Regulatory Developments 2009

SEC Approves Significant New Proxy Disclosure Requirements

On December 16, 2009, the U.S. Securities and Exchange Commission ("SEC" or the "Commission") approved substantial revisions to its proxy rules.[1] The changes are intended to enhance the information provided to shareholders and enable them to evaluate better the leadership of public companies. These new disclosure requirements call for significant new disclosure in proxies and information statements, annual reports, and registration statements filed with the Commission.

Timing of Application of the New Proxy Disclosure Requirements

For a company with a fiscal year ending on or after December 20, 2009, the new disclosure requirements apply to any Form 10-K or proxy statement filed on or after February 28, 2010.[2] In this regard, if such a company files its 2009 Form 10-K before February 28, 2010, and its proxy statement on or after February 28, 2010, the company must comply with the new requirements in its proxy statement. Further, if such a company is required to file a preliminary proxy statement and expects to file its definitive proxy statement on or after February 28, 2010, then the company must comply with the new requirements in that preliminary proxy statement (even if filed before February 28, 2010).[3]

If a company's fiscal year ends before December 20, 2009, its 2009 Form 10-K and related proxy statement are not required to comply with the new proxy disclosure requirements (even if filed on or after February 28, 2010).[4]

Disclosure Regarding Risks Arising from Compensation Policies and Practices

Amended Item 402 of Regulation S-K requires a company to address any employee compensation policies and practices that create risks that "are reasonably likely to have a material adverse effect on" the company.[5] The threshold for this

1. Proxy Disclosure Enhancements, Securities Act Release No. 33-9089, 74 Fed. Reg. 68334 (Dec. 23, 2009) (to be codified at 17 C.F.R. pts. 229, 239, 240, 249 & 274) [hereinafter Adopting Release].
2. *Id*. at 68340.
3. *Id*.
4. *See id*.
5. *Id*. at 68363–64 (to be codified at 17 C.F.R. § 229.402(s)).

disclosure requirement was modified from the initial proposal, which would have required disclosure of compensation policies for employees generally if "risks arising from those compensation policies and practices may have a material effect on the company."[6] The adopted disclosure standard is now consistent with the standard used in Management's Discussion and Analysis for disclosing material trends and uncertainties.[7]

In determining whether new disclosure is required, a company may consider offsetting and mitigating factors.[8] As an example, a company may have a form of compensation that incentivizes employees to take risks, but if the company has taken some other action to ensure that those specific risks are consistent with the company's overall risk profile, the disclosure may not be required, as any risks presented by the form of compensation may not be "reasonably likely to have a material adverse effect on the company."[9]

If a company determines that enhanced disclosure of compensation policies and practices is required, the level of disclosure required depends on the particular facts and circumstances for that company.[10] Disclosure may include:

- The general design philosophy of the company's compensation policies and practices for employees whose behavior would be most affected by the incentives . . . ;
- The company's risk assessment or incentive considerations, if any, in structuring its compensation policies and practices . . . ; [or]
- How the company's compensation policies relate to the realization of risks resulting from the actions of employees in both the short and long term . . . .[11]

As proposed, this disclosure was to be included in the company's Compensation Discussion and Analysis ("CD&A").[12] As adopted, however, the Commission determined that this disclosure should be included in the discussion of the company's compensation, but not in the CD&A.[13] The Commission indicated that it made this change to clarify that the enhanced disclosure relates to employees generally, while the CD&A is limited to disclosure regarding compensation of the company's named executive officers only.[14] With regard to named executive officers, however, the Commission noted that "to the extent that risk considerations are a material aspect of the company's compensation policies or decisions

6. *See* Proxy Disclosure and Solicitation Enhancements, Securities Act Release No. 33-9052, 74 Fed. Reg. 35076, 35078 (proposed July 17, 2009) [hereinafter Proposing Release].
7. Adopting Release, *supra* note 1, 74 Fed. Reg. at 68336.
8. *Id*. at 68336–37.
9. *See id*.
10. *Id*. at 68337.
11. *Id*.
12. Proposing Release, *supra* note 6, 74 Fed. Reg. at 35078.
13. Adopting Release, *supra* note 1, 74 Fed. Reg. at 68337.
14. *Id*.

for named executive officers, the company is required to discuss them as part of its CD&A under the current rules."[15]

Value of Option and Stock Awards Included in Summary Compensation Table

Amended Item 402 of Regulation S-K requires a company to disclose the aggregate grant date fair value of equity-based awards granted during the fiscal year to named executive officers and directors (computed in accordance with Accounting Standards Codification Topic 718, Compensation—Stock Compensation).[16] This fundamentally alters the existing requirement, under which a company is required to report the dollar amount recognized for financial statement reporting purposes for the fiscal year with respect to all awards granted to such individuals.[17]

The new disclosure requirements are required for fiscal years ending on or after December 20, 2009.[18] In the first year that companies become subject to the amended reporting standard, they will be required to recompute the value of option and stock awards reported in the Summary Compensation Table for each previous year already reported.[19] For example, a company with a fiscal year ending on or after December 20, 2009, will be required to report the aggregate grant date fair value of option and stock awards granted to each named executive officer in 2009 as well as in 2008 and 2007, requiring those companies to recompute the amount previously reported in the Summary Compensation Table for those previous years.[20] The Commission has clarified that the restatement of option and stock award values for previous years will not require any change in the named executive officers previously identified in those years or the inclusion of additional named executive officers in the current year.[21]

