Corporate and Securities Update:

Major Corporate Governance Proposals Are on the Way

JULY 2, 2009

Fenwick FENWICK & WEST LLP

On July 1 the Securities and Exchange Commission took action on three measures that affect public company compensation and governance. Public company boards and executive management may wish to begin tracking these developments, in anticipation of the 2010 proxy season.

While one Commission initiative, involving public companies receiving money from the Troubled Asset Relief Program (TARP), will not affect technology and life sciences companies directly, its actions on two other fronts have immediate importance to all public companies:

- Proposed changes to enhance proxy statement disclosure about compensation and governance; and
- Approval of a New York Stock Exchange rule change to eliminate broker voting of uninstructed shares in uncontested director elections.

Proposed Compensation and Governance Disclosures

The Commission proposed rule changes that are intended to improve public company disclosures about compensation and corporate governance matters in connection with solicitation of proxies for annual meetings. Details of the proposals are not yet available, but the SEC stated that the new disclosures will cover:

- The relationship of a company's overall compensation policies to risk. This would be the first mandated disclosure about a company's general compensation policies, not just its executive compensation programs. The disclosures will likely include CD&A discussion of the consideration given to risk in establishing general compensation programs as well as executive compensation. The relationship of compensation to risk would likely become a regular feature of Compensation Committee deliberations, though the extent of the analysis and related disclosure is likely to vary considerably at different companies and in different industries.
- Qualifications of director nominees. The new disclosures would go beyond the currently-required brief description of business experience, to include a specific disclosure of each candidate's particular experience, attributes or skills that qualify him or her to serve as a board member. Background information would include material legal proceedings in the past 10 years, rather than the current five years.
- Company leadership structure. The proposals would require disclosure of why a board has chosen a particular leadership structure (such as combined or separated positions of Chief Executive Officer and Chairman of the Board), and a description of the board's role in risk management.
- Potential conflicts of interests of compensation consultants. The proposals would require additional disclosures about services rendered to the company and its affiliates, and to the Compensation Committee, by consultants advising on executive compensation.
- Changes to how annual equity awards to executive officers and directors are reported. It appears that the Commission has proposed that issuers report full grant date fair value of equity awards in the Summary Compensation Table.
- Form 8-K reporting of voting results (rather than the current Form 10-Q or Form 10-K disclosure). Faster, more prominent disclosure of this information may influence how companies choose to reach out to shareholders to participate in the voting process, particularly in light of the discretionary voting rule change described below.

Public comment on these compensation and governance disclosure proposals is invited, for a period of 60 days after the proposals are published.

Final Discretionary Broker Voting Rule Change

The Commission also approved a New York Stock Exchange rule amendment that would eliminate discretionary voting by brokers in director elections. NYSE Rule 452 currently allows brokers to exercise discretionary voting authority – and thus vote – on matters that the NYSE considers "routine." Voting to elect directors in uncontested matters has been considered routine until now, and brokers have historically voted in favor of the company's proposed slate of directors. Because NYSE Rule 452 applies to brokers, it governs how they vote shares of companies on other exchanges, such as NASDAQ. Specifically, the NYSE proposal would add "election of directors" to the list of enumerated items for which a member broker generally may not vote without instructions from the customer that is the beneficial owner of the shares. This change will apply to shareholder meetings held on or after January 1, 2010.

The stated principle behind approval of this change is to enhance corporate governance and accountability by helping assure that the shares voted in director elections are held by investors that have an economic interest in the vote. In practice, we expect the number of shares voted at routine annual meetings to decline substantially, because votes cast for directors historically have included a significant number of discretionary votes that will be prohibited under the revised Rule 452. Many companies may wish to experiment with shareholder outreach efforts to increase voter participation. In particular, companies that have a majority vote requirement for election of directors and companies that may not have a quorum based on institutional investor holdings would have special reason for outreach to individual shareholders.

If you have any questions about these developments and their potential implications for your company, please call your regular Fenwick & West contact, or any member of our corporate securities group. Also please feel free to contact Horace Nash, Scott Spector, Dan Winnike, Jeff Vetter and Laird Simons, who contributed to this client alert.