

## NEW YORK

1285 Avenue of the Americas  
New York, NY 10019-6064  
+1 212 373 3000

## WASHINGTON, D.C.

2001 K Street NW  
Washington, DC 20006-1047  
+1 202 223 7300

## LONDON

Alder Castle, 10 Noble Street  
London EC2V 7JU  
United Kingdom  
+44 20 7367 1600

## TOKYO

Fukoku Seimei Building, 2nd Floor  
2-2, Uchisaiwaicho 2-chome  
Chiyoda-ku, Tokyo 100-0011  
Japan  
+81 3 3597 8101

## BEIJING

Unit 3601, Fortune Plaza Office  
Tower A  
No. 7 Dong Sanhuan Zhonglu  
Chao Yang District, Beijing 100020  
People's Republic of China  
+86 10 5828 6300

## HONG KONG

12th FL, Hong Kong Club Building  
3A Chater Road  
Central Hong Kong  
+852 2846 0300

July 27, 2009

## SEC Proposes Changes to Compensation and Corporate Governance Disclosures and Proxy Solicitation Rules

The SEC has published proposed amendments to its rules regarding (i) the disclosure of executive and director compensation and corporate governance policies and (ii) proxy solicitations. These proposed amendments are the most recent in a series of proposed changes to proxy statement disclosure, director elections and other corporate governance matters that could apply to U.S. public companies as early as the 2010 proxy season. Earlier this month, the SEC approved the NYSE's elimination of broker discretionary voting in director elections.<sup>i</sup> The SEC has also proposed proxy access rules that would allow shareholders meeting certain share ownership thresholds and other requirements to nominate directors via company proxy materials.<sup>ii</sup> These SEC actions are in addition to several pieces of corporate governance legislation being proposed in Congress, including the Shareholder Bill of Rights Act of 2009 introduced by Senators Charles Schumer of New York and Maria Cantwell of Washington in May.<sup>iii</sup>

In brief, the proposed disclosure and proxy solicitation amendments would:

- require that the Compensation Discussion & Analysis ("CD&A") address how a company's overall compensation policies **for all employees** create incentives that can affect the company's risk and management of that risk;
- require the full grant date fair value of stock and option awards to be reported in the Summary Compensation Table and Director Compensation Table rather than the amount recognized for financial statement reporting purposes;
- provide that forgone salary and bonus be reported in the Summary Compensation Table based on the form of compensation received in lieu of the forgone amounts, rather than as salary and bonus;
- require disclosure of a company's leadership structure (including whether there are separate board chair and CEO positions and, if not, whether there is a lead independent director) and a discussion of why the company believes its structure is the best for the company;
- require disclosure about the role of a company's board of directors in its risk management process;

- require disclosure of fees paid to, services provided by, and approval of retention of compensation consultants and their affiliates that play any role in determining or recommending the amount or form of executive and director compensation if they also provide other services to the company;
- require enhanced disclosure of a director or director nominee's background, including disclosure of:
  - the specific experience, qualifications, attributes, or skills during the past five years or longer, if material, that qualify him or her to serve as a director or board committee member (including that person's risk assessment skills and particular areas of expertise); and
  - public company directorships held during the past five years (instead of only current directorships);
- increase the period for which disclosure of legal proceedings involving directors, director nominees or executive officers is required from five to 10 years;
- require disclosure of the results of shareholder votes on Form 8-K within four business days after the result is known (rather than on a less timely basis in Form 10-Q or 10-K as is currently required); and
- clarify the SEC's proxy solicitation rules so that:
  - providing an unmarked management proxy card and requesting that the card be returned to the company is not a "form of revocation" for purposes of determining whether a person could qualify for a proxy solicitation exemption under Exchange Act Rule 14a-2(b)(1);
  - share ownership is not a prerequisite for a person to be found to have a substantial, non-pro rata interest in a solicitation such that he or she is disqualified from a proxy solicitation exemption under Rule 14a-2(b)(1)(ix);
  - a person offering a short slate of director nominees may round out its slate with other non-management director candidates under Rule 14a-4(d)(4) so long as the soliciting persons are not acting together;
  - any reasonable specified conditions upon which solicited proxies will be voted must be objectively determinable; and
  - the participant information required by Rule 14a-12(a)(i) to be included on soliciting material must be included in the material or filed under cover of Schedule 14A no later than the first time that a soliciting communication is made.