Amended Item 402 of Regulation S-K also includes an instruction to clarify that performance-based equity awards should be valued based on the probable outcome of the performance conditions (as of the grant date), rather than on the maximum value of the award if all performance conditions are satisfied.[22] To provide shareholders with information about a performance award's potential maximum value over the performance period, the Summary Compensation Table and Director Compensation Table are required to include a footnote that discloses the maximum value of the award, assuming the highest level of performance conditions probable.[23]

15. *Id.* at 68336 n.38.
16. *Id.* at 68362 (to be codified at 17 C.F.R. § 229.402(c)(2)(v)–(vi)).
17. 17 C.F.R. § 229.402(c)(2)(v)–(vi) (2009).
18. Adopting Release, *supra* note 1, 74 Fed. Reg. at 68340.
19. *Id.*
20. *See id.*
21. *Id.*
22. *Id.* at 68362 (to be codified at Instruction 3 to 17 C.F.R. § 229.402(c)(2)(v)–(vi)).
23. *Id.*

Disclosure Regarding Directors and Director Nominees

Amended Item 401 of Regulation S-K requires expanded narrative disclosure regarding the particular experience, qualifications, attributes, or skills which, in light of the company's business and structure, led the company's board of directors to conclude that the person should serve as a director.[24] This disclosure is required to speak to the directors' and nominees' qualifications as of the time it is made.[25]

The disclosure will be required annually for all directors and nominees, even for directors on classified boards that are not up for election.[26] The Commission eliminated the proposed requirement that would have required disclosure of a nominee's qualifications to serve on a particular board committee.[27] "However, if an individual is chosen to be a director or a nominee to the board because of a particular qualification, attribute or experience related to service on a specific committee, such as the audit committee," this disclosure should be included "as part of the individual's qualifications to serve on the board."[28]

The Commission also expanded the disclosure requirements regarding the background of nominees and directors to include:

- Disclosure regarding any directorships held at public companies or registered investment companies by a director or nominee at any time during the past five years. This will be a change from the current rule, which requires disclosure only of directorships *currently* held by nominees or directors; and
- Disclosure regarding specified legal proceedings during the past ten years. This will be a change from the current rule, which requires disclosure of legal proceedings during only the past *five* years. This disclosure requirement applies to both directors and executive officers.[29]

Additionally, the list of legal proceedings required to be disclosed if involving a nominee or director will be expanded to include:

- Any judicial or administrative proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity;
- Any judicial or administrative proceedings based on Federal or State securities, commodities, banking or insurance laws and regulations, or any settlement of these actions; and
- Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization.[30]

24. *Id*. (to be codified at 17 C.F.R. § 229.401(e)).
25. *Id*.
26. *Id*. at 68342.
27. *Id*. at 68343.
28. *Id*.
29. *Id*.
30. *Id*.

Preparation of the new disclosures requires revisions to the information collected from directors, as well as the timing of requests for that information. Further, as the new disclosures require specific information regarding directors that has not been disclosed previously, it will be necessary to provide directors with sufficient time to consider the new disclosures.

Disclosure Regarding the Consideration of Diversity in Identifying Nominees for Director

Amended Item 407(c) of Regulation S-K requires a company to disclose whether, and if so, how, the nominating committee or board of directors considers diversity in identifying nominees for directors.[31] If the company has a policy with regard to consideration of diversity in identifying director nominees, Item 407(c) also requires disclosure of the manner in which that policy is implemented and the manner in which the nominating committee or board of directors assesses the policy's effectiveness.[32] Diversity is not defined in the amendments, but may be defined in a manner most appropriate to the company (including diversity as it relates to individuals' background or perspectives).[33] In this regard, it is likely that the disclosure will address the board's efforts to assess diversity with regard to the composition of the entire board of directors.

Disclosure regarding a board's consideration of diversity will need to include a discussion of the diversity that is sought in establishing the appropriate board composition. Until the Commission provides further guidance, it is likely that a company that does not have a stand-alone policy regarding the consideration of diversity will include a disclosure that (1) sets forth the company's statements of principle that require diversity considerations; (2) indicates that the company does not have a separate policy regarding the consideration of diversity; and (3) provides information regarding the manner in which the board of directors considers diversity and assesses the effectiveness of its diversity efforts.

Disclosure Regarding Board Leadership Structure and Role in Risk Oversight

New Item 407(h) of Regulation S-K will require a company to provide disclosure regarding its "leadership structure," including disclosure regarding:

- Whether the company has combined or separated the chief executive officer and board chair positions;
- The basis for the board's view that the company's particular leadership structure is appropriate for the company at the time of filing the proxy or information statement; and

31. *Id*. at 68364 (to be codified at 17 C.F.R. § 229.407(c)(2)(vi)).
32. *Id*. at 68343–44.
33. *Id*. at 68344.

