

## SECURITIES ALERT

### PREPARING YOUR 2010 PROXY STATEMENT AND PERIODIC REPORTS: AN ACTION ITEM CHECKLIST OF RECENT CHANGES AND CONSIDERATIONS

Companies preparing their 2010 proxy statements and other periodic reports should keep in mind some recent rule changes and other developments that may affect their disclosures in these documents. While there are only a few rule changes relating to the Form 10-K, 10-Q and 8-K, there are several important rule changes relating to the proxy statement. Companies should also consider recent guidance provided by Securities and Exchange Commission staff about disclosure matters related to these documents, as well as the effect of the elimination of broker discretionary voting in uncontested director elections. To help companies address these changes and considerations, we have attached to this alert an [action item checklist](#). While we summarize below the changes and considerations, we address them in greater detail in the checklist.

#### PROXY STATEMENT CHANGES AND CONSIDERATIONS

##### 1. Enhanced SEC Disclosure Requirements

Recent amendments to SEC disclosure rules will require public companies to provide enhanced proxy statement disclosure about certain executive compensation and corporate governance matters. Among other things, the amended rules—

- require that stock awards and option awards granted to executives and directors be reported at grant date fair value, rather than the value recognized for the fiscal year for financial reporting purposes
- require discussion of how a company's compensation policies and practices for employees affect the company's risk and management of risk if the risks arising from such policies and practices are reasonably likely to have a material adverse effect on the company
- require discussion of the board of directors' role in risk oversight
- require disclosure of the board's leadership structure (such as whether it separates or combines the CEO and chairman of the board positions) and the reason(s) the company has chosen its particular leadership format

- require disclosure of the specific qualifications and attributes of directors and nominees that qualify them to serve on the board, and the role, if any, diversity plays in the selection of nominees
- expand the disclosure about directors and nominees to include any directorships at public companies and registered investment companies held by them in the past five years, not just those currently held
- lengthen the time period for disclosing certain legal proceedings involving directors, nominees and executive officers from the past five years to the past 10 years and expand the types of legal proceedings for which disclosure is required
- require disclosure, in certain circumstances, of fees paid to, and services provided by, compensation consultants if they played a role in determining or recommending the amount or form of executive or director compensation and also provided more than \$120,000 of additional services to the company.

The SEC has published guidance for transitioning to the new disclosure rules.<sup>1</sup> The enhanced disclosure requirements will apply to proxy statements, as well as annual reports on Form 10-K, that are filed on or after February 28, 2010 for companies with fiscal years ending on or after December 20, 2009. If a company with a fiscal year ending on or after December 20, 2009 files its preliminary proxy statement before February 28, 2010, but expects to file its definitive proxy statement on or after that date, the preliminary proxy statement must comply with the new disclosure rules. If a company with a fiscal year ending on or after December 20, 2009 files its 2009 Form 10-K before February 28, 2010 and its proxy statement on or after February 28, 2010, the proxy statement must comply with the new rules. A company may elect to voluntarily comply with the new disclosure requirements before it is required to do so, but if it elects to comply with the new disclosure requirements relating to the reporting of stock and option awards in the Summary Compensation Table and Director Compensation Table, it must also comply with all of the other Regulation S-K amendments that apply to the form being filed.

## **2. Elimination of Broker Discretionary Voting in Director Elections**

Commencing January 1, 2010, brokers will no longer be permitted to use their discretion in voting for directors in uncontested elections where the brokers have not received specific instructions from their clients on how to vote the shares. Because brokers typically have cast discretionary votes in favor of management's nominees in uncontested elections, the rule change is expected to have a major impact on public companies. The rule change, which amends New York Stock Exchange Rule 452, applies to all brokers that are NYSE member firms and, therefore, will affect all public companies regardless of the stock exchange on which a company's stock is listed.

## **3. Change in SEC Staff Position on Exclusion of Certain Shareholder Proposals under Rule 14a-8**

Rule 14a-8(i)(7) allows companies to exclude from their proxy statements shareholder proposals relating to ordinary business operations. In a Staff Legal Bulletin issued in October 2009,<sup>2</sup> the SEC's Division of Corporation Finance announced that it will limit the availability of this exclusion as it applies to shareholder proposals relating to risk and CEO succession planning:

- *Risk.* Previously, SEC staff generally allowed companies to exclude shareholder proposals that relate to the company engaging in an internal assessment of risks and liabilities that the company faces as a result of its

<sup>1</sup> Compliance and Disclosure Interpretations regarding Proxy Disclosure Enhancements Transition (Dec. 22, 2009).

