Whether the company has a lead independent director.
- A discussion of the board's role in the company's risk management process and the effect, if any, that this has on the way a company has organized its leadership structure.

(5) The proposal would require the following additional disclosures with respect to compensation consultants:

- Fees and services of compensation consultants related to executive and director compensation.
- Additional services provided by compensation consultants and affiliates and fees paid for such additional services.
- Whether the decision to engage the compensation consultant for any other services was recommended or made by management.
- Whether the board of directors or the compensation committee has approved the other services.

(6) The proposal would require disclosure of the results of shareholder votes in a Form 8-K filed within 4 business days of the end of the meeting on the vote.

(7) Finally, the proposal would clarify the operation of certain proxy rules by amending the rules to:

- Clarify that an unmarked copy of management's proxy card that is requested to be returned to management is not a "form of revocation" that would render unavailable the exemption provided by the rule for certain solicitations from the proxy rules (14a-2(b)).
- Provide that a soliciting person can round out its short slate with nominees named in a non-management proxy statement in the same manner as already permitted by the rule for nominees named in a company's proxy statement (14a-4(d)).
- Clarify that any conditions specified by a soliciting party as to when it may not vote shares it has received proxy authority over must be objectively determinable (14a-4(e)).
- Clarify that information regarding identity and interests of participants in a solicitation must be available and on file no later than the time shareholders are first solicited (14a-12).

Approval of NYSE Rule to Eliminate Broker Discretionary Voting for Director Elections.

The third action garnered the most objections by the Commissioners, with Commissioners Paredes and Casey declaring their opposition to the proposal. NYSE Rule 452 currently allows brokers, as the record holders of shares, to vote on behalf of beneficial owners on "routine" matters in the absence of instructions by the beneficial owner to the broker on how to vote. The SEC approved the NYSE proposal amending NYSE Rule 452 so that no director election would be "routine" under the rule, thereby eliminating broker discretionary voting in all director elections whether contested or uncontested.

Proponents of the Rule argue that eliminating broker discretionary voting enfranchises retail shareholders and promotes corporate accountability. They argue that current Rule 452 allows brokers to vote shares even though

they have no economic interest and that election decisions should not be made by people who do not own the shares. In fact, they see the decrease in retail voting, since the SEC adopted e-proxy rules permitting companies to deliver proxy materials electronically, as having increased the number of broker votes. They argue that brokers tend to vote in line with management, rather than allowing the persons with economic interest to vote their shares. Supporters also point to the fact that increasingly widespread "just vote no" or "withhold campaigns" are not considered contested elections and are therefore eligible for broker votes but are by no means "routine matters." They argue that the Rule will act as an incentive for increased shareholder communications and education efforts. As Commissioner Aguilar pointed out, the fact that inaction translates into an actual vote, is an odd result for such an important shareholder right.

Objections to the Rule voiced by Commissioners Paredes and Casey focused on the concern that the Rule would suppress the voice of retail shareholders and should be addressed as part of a comprehensive assessment of the proxy voting system. They argued that eliminating the discretionary broker vote will increase the influence of institutional investors and that broker votes mimic the retail shareholder vote since retail shareholders tend to side with management when voting. Opponents argue that because retail investors are voting less frequently since the adoption of e-proxy the influence of institutional investors will certainly increase. Further, they argue that rather than considering Rule 452 separately, a comprehensive review of the proxy process should be undertaken, including a review of "over-voting" and "empty-voting" issues, the role and influence of proxy advisory firms, proportional voting and client directed voting, e-proxy and company communications with shareholders. Other concerns include the difficulties for smaller

companies to obtain quorums and the concern that the Rule will interfere with the move toward majority voting because it will increase the influence of institutional shareholders.

The Rule change was first proposed in 2006 and will take effect for the 2010 proxy season. In voicing her belief that action on the rule request is overdue, Commissioner Walter affirmed that the Rule should “mark the beginning of a more in depth look into other “proxy plumbing issues” which are critical to the proper functioning of the proxy process such as:

- Shareholder communications (the “NOBO/OBO” distinction between non-objecting beneficial owners who do not object to the release of their identity to companies whose shares they hold and objecting beneficial owners who do object to the release of their identity). Removing broker discretionary voting highlights the importance of providing companies with greater access to shareholders by removing the NOBO/OBO distinction.
- Over voting (voting more shares than are issued due in part to broker share lending).
- Empty voting (voting rights divorced from economic interests such as when hedge funds borrow shares from institutional investors).

For more information, please contact the following Jenner & Block attorneys:

Joseph P. Gromacki
Partner
Tel: 312 923-2637
Email: jgromacki@jenner.com

Jerry J. Burgdoerfer
Partner
Tel: 312 923-2820
Email: jburgdoerfer@jenner.com

William L. Tolbert
Partner
Tel: 202 639-6038
Email: wtolbert@jenner.com

Elaine Wolff
Partner
Tel: 202 637-6389
Email: ewolff@jenner.com