### Effective Dates

The SEC anticipates that compliance with any adopted amendments would begin in the 2010 proxy season following the publication of any final rule in the Federal Register. The proposed rule is subject to public comment through September 15, 2009.

### Proposed Changes to the CD&A – Risks Created by Employee Compensation

Under the proposed amendments, a company would be required to determine if its compensation policies for employees generally, not just for "named executive officers" (i.e., the

CEO, CFO, and the next three most highly compensated executive officers), foster risks that may have a material effect on the company. If so, the company would need to include a section in its CD&A discussing and analyzing its broader compensation policies and overall actual compensation practices. The SEC noted in the proposing release that it expects that companies “will need to consider the level of risk that employees might be encouraged to take to meet their incentive compensation elements.”

This proposal represents a departure from the current focus of the executive compensation disclosure rules, which only cover the compensation programs and policies for a company’s named executive officers. The current rules require that the CD&A discuss such risk considerations if they are a material aspect of the pay policies or decisions as they relate to a company’s named executive officers. The proposing release states that compensation policies that may create risk to a company may not be apparent from a discussion of compensation policies for named executive officers only.

The proposal explains that the information to be disclosed will vary depending upon the nature of the company’s business and its compensation approach. It provides that the situations that may raise material risks to the company and therefore require discussion and analysis could include compensation policies and practices:

- at a business unit of the company that carries a significant portion of the company’s risk profile;
- at a business unit with compensation structured significantly differently than other units within the company;
- at business units that are significantly more profitable than others within the company;
- at business units where compensation expense is 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, but the income and risk to the company from the task extend over a significantly longer period of time.

The proposing release emphasizes that these are examples only and that disclosure must be tailored to the facts and circumstances of the company. The release also notes that disclosure would be required only if there is potential for a material effect on the company.

The proposed rule also identifies examples of the issues a company may need to address regarding the compensation policies or practices discussed. These include:

- the general design philosophy of the company’s compensation policies for employees whose behavior would be most impacted by the incentives established by the policies, as such policies relate to or affect risk taking by employees on behalf of the company, and the manner of its implementation;
- the company’s risk assessment or incentive considerations, if any, in structuring compensation policies or in awarding and paying compensation;
- how the company’s compensation policies relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;

- the company's policies regarding adjustments to its compensation policies to address changes in its risk profile;
- material adjustments the company has made to its compensation policies or practices as a result of changes in risk profile; and
- the extent to which the registrant monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees.

### Changes to Tabular Disclosure

*Equity Awards* -- The proposed amendments would require that the aggregate grant date fair value of stock and option awards computed in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment ("FAS 123R") would need to be reported in the Summary Compensation Table and the Director Compensation Table instead of in the Grants of Plan-Based Awards Table and by footnote in the Director Compensation Table as currently required. The current rules for the Summary Compensation Table and Director Compensation Table require disclosure of the dollar amount recognized for financial statement reporting purposes for the fiscal year, as calculated in accordance with FAS 123R. This disclosure would be removed under the proposed rules.

Noting that the current rules may have resulted in investor confusion, the SEC stated that it is proposing the change in response to comments that investors find that disclosure of the size of equity awards granted in a fiscal year is more informative than the accounting charge for outstanding equity awards for the year. The proposing release observes that requiring disclosure of the value of equity awards made in a given fiscal year will reflect compensation decisions made during the year, which investors may find material to their voting and investment decisions.

It is not clear whether this change will be implemented prospectively. The Summary Compensation Table shows three years of compensation for each named executive officer, and the proposing release raised the possibility that companies would be required to restate prior years' equity award amounts in accordance with the new rule.

Under the proposals, the Summary Compensation Table would report the value of awards granted in the relevant fiscal year. The SEC has requested comments on whether the Summary Compensation Table should instead report the value of awards granted for services in a relevant fiscal year, even if the grant was made after the fiscal year when the services were performed.