<sup>2</sup> Staff Legal Bulletin No. 14E (CF), available at <http://sec.gov/interps/legal/cfs1b14e.htm>.

operations. The staff now will, instead, focus on the subject matter to which the risk pertains, and if the subject matter “transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote,” the proposal generally will not be excludable under Rule 14a-8(i)(7). The SEC expressly noted that a proposal that focuses on the board’s role in the oversight of risk management may be such a proposal. The new SEC staff position will also likely result in more proposals dealing with environmental and social policy issues making their way onto company ballots.

- *CEO Succession Planning.* Previously, SEC staff allowed companies to exclude shareholder proposals calling for companies to disclose their policies regarding CEO succession planning on the grounds that these proposals related to the termination, hiring or promotion of employees, which are ordinary business matters. Going forward, the staff generally will not allow the exclusion of proposals relating to CEO succession planning.

The SEC did not change its policy that proposals that seek to “micro-manage” the company are excludable and expressly noted that a proposal on CEO succession planning could be excluded when it seeks to “micro-manage the company by probing too deeply into matters of a complex nature” for which shareholders typically would not be in a position to make an informed judgment.

In the bulletin, the SEC also encouraged companies to notify the staff of the date on which they intend to submit correspondence in connection with a no-action request. Companies can notify the staff by telephone (202-551-3500) or e-mail ([shareholderproposals@sec.gov](mailto:shareholderproposals@sec.gov)).

#### 4. Tougher SEC Review

In a November 9, 2009 speech,<sup>3</sup> the SEC’s Deputy Director of the Division of Corporation Finance, Shelley Parratt, announced that the SEC will be taking a tougher stance in its review of proxy statement disclosures regarding executive compensation and Compensation Discussion and Analysis (CD&A). Previously, the SEC had often allowed companies to agree to reflect SEC staff comments in future filings. Deputy Director Parratt, however, commented that, because companies have now had three years to digest the existing disclosure rules, “any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules.”

In her speech, Parratt also discussed some topics on which companies should focus their attention in the coming year:

- *Analysis:* The SEC wants to see better explanation of *why* executive officers were compensated as they were, rather than just a description of the actions taken by the compensation committee.
- *Performance Targets:* Parratt reiterated that in deciding whether disclosure of performance targets is required, a company must first determine whether the performance targets are material. If the performance targets are material, they must be specifically disclosed unless the disclosure would likely cause the company substantial competitive harm (under the same standard as used in confidential treatment requests). Absent highly unusual circumstances, the staff does not believe that disclosure of performance targets will result in competitive harm *after* the company has disclosed the amounts, especially where the performance targets are tied to company-wide financial results that are publicly disclosed. If a company does decide to omit a performance target where

<sup>3</sup> Available at <http://www.sec.gov/news/speech/2009/spch110909sp.htm>.

disclosure would cause competitive harm, it must disclose with meaningful specificity how difficult or likely it would be for the company or executive to achieve the target.

*Benchmarking.* If a company refers to a peer group used for benchmarking purposes, the SEC wants to see the names of the peer group companies, how they were selected and where actual results fell relative to the benchmark.

## 5. New Compliance and Disclosure Interpretations

During 2009, the SEC issued new Compliance and Disclosure Interpretations (CDIs) that may affect disclosures in the proxy statement. Among other things, there are new CDIs addressing the reporting of—

- clawbacks (CDIs for Reg. S-K Question 117.03)
- compensation of a person who has not been a named executive officer in all three years (CDIs for Reg. S-K Question 119.18)
- gross-up payments that are payable in a subsequent year (CDIs for Reg. S-K Question 119.19)
- grant-date fair value of equity awards allocated over several years with separate performance periods (CDIs for Reg. S-K Question 120.06)
- effect of amendment of an equity award on fair value (CDIs for Reg. S-K Question 120.07)
- restricted stock units that cease being subject to performance-based vesting conditions and become subject to service-based vesting (CDIs for Reg. S-K Question 122.03)
- reporting of deferred receipt of vested equity award (CDIs for Reg. S-K Question 125.05)
- effect of life insurance proceeds paid upon the death of an executive officer for purposes of determining whether the officer is a named executive officer and the amount of compensation (CDIs for Reg. S-K Interpretive Response 217.14)
- compensation in excess of \$120,000 paid to a director's child who is employed by the company, which compensation would be reportable as a related party transaction (CDIs for Reg. S-K Interpretive Response 230.07).

## 6. Changes to NYSE Corporate Governance Rules

For companies listed on the New York Stock Exchange, there are several changes to the NYSE corporate governance rules that will affect disclosures in the proxy statement. Among other things, the amended rules—

- *Eliminate categorical standards disclosures.* The amended rules continue to require that the board assess a director's independence under the NYSE's general independence definition and bright-line tests, but the amended rules replace the related disclosure requirements with those required by Regulation S-K Item 407(a), which requires disclosure for each director, by specific category or type, of any transactions the board considered. Thus, the NYSE rules will no longer refer to categorical standards, although companies may continue to find categorical standards useful in determining director independence.