- Where the chief executive officer and chairman positions are combined, whether and why the company has a "lead independent director," and the specific role the lead independent director plays in the leadership of the company.[34]

Management and the board of directors should review the current board leadership structure and understand the reasons why this leadership structure continues to be in the company's best interest. Where a company does not separate the chief executive officer and board chair positions or have a lead independent director, the new rules do not require a change in the company's leadership structure; however, the company will now be expected to disclose its rationale for why it is not appropriate to split these positions or establish a lead independent director position.[35] Further, as the required disclosure must speak as of the time it is made, the company should focus on its continued soundness in light of the company's particular facts and circumstances.

New Item 407(h) of Regulation S-K also requires disclosure regarding the extent of the board's role in the company's risk oversight.[36] The new disclosure requirements regarding risk oversight recognize that boards do not perform a direct risk management function but, instead, perform a risk oversight function.[37] Accordingly, the new disclosure requirements will focus on the board's process and structure for dealing with risk and not require disclosure regarding the particular decisions made with regard to risk.[38] As such, the disclosure should focus on the board structure for overseeing risk, the reason for that structure, and the manner in which the board receives information from those responsible for managing risk; the disclosure should not address particular risk determinations.

Disclosure Regarding Compensation Consultants

Under amended Item 407(e) of Regulation S-K, a company may now be required to disclose additional information regarding compensation consultants that played a role in determining or recommending the amount or form of executive or director compensation during the prior fiscal year.[39] This new disclosure will be required *only if* that compensation consultant or any of its affiliates also provided additional services to the company or any of its affiliates during the prior fiscal year.[40] The additional disclosure includes:

- The aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for all additional services provided to the company or its affiliates; and

34. *Id*. at 68365 (to be codified at 17 C.F.R. § 229.407(h)).
35. *Id*. at 68345.
36. *Id*. at 68365 (to be codified at 17 C.F.R. § 229.407(h)).
37. *See id*. at 68345.
38. *Id*.
39. *Id*. at 68364–65 (to be codified at 17 C.F.R. § 229.407(e)(3)(iii)).
40. *Id*.

- If the compensation consultants are engaged by the compensation committee or the board: (1) whether the decision to engage the consultant or its affiliates for the additional services was made or recommended by management; and (2) whether the compensation committee or the board approved the engagement of the consultant or its affiliates to perform the additional services.[41]

The additional disclosure is not required in specified circumstances that the Commission determined should not raise potential conflicts of interest, for example:

- Fees paid for additional services must exceed $120,000 during the company's fiscal year to trigger disclosure of aggregate fees paid for both executive compensation consultant services and for additional services;
- Fees paid for consulting on broad-based plans that do not discriminate in favor of executive officers or directors are not required to be disclosed; and
- Fees paid for additional services limited to providing information to the company, such as a survey that is not customized for the company or only is customized based on parameters that are not developed by the compensation consultant, are not required to be disclosed.[42]

To determine if additional services provided by compensation consultants require disclosure for the current fiscal year, companies should identify and review all services provided by the compensation consultant(s) or any of its affiliates. To prepare compliance with the new compensation consultant disclosure requirements on an ongoing basis, companies should ensure that they have a policy in place setting forth specific procedures for both recommending and approving the performance of additional services by a compensation consultant or its affiliate.

Reporting Voting Results of Shareholder Meetings

For shareholder meetings held on or after February 28, 2010, a company is required to disclose voting results by filing a Form 8-K with the Commission within four business days of the meeting at which the vote was held.[43] If final voting results are not yet available, the company may report preliminary voting results on its Form 8-K and file an amendment to the Form 8-K to report final voting results.[44] This amendment would be due within four business days of the date that final results first become available.[45]

41. *Id.*
42. *Id.*
43. *Id.* at 68350.
44. *Id.*
45. *Id.*

Impact of the New Proxy Disclosure Requirements on Company Practices and Policies

As described above, the new proxy disclosure requirements increase a company's required disclosures to shareholders concerning director qualifications, board leadership, and executive compensation. The new disclosures provided by companies will be closely scrutinized by investors, proxy advisors, and other third parties. RiskMetrics Group, Inc., for example, recently announced that it will carefully analyze the new disclosures during the 2010 proxy season and its review may inform the basis for future voting policy changes.[46] Therefore, a likely indirect (but not necessarily unintended) effect of the new proxy disclosure requirements is that many companies will change or adjust existing practices and policies to facilitate disclosure that will most closely reflect best practices. Likely changes include the following:

- Compensation committees will take a more active role in reviewing a company's overall compensation programs and ensuring that they include appropriate safeguards to mitigate any potential for unnecessary or excessive risk-taking, such as multiple performance metrics and caps for incentive-based compensation, clawback provisions, and stock ownership guidelines.
- While board practices for selecting director nominees will remain largely unchanged, the use of skills matrices to assess the skills and qualifications of the board of directors as a whole is likely to continue to increase. Moreover, many boards of directors already consider diversity in selecting director nominees (even if they do not have a formal policy to do so); therefore, the selection practice in this area is not expected to change significantly. However, to assist the board in assessing the effectiveness of its practices regarding diversity, some companies may choose to revise their board self-evaluation forms or processes to seek express input from directors about the board's diversity efforts and whether the board is sufficiently diverse (as determined in accordance with the definition used by the board).
- Companies that currently combine the chairman and chief executive officer positions are unlikely to separate those positions in response to the Commission's new board leadership disclosure requirements. However, for companies that combine those positions, the new disclosure rules may encourage more boards to designate a lead independent director. Further, it will be necessary for the boards of such companies to reevaluate annually its rationale and disclosure in this area.
- Many companies are likely to reevaluate their risk management and board oversight processes in light of the new disclosure requirements. Compa-