*Forgone Salary and Bonus* --The amendments would also provide that companies may report the amount of salary and bonus forgone at a named executive officer's election in the column applicable to the form of award elected. Under this change, the Summary Compensation Table disclosure would reflect the form of compensation ultimately received by the named executive officer. Under current rules, this amount is disclosed in the salary and bonus columns. As noted above, the SEC has requested comments on whether the value of equity awards granted after the close of the fiscal year in which the related services were performed should nonetheless be reported in the Summary Compensation Table for the fiscal year in which the related services were performed. The outcome of this question may also impact the time at which equity awards granted in lieu of forgone salary or bonus are disclosed, if such awards are granted after the close of the fiscal year in which the related services were performed.

### Enhanced Director and Nominee Disclosure

The SEC is proposing amendments to Regulation S-K to enhance disclosure with respect to each incumbent director or director nominee (including shareholder nominees). The proposed new rules would:

- require disclosure of the specific experience, qualifications, attributes, or skills that qualify a person to serve as a director of the company and as a member of any committee that the person serves or is chosen to serve on (if known), in light of the company's business and structure, during the past five years. If material, this information could cover the person's risk assessment skills, particular areas of expertise, or other relevant qualifications and why that person's services as a director would benefit the company at the time of the relevant filing; and
- require disclosure of any public company directorships held at any time during the past five years (instead of only current directorships).

The SEC also proposes to lengthen the time for which disclosure of legal proceedings involving directors, director nominees, or executive officers is required from five to 10 years.

### Disclosure Regarding Company Leadership Structure

The SEC is proposing amendments to Regulation S-K to require that companies discuss whether and why they have chosen to combine or separate the principal executive officer and board chair positions. Companies with a combined principal executive officer and board chair position would be required to disclose whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. The proposing release makes clear that the SEC does not have a view as to what leadership structure is best; rather, the SEC believes that the enhanced disclosure will allow investors to better understand how boards function.

### Disclosure Regarding Board Roles in Risk Management

The SEC is proposing amendments to Regulation S-K to require a company discuss its board's role in the company's risk management process and the effect that this has on the company's leadership structure. The SEC expects that this requirement would enable investors to learn how companies perceive the role of their boards and the relationships between boards and senior management in managing the material risks facing the company. The proposing release notes the SEC's view that it is important for investors to understand a board's or a board committee's role in managing risks.

The proposal states that companies should explain how their boards implement and oversee their responsibilities for managing risk. For example, is the board as a whole responsible for such oversight, or is responsibility delegated to a committee? Disclosure might address whether the persons who oversee risk management report directly to the full board or to a committee of the board. Disclosure might also address how the board, or committee, monitors risk.

We note that the proposed Shareholder Bill of Rights Act of 2009 has a provision requiring the establishment of a risk committee.

## Disclosure Regarding Compensation Consultant Fees and Services

Under proposed changes to Regulation S-K, if a compensation consultant or its affiliate plays a role in determining or recommending the amount or form of executive or director compensation and also provides other services to the company during the last fiscal year, the company would be required to disclose the following:

- the nature and extent of such other services provided to the company or its affiliates by the consultant and any of its affiliates;
- the aggregate fees paid for such other services, and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation;
- whether the decision to engage the consultant or its affiliates for such other services was made, recommended, subject to screening, or reviewed by management; and
- whether the board or the compensation committee has approved these other services.

Disclosure would not be required if a consultant's only role in recommending the amount or form of executive or director compensation is in connection with consulting on broad-based plans that do not discriminate in favor of executive officers or directors, such as 401(k) plans or health insurance plans.

Disclosure under this amended rule could be extensive for large companies with many affiliates requiring non-executive and director compensation consulting services or to the extent there is consolidation of compensation and benefits consulting providers.

The proposing release noted that the rule is designed to address investor concern that the provision of non-executive or director compensation services and the fees those services generate may influence the executive compensation advice the consultants provide. The SEC noted in its proposing release that compensation consultants often earn much larger fees for non-executive or director compensation services than they do for consulting on executive and director compensation matters, and there may be "the appearance, or risk, of a conflict of interest that may call into question the objectivity of the consultant's executive pay recommendations." Under current rules, fee disclosure is not required.