- *Allow Web site disclosures of certain matters.* The amended rules permit a company to disclose on its Web site rather than in its proxy statement (or Form 10-K, if the company does not file a proxy statement) certain matters, provided the proxy statement (or annual report as applicable) states that the disclosures are made on the Web site and gives the Web site address:
- certain company contributions to a tax-exempt entity where an independent director is an executive officer
- the name of the director who presides at executive sessions and the method of selecting the presiding director if the position is rotated
- how interested parties can communicate with directors
- a board determination that service by an audit committee member on more than three public company audit committees does not impair such director's service on the company's audit committee.
- *Clarify communications with directors.* The amended rules clarify that all interested parties, not just shareholders, must be able to communicate directly with the presiding director or with the non-management or independent directors as a group. A company must disclose the method for such communications either in its proxy statement or on its Web site (or Form 10-K if the company does not file a proxy statement) provided the proxy statement (or annual report as applicable) states that fact and gives the Web site address. Companies that choose to provide the information in their proxy statement should make sure that their disclosure addresses the means by which all interested parties, and not just shareholders, can communicate.
- *Require proxy statement disclosure of Web site postings of committee charters.* Companies must disclose in their proxy statements (or Form 10-K if the company does not file a proxy statement) that its committee charters are available on its Web site and give the Web site address. This applies to charters for the nominating/corporate governance committee, compensation committee and audit committee.
- *Eliminate requirement to disclose availability of hard copies of corporate governance guidelines and committee charters.* While companies must still disclose in their proxy statements that their corporate governance guidelines, committee charters and code of business conduct and ethics are available on their Web sites and give the Web site address, they are no longer required to provide paper copies of these documents on request. Accordingly, companies are no longer required to disclose in their proxy statements that such documents are available in paper format on request.
- *Conform disclosure for controlled companies with Regulation S-K.* If a company is relying on the exemption from certain NYSE corporate governance rules that is provided for controlled companies, it need only comply with the disclosure requirements in Instruction 1 to S-K Item 407(a).

## 7. Proposed E-Proxy Rule Changes

The SEC has proposed amendments to the rules governing the form of notice that a company must send to shareholders when a company uses the notice-only method of e-proxy. The proposed amendments would give companies greater flexibility in the formulation of the notice and would allow the notice to be accompanied by additional materials explaining the notice and voting process. Companies that are planning to use e-proxy should continue to monitor the status of these proposed amendments, as they may be amended in time for the 2010 proxy season.

## OTHER PERIODIC REPORTS CHANGES AND CONSIDERATIONS

### 1. Form 10-K

- *Change to Cover Page.* Companies will need to make sure that the cover page of Form 10-K includes the following language related to XBRL that was added to the cover page effective April 13, 2009—

“Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No”

Companies (including companies that voluntarily submit Interactive Data Files) should not start checking the cover page box relating to Interactive Data File compliance until they are required to submit those files.

- *FASB Codification.* Companies will need to make sure that references to generally accepted accounting principles in Management’s Discussion and Analysis and in the notes to financial statements reflect the new FASB Accounting Standards Codification. In July 2009, the Codification became the sole authoritative source for nongovernmental U.S. generally accepted accounting principles, with the exception that SEC accounting guidance is also authoritative for public companies. The Codification is not intended to change U.S. GAAP, but it does change references to accounting standards in MD&A and in the notes to financial statements. The Codification is effective for financial statements for periods ending after September 15, 2009. Consequently, for calendar year-end companies, the Codification first applied to their third-quarter Form 10-Qs.

In August 2009, the SEC issued an interpretive release emphasizing that the Codification does not supersede SEC rules or regulations and also stating that references in existing SEC rules and guidance to specific standards under U.S. GAAP should be understood to mean the corresponding reference in the Codification.<sup>4</sup>

SEC staff and the Center for Audit Quality also have provided guidance on how to transition to the Codification.<sup>5</sup> The SEC and FASB both encourage companies to use “plain English” references to Codification topics, rather than numerical citations. For financial statements for periods ending after September 15, 2009, if there are specific references—

- companies should use Codification references
  - references to specific GAAP should be consistent for all periods (consequently, disclosures for comparative periods should not refer to only pre-Codification literature).
- *Shareholder Voting Results.* Effective February 28, 2010, the requirement to disclose shareholder voting results for a shareholder meeting that occurs in the fourth quarter of the fiscal year will be eliminated. Instead, for any shareholder meeting occurring on or after February 28, 2010, shareholder voting results must be reported on a Form 8-K, as discussed below.