46. RiskMetrics Group, Inc., U.S. Proxy Disclosure Requirements: FAQ, http://www.riskmetrics.com/policy/2010_NewUSDisclosureFAQ (last visited Feb. 24, 2010).

nies that do not have formal enterprise risk management programs with clearly prescribed board oversight responsibilities may choose to formalize this process. Formalization may include the designation of a separate risk oversight or compliance committee and a formalization of the manner in which the individuals who supervise the day-to-day risk management responsibilities interact with the board of directors.

- Finally, compensation consulting services provided to management are likely to be closely scrutinized by the company's compensation committee including the adoption of more robust procedures for the recommendation and approval of any additional services provided by a compensation consultant.

Advent of Interactive Data Tagging

The final rules relating to the filing of financial data in interactive format, commonly known as eXtensible Business Reporting Language ("XBRL"), were adopted by the SEC, effective April 13, 2009.[47] The rules generally require Securities Act registration statements, as well as annual and quarterly reports that are filed under the Exchange Act and contain financial statements or financial statement schedules, to include an exhibit submitting financial data in XBRL format.[48]

The process requires the filer to identify, or "tag," its financial data using a standard list of definitions, or taxonomy, based on U.S. generally accepted accounting principles ("U.S. GAAP") or International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS").[49] The taxonomy also includes items required by SEC regulations and other items commonly used by companies in their financial statements.[50] The standard taxonomy is included in the EDGAR Filer Manual.[51]

There are five standard industry-specific lists of tags, with the majority of companies falling under the Commercial and Industrial group.[52] Each tagged amount must be mapped to the applicable monetary value, percentage, share amount, or other number.[53] In each case, the element with the narrowest definition that still reflects all material characteristics of the element should be used.[54] If the standard

47. Interactive Data to Improve Financial Reporting, Securities Act Release No. 33-9002, 74 Fed. Reg. 6776 (Feb. 10, 2009) (to be codified at 17 C.F.R. pts. 229, 230, 232, 239, 240 & 249) [hereinafter Interactive Data].

48. *Id*. at 6780.

49. *Id*. at 6778. The SEC's filing system is expected to accommodate use of the IFRS list of tags by mid-2011. *See id*. at 6786 n.136.

50. *Id*. at 6778.

51. 17 C.F.R. § 232.301 (2009).

52. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6798 & n.284.

53. 17 C.F.R. § 232.405(c) (2009).

54. *See* U.S. Securities and Exchange Commission, Staff Observations from Review of Interactive Data Financial Statements, http://www.sec.gov/spotlight/xbrl/staff-review-observations.shtml (last visited Feb. 24, 2010) [hereinafter Staff Observations].

tags do not accurately reflect the nature of a line item in the filer's financial statements, the company may create a company-specific element, known as an extension.[55] Filers must be careful not to create extensions unnecessarily.[56]

A company may use commercially available software or an outside service provider to accomplish the tagging process.[57] Financial information in interactive data format must be converted or "rendered" by a viewer to turn it into a format readable by humans.[58] The SEC's web site includes such a viewer.[59] The information as rendered by the viewer is not required to have an appearance identical to the financial statements filed in the traditional format (HTML or ASCII).[60]

The tagging requirements are being phased in over a three-year period as follows:

- Domestic and foreign companies that are large accelerated filers,[61] use U.S. GAAP, and have a public float of more than $5 billion were required to begin filing interactive data exhibits with their first quarterly report on Form 10-Q or annual report on Form 20-F or 40-F containing financial statements for a period ending on or after June 15, 2009.[62]
- All other large accelerated filers using U.S. GAAP must begin filing interactive data exhibits with their first Form 10-Q, 20-F, or 40-F containing financial statements for a period ending on or after June 15, 2010.[63]
- All remaining filers using U.S. GAAP and foreign companies that use IFRS must begin filing interactive data exhibits with their first Form 10-Q, 20-F, or 40-F containing financial statements for a period ending on or after June 15, 2011.[64]

During the first year of compliance, a filer is required to tag all of the numbers appearing on the face of its financial statements (including parenthetical amounts in captions), as well as tagging its financial statement footnotes and schedules as blocks of text.[65] Beginning in the second year of compliance, companies are required to tag footnotes using four different levels of detail, including tagging each complete footnote, each significant accounting policy within the applicable foot-