## Reporting of Voting Results on Form 8-K

The SEC is proposing to require that companies disclose on Form 8-K the results of shareholder votes within four business days after the end of the meeting at which the votes were held. The current requirement to disclose such results on Form 10-Q or Form 10-K would be deleted if the proposal is adopted. If the matter voted on at the meeting relates to a contested director election and voting results cannot be definitively determined at the end of the meeting, the company would be required to disclose preliminary voting results within four business days after their determination and update such filing within four days after final results are certified. In the proposing release, the SEC noted that voting results on matters important enough to be submitted to shareholders for a vote should be provided to investors on a more timely basis than under the current rules.

## Proxy Solicitation Reforms

The SEC is also proposing revisions to its rules governing the proxy solicitation process. The purpose of the revisions is to provide clarity and address issues that have arisen, and the SEC expects that the changes would provide greater certainty to soliciting parties, help shareholders receive timely and complete information, and facilitate shareholder voting. Specifically, the amendments would provide that:

- providing an unmarked management proxy card and requesting that the card be returned to the company is not a “form of revocation” for purposes of determining whether a person could qualify for a proxy solicitation exemption under Exchange Act Rule 14a-2(b)(1), even if the practical effect of returning an unmarked proxy card is to cause the revocation of any prior votes by that shareholder;
- share ownership is not a prerequisite for a person to be found to have a substantial, non-pro rata interest in an solicitation such that he or she is disqualified from a proxy solicitation exemption under Rule 14a-2(b)(1)(ix);
- a person offering a short slate of director nominees may round out its slate with other non-management director candidates under Rule 14a-4(d)(4) so long as the soliciting persons are not acting as a “group” as defined under Section 13(d) of the Exchange Act and are not participants in the other person’s proxy solicitation;
- any reasonable specified conditions upon which solicited proxies will be voted must be objectively determinable; and
- participant information required by Rule 14a-12(a)(i) to be included on soliciting material must be included in the material or filed under cover of Schedule 14A no later than the first time that a soliciting communication is made.

## Requests for Comment on Whether Additional Reforms Should be Adopted

As noted at the outset, the proposed rule changes are a part of a larger group of reform proposals making their way through the SEC and Congress. The proposing release requests public comment on whether even more reforms should be considered, such as:

- expanding portions of current compensation disclosure rules to cover all executive officers rather than just the named executive officers;
- eliminating the ability to avoid disclosing performance targets due to the potential adverse competitive effect of disclosure and expanding disclosure of performance targets on an after-the-fact basis, even if contemporaneous disclosure would have resulted in competitive harm;
- incorporating the CD&A into the Compensation Committee Report;
- requiring disclosure of whether compensation committee members have expertise in compensation matters and whether the compensation committee has the resources to hire its own legal counsel;
- requiring disclosure about whether or not a company’s compensation arrangements include “hold to retirement” and/or “claw back” provisions;
- requiring disclosure of the relationship of pay among a company’s executive officers;
- requiring disclosure of the total number of compensation plans a company maintains and the total number of variables in all its plans; and

- requiring the disclosure of the benefit executives would receive from tax gross-up arrangements.

\* \* \*

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Any questions concerning the issues addressed in this memorandum may be directed to Mark S. Bergman (44-20-7367-1601), Raphael M. Russo (212-373-3309), Lawrence I. Witdorhich (212-373-3237), Frances F. Mi (212-373-3185), Erin Murphy (212-373-3106) or Paul R. Koppel (212-373-3040).

- 
- <sup>i</sup> For a discussion of this development, see our memorandum entitled *NYSE Ends Broker Discretionary Voting* at <http://www.paulweiss.com/resources/pubs/detail.aspx?publication=2414>
- <sup>ii</sup> For a discussion of this development, see our memorandum entitled *SEC Publishes Proxy Access Proposal* at <http://www.paulweiss.com/files/upload/18Jun09SEC.pdf>
- <sup>iii</sup> For a discussion of this development, see our memorandum entitled *The Shareholder Bill of Rights Act of 2009* at <http://www.paulweiss.com/files/upload/28May09SBoR.pdf>.