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Proxy Season Heats Up as New Executive Compensation Rules are Effective and SEC Provides New Disclosure Guidance

With Spring just a few weeks away, it also means that the annual proxy statement season for calendar year public companies is in full swing. February 28th marked the effective date for the SEC's expanded executive compensation and corporate governance disclosure rules which we have previously reported on (see our December 18, 2009 blog).

In connection with the adoption of these new rules, the SEC's staff has regularly been updating its interpretive guidance (see for example our December 23, 2009 blog). Such guidance can be helpful to companies when questions arise regarding how to correctly comply with the SEC's regulations. Most recently, on March 1, 2010, the SEC's staff added/revised/withdrew various interpretations addressing proxy statement disclosure issues. The SEC's staff also previously added new executive compensation disclosure interpretations in January 2010 and February 2010.

Below is a brief overview of the SEC staff's recent updates to some of its interpretive guidance with respect to executive compensation and corporate governance disclosure requirements, which are relevant not only for purposes of annual proxy statements but in registered offerings of securities:

NEW INTERPRETATIONS

- ***Director Qualifications and Experience*** – The SEC issued new interpretations that reiterate its desire for companies to provide fuller disclosure regarding the specific attributes/qualifications of each individual director on a person by person basis. This information would also be required for those directors who are not up for re-election in the case of a classified board. However, the SEC also reiterated that this information need not be provided for directors whose term would not be continuing after the applicable meeting of shareholders.

- ***Equity Compensation*** -As we previously reported in our December 18, 2009 blog, the SEC changed the requirements with respect to reporting equity compensation values in the Summary Compensation Table (and Director Compensation Table). That is, the grant date value of the estimated dollar values of equity-based compensation awards (as determined under FASB ASC Topic 718) will now be utilized as compared to the prior requirement of using the annual financial

accounting expense recognized for such equity awards. Therefore, a number of new interpretations were provided regarding the reporting of equity compensation awards. For example, an interpretation was issued covering involved how to report the amount of compensation when a named executive officer leaves the company and, in connection with such separation from employment, the company then decides to accelerate vesting of an option grant that had been granted earlier in the same fiscal year. In addition, guidance was issued covering the exclusion of estimated forfeitures in valuing time-based vesting equity awards along with clarifying that an equity award that is forfeited by an executive officer in the year of grant will nevertheless still be included in determining whether such officer is one of the top most compensated executive officers for such year. The SEC also clarified when to report the grant of a performance based equity compensation award if a company's compensation committee retains discretion to reduce the earned value of the award (as often is the case for awards that are seeking to qualify as performance-based compensation under Internal Revenue Code Section 162(m)). And, the SEC's new interpretations addressed the proper reporting of compensation in the proxy's Summary Compensation Table when the settlement of incentive compensation arrangements can or does occur with company stock rather than cash.

- ***Compensation Consultants*** **-** Depending on the underlying facts (see our December 18, 2009 blog), the expanded rules can require a company to disclose additional information regarding fees paid to a company's compensation consultant for other services rendered by the consultant to the company (depending on what the other services were and for what purpose they were performed). The SEC issued new interpretations covering the types of such other services provided by the consultant along with addressing situations where the consultant's services are not customized for a company or are limited to broad-based plans that do not favor executive officers.

- ***Risk Management*** **-** The new rules provide that if risks arising from a company's compensation policies and practices are "reasonably likely to have a material adverse effect on the company", then the company must provide disclosure about such policies and practices as they relate to risk management and risk-taking incentives that can affect the company's risk and management of that risk. A new interpretation was issued stating that such disclosure should be presented together with a company's executive compensation disclosures.

- ***Reporting of Shareholder Votes*** **-** The new rules require accelerated reporting of shareholder votes on Form 8-K within four business days of the shareholder meeting. The SEC provided a new interpretation stating that the end of the shareholder meeting is the triggering event for starting the four day period (such that if the meeting ended on Tuesday, day one would be Wednesday, and the four-business day filing period would end on Monday).

- ***Disclosure Requirements in Registration Statements*** - The SEC issued interpretations reiterating that if a registration statement or post-effective amendment is filed after the end of an issuer's fiscal year end but before its Form 10-K is due:
    - if filed on Form S-1, it must include Item 402 executive compensation disclosure prior to effectiveness
    - if filed on Form S-3, it may forward incorporate by reference to a subsequently filed Form 10-K

If a non-automatic shelf registration statement or post-effective amendment thereto is to be filed after the due date for the Form 10-K, the issuer must either file the definitive proxy statement before the Form S-3 is declared effective or include the officer and director information in the Form 10-K.

REVISED INTERPRETATIONS

- ***Equity Compensation*** - The SEC revised an interpretation covering the reporting of "re-load options" (i.e., where the optionee receives a new grant of options upon the exercise of an option) that were granted to a named executive officer. In such case, the grant date fair value of the additional options would need to be reported in the Summary Compensation Table in the aggregate amount. The SEC also has now stated that a company may provide the required valuation assumptions information for equity compensation awards (that would typically be incorporated by a reference to the company's financial statements) by reference to the Grants of Plan-Based Awards Table if the valuation assumptions are reported in such table.

WITHDRAWN INTERPRETATIONS

- ***Equity Compensation*** - As a result of the change in reporting equity compensation by switching to using grant date fair value, a number of the SEC's interpretations addressing the prior requirements of annual expense reporting became obsolete and therefore were withdrawn.

As we have mentioned in several of our prior blogs (see for example our December 18, 2009 blog), in addition to complying with the expanded disclosure rules, the SEC has clearly signaled that it will be expecting, and looking for, fuller compliance with its executive compensation reporting regulations along with clearer and more transparent company disclosures in annual proxy statements. Two primary areas that continue to receive greater SEC scrutiny are disclosure of performance targets and compensation

benchmarking. Specific disclosure of performance targets which are a material element of compensation, and the actual achievement level against such targets, is required unless the company has a compelling explanation of why such disclosure would cause it competitive harm. And, the SEC has indicated that the competitive harm argument is unlikely to be successful after the company has disclosed the actual bonus amounts and particularly if the performance targets are tied to company-wide financial results that are publicly reported. Similarly, when a company refers to a peer group used for benchmarking purposes, the SEC expects to see disclosure of the names of the peer group companies, how they were selected, and where actual awards fell relative to the benchmark. Therefore, in conjunction with responding to the new disclosure requirements, reporting companies should avoid simply repeating last year's proxy disclosures. Rather, companies should consider re-examining the text and format of their prior /proxy disclosures from a fresh perspective with an objective of effecting improvements to the extent possible. Failure to do so could provoke comments from the SEC which could then force the company to have to amend its SEC filings.

If you have any questions regarding this information, please contact Greg Schick at (415) 774-2988.