55. U.S. Securities and Exchange Commission, Interactive Data for Financial Reporting: A Small Entity Compliance Guide, http://www.sec.gov/info/smallbus/secg/interactivedata-secg.htm (last visited Feb. 24, 2010) [hereinafter Small Entity Compliance Guide].
56. *See* Staff Observations, *supra* note 54.
57. *See* Small Entity Compliance Guide, *supra* note 55.
58. *Id*.
59. *Id*.
60. *See* Staff Observations, *supra* note 54.
61. *See* 17 C.F.R. § 240.12b-2 (2009).
62. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6785; 17 C.F.R. § 229.601(b)(101)(i)(A) (2009).
63. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6785; 17 C.F.R. § 229.601(b)(101)(i)(B) (2009).
64. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6785; 17 C.F.R. § 229.601(b)(101)(i)(C) (2009).
65. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6788; 17 C.F.R. § 232.405(f) (2009).

note, and each table as a separate block of text, as well as each monetary value, percentage, and number within each footnote.[66] A thirty-day grace period applies to the initial interactive data exhibit a company is required to file and again to the first exhibit required to include detailed tagging of footnotes and schedules.[67]

Following the three-year phase-in period, newly public companies become subject to the XBRL exhibit requirements for the first Form 10-Q, 20-F, or 40-F, as applicable, due after becoming a public company.[68] Interactive data exhibits must be filed with registration statements filed under the Securities Act (other than for initial public offerings) with the first filing establishing a price or price range and thereafter when the financial statements are changed.[69] The tagging requirements also apply to current reports on Form 8-K that contain audited annual financial statements that have been revised from a previously filed interactive data exhibit.[70]

Once a company becomes subject to the XBRL tagging requirements, it must also post the interactive data exhibit on its corporate web site, if it has one.[71] The web site should be at the same internet address the company normally uses to provide information to investors.[72] A hyperlink to the SEC's web site does not satisfy this requirement, but a hyperlink directly to the file on another third-party web site may comply if access is free of charge.[73] The interactive data must remain posted for at least twelve months.[74]

Companies that fail to file a required interactive data exhibit will be deemed to be ineligible to use Form S-3, F-3, S-8, or similar short form registration statements and to be out of compliance with the current public information requirement of Rule 144, the safe harbor exemption for re-sales of securities under the Securities Act.[75] Once the company files all its required interactive data exhibits, it will be deemed to have timely filed its Exchange Act reports.[76]

The certification requirements of Rules 13a-14 and 15d-14 under the Exchange Act do not apply to interactive data exhibits.[77] The controls and procedures relating to interactive data exhibits do, however, fall within the scope of "disclosure controls and procedures" for purposes of evaluating the effectiveness of such

66. 17 C.F.R. § 232.405(d) (2009).
67. *Id.* § 232.405(a)(2)(ii).
68. *See* Small Entity Compliance Guide, *supra* note 55.
69. 17 C.F.R. § 229.601(b)(101)(i) (2009).
70. *Id.*
71. 17 C.F.R. § 232.405(g) (2009).
72. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6792.
73. U.S. Securities and Exchange Commission, Compliance and Disclosure Interpretations: Interactive Data, Question 130.09 (Sept. 14, 2009), http://www.sec.gov/divisions/corpfin/guidance/interactivedatainterp.htm [hereinafter Interactive Data C&DIs].
74. 17 C.F.R. § 232.405(g) (2009).
75. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6781.
76. *Id.*
77. *See id.; see also* 17 C.F.R. §§ 240.13a-14(f), 240.15d-14(f) (2009).

controls under Rules 13a-15 and 15d-15[78] under the Exchange Act and Item 307 of Regulation S-K.[79]

Companies may voluntarily comply with the interactive data filing requirements before they are required to do so under the phase-in schedule.[80] Voluntary filers may nevertheless wait to submit detail-tagged footnotes and schedules until required and may cease voluntary submissions at any time.[81]

Under a temporary rule that expires on October 31, 2014, during the first twenty-four months after a filer is first required to submit interactive data exhibits, the files are subject to the antifraud provisions of the federal securities laws but are protected from liability under those provisions or any other liability provision for failing to comply with the tagging requirements as long as the company made a good-faith effort to comply and promptly corrected the error after discovering it.[82] Following expiration of the modified liability provisions, interactive data files are not deemed filed for purposes of section 11 of the Securities Act[83] or section 18 of the Exchange Act[84] or otherwise subject to liability imposed by those sections, and are not deemed to be part of any registration statement to which they relate or to be incorporated by reference, but are subject to all other liability and antifraud provisions of the federal securities laws.[85]

Impact of Interactive Data Tagging

While the impact of the XBRL on a company will be minimal, a decision should be made on how to handle XBRL exhibits well in advance of the filing deadline. Practitioners also should plan to complete their review of the financial statements and footnotes earlier to allow sufficient time for the tagging process to be completed. Ideally, the financial data in the registration statement or report and the interactive data exhibit should be updated concurrently throughout the drafting process. Last minute changes to the financial data will significantly increase the risk of missing a filing deadline.