<sup>4</sup> SEC Interpretive Release Nos. 33-9062A; 34-60519A (Aug. 19, 2009)

<sup>5</sup> June 23, 2009 meeting of SEC staff and Center for Audit Quality summarized at [http://www.thecaq.org/resources/secregs/pdfs/highlights/2009\\_0623\\_highlights.pdf](http://www.thecaq.org/resources/secregs/pdfs/highlights/2009_0623_highlights.pdf)

- *Start Date for Auditor Report on Internal Control for Non-accelerated Filers.* Commencing with its first annual report for a fiscal year ending on or after June 15, 2010, a non-accelerated filer must include an attestation report from its independent auditors regarding the company's internal control over financial reporting. Smaller companies should note, however, that there is legislation pending in Congress that would eliminate this requirement.
- *New Compliance and Disclosure Interpretations Regarding XBRL.* The SEC issued new CDIs during 2009 regarding XBRL. These CDIs are available [here](#).
- *Changes to NYSE Corporate Governance Rules.* An NYSE-listed company is no longer required to disclose in its Form 10-K that it filed the CEO certification required by the NYSE as well as the CEO and CFO certifications required by the SEC. There are also several disclosure changes that apply to companies that do not file an annual proxy statement and, instead, are required to make disclosures in their Form 10-K.
- *Amendments to Oil and Gas Reserve Disclosure Requirements.* The SEC has amended the reporting requirements for oil and gas reserves. These amendments, which are effective for annual reports on Form 10-K for fiscal years ending on or after December 31, 2009, revise Regulation S-K, Regulation S-X and Industry Guide 2.<sup>6</sup>

The SEC also issued new CDIs on October 26, 2009 regarding the amended rules. These CDIs are available [here](#).

The SEC's Office of the Chief Accountant issued Staff Accounting Bulletin No. 113 on October 30, 2009, which contains updated guidance on accounting rules related to the oil and gas industry. This Staff Accounting Bulletin is available [here](#).

- *Staff Comments at December 2009 AICPA National Conference on Current SEC and PCAOB Developments.* Several SEC staff members gave speeches that address matters relevant to accounting and Management's Discussion and Analysis, including—
  - goodwill impairment disclosures
  - income tax disclosures
  - disclosure of the impact of recently issued accounting standards.

Reports of the conference are available from several major accounting firms.

## 2. Form 10-Q

*Shareholder Voting Results.* Effective February 28, 2010, the requirement to disclose the voting results on Form 10-Q for the quarterly period in which a shareholder meeting occurred will be eliminated. Instead, for shareholder meetings occurring on or after February 28, 2010, shareholder voting results must be reported on a Form 8-K, as discussed below.

<sup>6</sup> SEC Release Nos. 33-8995; 34-59192 "Modernization of Oil and Gas Reporting" (Dec. 31, 2008), available at <http://sec.gov/rules/final/2008/33-8995.pdf>

*XBRL for Certain Large Accelerated Filers.* Large accelerated filers with public floats of less than \$5 billion that use U.S. GAAP will be required to comply with the SEC’s XBRL requirements in the first Form 10-Q (or Form 20-F or Form 40-F, if applicable) that contains financial statements of the company for a fiscal period that ends on or after June 15, 2010.<sup>7</sup> Currently, only certain large accelerated filers with public floats in excess of \$5 billion are subject to the requirements, which require that an Interactive Data File formatted in eXtensible Business Reporting Language (XBRL) be submitted to the SEC and posted on a company’s Web site.

*New Compliance and Disclosure Interpretations.* As discussed above, the SEC issued new CDIs during 2009 regarding XBRL. The SEC also confirmed in a CDI that if a company is current but not timely in its reporting obligations, the company may check the “yes” box on the cover page of a Form 10-Q indicating that it has filed all required reports during the preceding 12 months so long as such reports have been filed by the date of the filing of the Form 10-Q (CDIs for Exchange Act Forms Question 105.03).

### 3. Form 8-K

*Shareholder Voting Results.* For any shareholder meeting occurring on or after February 28, 2010, voting results must be reported under a new Item 5.07 to Form 8-K, which must be filed within four business days after the meeting at which the vote was taken.

*NYSE Rule Change for Code of Ethics Waivers.* NYSE rule changes allow listed companies to report a waiver of the code of business conduct and ethics for an executive officer by means of a press release, Web site disclosure or a Form 8-K. The disclosure must be made within four business days.

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<sup>7</sup> They must also comply with the XBRL requirements in any registration statement under the Securities Act of 1933 that contains a price or price range and includes financial statements of the company for a fiscal period that ends on or after June 15, 2010. S-K Item 601(b) (101).