Additional Guidance on the Exclusion of Shareholder Proposals Under Rule 14a-8

On October 27, 2009, the SEC Division of Corporation Finance (the "Division") provided additional guidance regarding the exclusion of shareholder proposals from proxy materials under Rule 14a-8 of the Exchange Act.[86] In the latest

78. 17 C.F.R. §§ 240.13a-15, 240.15d-15 (2009).
79. *See id.* § 229.307; *see also* Interactive Data CD&Is, *supra* note 73, Question 162.01.
80. Interactive Data, *supra* note 47, 74 Fed. Reg. at 6781.
81. *Id.*
82. *See id.* at 6794 & n.233; *see also* 17 C.F.R. § 229.406T (2009).
83. 15 U.S.C. § 77k (2006).
84. *Id.* § 78r.
85. 17 C.F.R. § 232.402(a) (2009).
86. *See* U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., Shareholder Proposals, Staff Legal Bulletin No. 14E (CF) (Oct. 27, 2009), *available at* http://www.sec.gov/interps/legal/cfslb14e.htm [hereinafter Staff Legal Bulletin No. 14E]; *see also* 17 C.F.R. § 240.14a-8(i) (2009).

of its continuing guidance regarding shareholder proposals,[87] the Division focused on the exclusion of proposals under Rule 14a-8(i)(7)[88] relating to risk and succession planning for a company's chief executive officer.[89] The Division also addressed the manner in which proponents and companies can notify the Division that they will be submitting correspondence in connection with a company's no-action request regarding the exclusion of shareholder proposals.[90]

Previous Exclusions of Proposals Related to Risk

The Division has previously addressed company no-action requests seeking to exclude shareholder proposals relating to environmental, financial, or health risks under Rule 14a-8(i)(7).[91] Companies have been allowed to exclude proposals when, taken as a whole, the proposal and supporting statement relate to the company engaging in an evaluation of a risk including an internal assessment of risk arising out of a company's ordinary business operations.[92] However, the Division has not allowed companies to exclude shareholder proposals under Rule 14a-8(i)(7) when the proposals and supporting statements are focused on "minimizing or eliminating operations that may adversely affect the environment or the public's health."[93]

Recently, a discernible increase in no-action requests seeking to exclude proposals as relating to an evaluation of risk has caused the Division to reexamine the analysis used for risk proposals.[94] Concerned that the current analysis under previous Staff Legal Bulletin No. 14C "may have resulted in the unwarranted exclusion of proposals that relate to the evaluation of risk but focus[ed] on significant policy issues,"[95] the Division reexamined its analysis for such proposals and adopted a "more appropriate framework to apply [in] analyzing these proposals."[96]

87. *See generally* U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., Shareholder Proposals, Staff Legal Bulletin No. 14 (July 31, 2001), *available at* http://www.sec.gov/interps/legal/cfslb14.htm; U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., Shareholder Proposals, Staff Legal Bulletin No. 14A (July 12, 2002), *available at* http://www.sec.gov/interps/legal/cfslb14a.htm; U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., Shareholder Proposals, Staff Legal Bulletin No. 14B (CF) (Sept. 15, 2004), *available at* http://www.sec.gov/interps/legal/cfslb14b.htm; U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., Shareholder Proposals, Staff Legal Bulletin No. 14C (CF) (June 28, 2005), *available at* http://www.sec.gov/interps/legal/cfslb14c.htm [hereinafter Staff Legal Bulletin No. 14C]; U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., Shareholder Proposals, Staff Legal Bulletin No. 14D (CF) (Nov. 7, 2008), *available at* http://www.sec.gov/interps/legal/cfslb14d.htm.

88. 17 C.F.R. § 240.14a-8(i)(7) (2009) allows the exclusion of shareholder proposals relating to a company's ordinary business operations.

89. *See* Staff Legal Bulletin No. 14E, *supra* note 86.

90. *Id.*

91. *See id. See also* Staff Legal Bulletin No. 14C, *supra* note 87.

92. *See* Staff Legal Bulleting No. 14E, *supra* note 86.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

New Analytical Framework for Excluding Proposals Related to Risk Under Rule 14a-8(i)(7)

The Division will no longer allow exclusions of shareholder proposals based solely on the fact that the proposal would require an evaluation of risk.[97] Instead, the Division will focus on whether the underlying subject matter of the risk evaluation concerns a matter of ordinary business.[98] Where a proposal's underlying subject matter "transcends the day-to-day business matters" of the company and instead raises policy issues of a significant nature appropriate for a shareholder vote, then the proposal will generally not be excludable under Rule 14a-8(i)(7) provided there is a sufficient nexus between the nature of the proposal and the company.[99] The Division will apply the same standards used in other Rule 14a-8(i)(7) proposals in determining whether the subject matter raises significant policy issues and has sufficient nexus to the company.[100] Additionally, proposals focusing on the board's role in the oversight of a company's management of risk may also raise significant policy issues appropriate for a shareholder vote and thus not be excludable under Rule 14a-8(i)(7).[101]

Exclusion of Proposals Focusing on CEO Succession Planning

Much like proposals related to the evaluation of risk, the Division has allowed the exclusion of proposals related to the adoption and disclosure of CEO succession planning policies as such proposals related to the termination, hiring, or promotion of employees as ordinary business matters under Rule 14a-8(i)(7).[102] In light of recent events, the Division now recognizes that CEO succession planning raises a significant policy issue regarding the governance of a corporation and thus transcends the day-to-day business matters of managing the company's workforce.[103] Recognizing that a key function of the board is to provide for succession planning so that a vacancy in leadership does not adversely affect the company, the Division will modify its treatment of succession planning proposals such that they will no longer be generally excludable under Rule 14a-8(i)(7).[104]

Alerting the Division Regarding Correspondence Related to No-Action Requests

Finally, the Division encourages companies and proponents of shareholder proposals intending to submit correspondence regarding a no-action request to

97. *Id.*
98. *Id.*
99. *Id.*
100. *See id. See also* Lowe's Cos., SEC No-Action Letter, 2008 WL 310592, at *2–5 (Feb. 1, 2008).
101. Staff Legal Bulletin No. 14E, *supra* note 86.
102. *See id. See also* National Instruments Corp., SEC No-Action Letter, 2009 WL 829066, at *3 (Mar. 5, 2009); Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 29106 (May 21, 1998) (to be codified at 17 C.F.R. §§ 240.14a-5, 240.14a-8).
103. Staff Legal Bulletin No. 14E, *supra* note 86.
104. *Id.*

contact the Division, including the date by which they intend to submit their correspondence so that the Division can review the correspondence prior to issuing a no-action response.[105] Shareholder proponents should submit any replies to no-action requests as soon as possible after the company submits its no-action request.[106]

Amendments to Regulation SHO

On July 27, 2009, the SEC amended Regulation SHO by adopting Rule 204.[107] The new rule makes permanent the temporary amendments contained in Interim Temporary Rule 204T, which the SEC adopted in 2008.[108] With some minor modifications, Rule 204 conforms to the delivery and close-out requirements contained in temporary Rule 204T. According to the SEC, these requirements will protect and provide enhanced stability in the markets and help reduce abusive conduct by short sellers.[109]

Originally promulgated by the SEC in June 2004, Regulation SHO addresses the short selling of securities by establishing uniform locate and close-out requirements for broker-dealers.[110] Under the regulation, broker-dealers accepting short sale orders must have reasonable grounds to believe that the security being borrowed can be delivered on the delivery date and, when the order involves a threshold security as defined as in Regulation SHO, the broker-dealer must purchase securities of like kind and quality to close out a fail to deliver position that persists for thirteen consecutive days.[111] Regulation SHO was intended to curtail instances of abusive "naked" short selling—the practice of selling a security short without first borrowing the security—that may manipulate the market for that security.[112]

In the second half of 2008, the SEC adopted a number of measures designed to limit short sales of securities in response to the unprecedented market turmoil. Short selling of the stock of Lehman Brothers and Bear Stearns was popularly cited as at least one of the causes of the demise of those financial institutions. Interim Rule 204T was adopted to address concerns regarding persistent failures to

105. *Id.*

106. *Id.*

107. Amendments to Regulation SHO, Exchange Act Release No. 34-60388, 74 Fed. Reg. 38266 (July 31, 2009) (to be codified at 17 C.F.R. pts. 200 & 242) [2009 Amendments to Regulation SHO].

108. *See id.* at 38265; *see also* Rule 204T, 17 C.F.R. § 242.204T (2008); Amendments to Regulation SHO, Exchange Act Release No. 34-58773, 73 Fed. Reg. 61706 (Oct. 17, 2008) (to be codified at 17 C.F.R. pt. 242) (adopting Rule 204T) [hereinafter 2008 Amendments to Regulation SHO].

109. 2009 Amendments to Regulation SHO, *supra* note 107, 74 Fed. Reg. at 38269.

110. Short Sales, Exchange Act Release No. 34-50103, 69 Fed. Reg. 48008 (July 28, 2004) (to be codified at 17 C.F.R. pts. 240, 241 & 242).

111. For an explanation of Regulation SHO and short sales generally, see U.S. Securities and Exchange Commission, Division of Market Regulation: Key Points About Regulation SHO (Apr. 11, 2005), http://www.sec.gov/spotlight/keyregshoissues.htm.

112. *Id.*

deliver by short sellers and potentially abusive naked short selling.[113] Interim Rule 204T was scheduled to expire on July 31, 2009.[114] As adopted, Rule 204 makes permanent the measures adopted by the SEC in Interim Rule 204T and requires the close-out of open fail to deliver positions.[115]

Rule 204(a) provides that, subject to certain exceptions, a participant of a registered clearing agency (a "Participant")

> must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by [the applicable] settlement date, or if a [P]articipant . . . has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the [P]articipant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date [T+4], immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity.[116]

There are a few exceptions to the general rule. First, Rule 204(a) provides a later settlement deadline in certain circumstances.[117] Rule 204(a)(1) provides that

> [i]f a [P]articipant . . . has a fail to deliver position at a registered clearing agency in any equity security and . . . can demonstrate on its books and records that . . . [this failure] resulted from a long sale, the [P]articipant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date [T+6] immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity."[118]

"If a [P]articipant . . . has a fail to deliver position at a registered clearing agency in any equity security resulting from the sale of a security that a person is deemed to own pursuant to . . . [Rule 200 of Regulation SHO (such as restricted shares that are transferable under Rule 144 under the Securities Act)], and that such person intends to deliver [the securities] as soon as all restrictions on delivery have been removed," the Participant has until no later than the beginning of regular trading hours on the thirty-fifth consecutive day following the trade date for the transaction to close out the position.[119]

Finally, if a Participant has a fail to deliver position in any equity security due to "bona fide market making activities by a registered market maker, options market maker, or other market maker obligated to quote in the over-the-counter market, the Participant . . . [has until] no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date [T+6]," by purchasing or borrowing securities of like kind and quantity, to close out the

113. 2008 Amendments to Regulation SHO, *supra* note 108, 73 Fed. Reg. at 61707.
114. *Id.* at 61706.
115. 2009 Amendments to Regulation SHO, *supra* note 107, 74 Fed. Reg. at 38266.
116. *Id.* at 38292 (to be codified at 17 C.F.R. § 242.204(a)).
117. *Id.*
118. *Id.* (to be codified at 17 C.F.R. § 242.204(a)(1)).
119. *Id.* (to be codified at 17 C.F.R. § 242.204(a)(2)).

position.[120] In the adopting release for the amendments to Regulation SHO, the SEC stated that it "intend[s] to examine [P]articipants' policies and procedures to determine whether, among other things, such policies and procedures require broker-dealers to monitor for delivery by the settlement date."[121]

As amended, Regulation SHO not only mandates the close-out requirements discussed above, but also limits the ability of non-compliant parties to continue shorting activities. Rule 204(b) provides that, when a Participant has a fail to deliver position with respect to any equity security and does not close the position as required by Rule 204(a), the Participant may not accept—on its own or through "any broker or dealer from which it receives trades for clearance and settlement, including any market maker that would otherwise be entitled to rely on the exception provided in Rule 203(b)(2)(iii)"—the

> short sale order in the equity security from another person, or effect a short sale in the equity security for its own account, to the extent that the broker or dealer submits its short sales to that [P]articipant for clearance and settlement, without first borrowing the security, or entering into a bona fide arrangement to borrow the security, until the [P]articipant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.[122]

A broker or dealer may be exempted from this limitation if it certifies to the Participant "that it has not incurred the fail to deliver position on [the] settlement date for a long or short sale in an equity security for which the [P]articipant has a fail to deliver position at a registered clearing agency," or is in compliance with Rule 204(e).[123]

Rule 204(c) provides that

> a [P]articipant must notify all brokers or dealers from which it receives trades for clearance and settlement, including any market maker that would otherwise be entitled to rely on the exception provided in [Rule 204(b)(2)(iii)]: (1) that the [P]articipant has a fail to deliver position . . . that has not been closed out in accordance with the requirements of [Rule 204(a)]; and (2) when the purchase that the [P]articipant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.[124]

This provision gives broker-dealers notice when a particular security to be cleared through the Participant will be subject to the borrow requirements of Rule 204(b), unless the broker or dealer can demonstrate that it is not responsible for the fail to deliver in a manner consistent with Rule 204(b).[125]

120. *Id.* (to be codified at 17 C.F.R. § 242.204(a)(3)).
121. *Id.* at 38272.
122. *Id.* at 38292 (to be codified at 17 C.F.R. § 242.204(b)).
123. 2009 Amendments to Regulation SHO, *supra* note 107, 74 Fed. Reg. at 38292 (to be codified at 17 C.F.R. § 242.204(b)).
124. *Id.* (to be codified at 17 C.F.R. § 242.204(c)).
125. *See id.*

Rule 204 allows Participants to allocate a fail to deliver position to broker-dealers. Under Rule 204(d), a Participant may allocate the responsibility to close out a fail to deliver position to the particular broker-dealer account whose trading activities have caused the fail, provided that the allocation is reasonable (or timely).[126] Upon such allocation, the applicable broker-dealer is subject to the close-out provisions of the amended regulation.[127]

Rule 204(e) provides that even in situations in which a Participant has not closed out a fail to deliver position, or has not allocated the position to a broker-dealer in accordance with the Rule, a broker-dealer is not subject to Rules 204(a) or (b) if it purchases or borrows the securities and:

> (1) The purchase or borrow is bona fide;
> (2) The purchase or borrow is executed after the trade date but no later than the end of regular trading hours on [the] settlement date for the transaction;
> (3) The purchase or borrow is of a quantity of securities sufficient to cover the entire amount of that broker's or dealer's fail to deliver position at a registered clearing agency in that security; and
> (4) The broker or dealer can demonstrate that it has a net flat or net long position on its books and records on the day of the purchase or borrow.[128]

Finally, Rule 204(f) provides that a Participant will have not satisfied the requirements of Rule 204 if it "enters into an arrangement with another person to purchase or borrow securities as required [under Rule 204], and the [P]articipant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow."[129] This provision prevents "sham close outs," in which a participant of a registered clearing agency—or a broker-dealer for which it clears transactions—enters into an arrangement with a counterparty to purchase securities for purposes of closing out a fail to deliver position and knows or has reason to know that the counterparty will not deliver the securities, thus creating another fail to deliver position.[130]

126. *Id.* (to be codified at 17 C.F.R. § 242.204(d)).
127. *Id.*
128. *Id.* at 38292–93 (to be codified at 17 C.F.R. § 242.204(e)).
129. *Id.* at 38293 (to be codified at 17 C.F.R. § 242.204(f)).
130. *Id.* at 38278.