

## SEC Issues Proposed Rule to Enhance Proxy Disclosure and Solicitation Requirements

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On July 10, 2009, the SEC issued Release No. 33-9052 "Proxy Disclosure and Solicitation Enhancements" (the "Release"). The Release proposes amendments to various SEC rules to (i) enhance certain executive and director compensation and corporate governance disclosure requirements, (ii) transfer to Form 8-K the requirement to disclose shareholder voting results and (iii) clarify the manner in which the SEC's proxy rules operate and address issues that have arisen in the proxy solicitation process. The proposed amendments are subject to a 60-day comment period and the rules will likely generate substantial comments, which may influence the final form of the rules. The SEC anticipates that the proposed amendments, in some form, will be effective for the 2010 proxy season.

### *Enhancement of Compensation and Governance Disclosure Requirements*

The Release proposes several disclosure requirements designed to enhance the information provided by companies in their proxy and information statements, including information about (i) the company's compensation policies and practices and their relationship to risk, (ii) the qualifications of directors and director nominees, (iii) the involvement of directors, nominees and executive officers in legal proceedings, (iv) the company's leadership structure, (v) the board's role in the company's risk management process, and (vi) potential conflicts of interests of the company's compensation consultants. The Release also proposes to revise the manner in which the value of the stock and option awards granted by the company is reported in both the Summary Compensation Table and Director Compensation Table.

### Expanded Risk Discussion Within CD&A.

The Release proposes to broaden the Compensation Discussion and Analysis ("CD&A") section of the proxy statement to include additional discussion and analysis of the company's compensation policies and overall actual compensation practices for its employees generally, including non-executive officers, if risks arising from those compensation policies or practices may have a **material** effect on the company. The additional discussion, to the extent required, would provide information about how the company's overall compensation policies for employees create incentives that can affect the company's exposure to, and management of, risk.

### *Compensation Policies and Practices Potentially Subject to Risk Disclosure.*

The obligation to discuss and analyze compensation policies and practices may apply to compensation policies and practices:

- at a business unit 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 represents a significant percentage of the unit's revenues; or
- that vary significantly from the company's overall risk and reward structure (e.g., when bonuses are awarded upon the accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time).

*Items to Address in Risk Discussion.* The Release provides the following examples of issues that the CD&A may need to address in its risk disclosures:

- the general design philosophy of the company's compensation policies for employees whose behavior would be most affected by the incentives established by the policies, as such policies relate to or affect risk taking by those employees on behalf of the company;
- the manner in which the company has implemented and will implement such philosophy;
- the risk assessment or incentive considerations that impact how the company structures its compensation policies or awards or pays 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 (e.g., claw back policies and holding periods);
- how the company decides to make adjustments to its compensation policies or practices 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 its risk profile;
- the extent to which the company monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees; and
- how the company's overall compensation policies create incentives that can affect risk and risk management.

Expanded Disclosure Regarding Directors and Nominees. The Release proposes to expand the disclosure requirements regarding directors, nominees for director and executive officers set forth in Item 401 of Regulation S-K.

- *Qualifications.* Disclose the particular experience, qualifications, attributes or

skills that qualify each of the company's directors or nominees to serve as a director and as a member of any board committee on which he or she serves in light of the company's business and structure. The Release identifies the following information as appropriate to disclose when addressing this requirement:

- risk assessment skills;
- the ability to respond to complex financial operational challenges;
- specific past experience useful to the company;
- areas of expertise; and
- why the director or nominee's service would benefit the company.

- *Directorships.* Disclose all directorships held by each director and nominee with public companies at any time in the past five years instead of the existing requirement of current public company directorships.
- *Legal Proceedings.* Disclose specified legal proceedings involving directors, nominees and executive officers over the past 10 years, as opposed to the existing five year disclosure requirement.

The proposed amendments relating to Item 401 also seek comment regarding (i) whether the proposed qualification disclosure should be provided on an annual basis or less frequently and (ii) whether the SEC should require disclosure regarding board diversity, including whether diversity is considered when nominating director candidates.

Disclosure of Leadership Structure. The Release proposes to expand Item 407 of Regulation S-K by requiring companies to discuss in their proxy and information statements their leadership structure and explain why it represents the best structure for their business. In addition to the general leadership structure discussion, the proposed amendment would also require a discussion of the following items:

- *Status of CEO and Chairman Position(s).* Disclose whether and why the company has combined or separated

its principal executive officer and board chairman positions.

- *Lead Director.* Disclose whether the company has a lead director, the reasons why it does or does not have one and, if applicable, identify the specific role the lead director plays in the company's management.
- *Board's Risk Management Role.* Discuss the board's role in the company's risk (credit, liquidity and operational) management process. The Release suggests that companies may want to address in the required discussion the relationship between the board and management in managing the material risks facing the company, how the board implements and manages its risk management function (e.g., through a committee), to whom the persons who oversee risk management report (e.g., the board or a committee), and whether and how the board or board committee monitors risk.

#### Expanded Disclosure of Compensation

Consultants. The Release proposes amendments to Item 407 of Regulation S-K that would require companies to disclose the following additional information regarding their compensation consultants if the compensation consultants or their affiliates (i) played a role in determining or recommending the amount or form of executive or director compensation awarded by the company, **and** (ii) provided additional services to the company:

- *Description of Services.* Describe the nature and extent of all additional services provided to the company or its affiliates during the last fiscal year by the compensation consultant and any affiliates.
- *Disclosure of Fees.* Disclose the aggregate fees paid for all additional services and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation.
- *Engagement of Compensation Consultant.* Discuss whether the decision to engage the compensation consultant

or its affiliates for non-executive compensation services was made, recommended, screened or reviewed by the company's management.

- *Approval of Additional Services.* Disclose whether the company's board of directors or compensation committee approved all of the non-executive compensation services provided to the company by the compensation consultant.

The proposed additional compensation consultant disclosure would not apply if the compensation 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 of the company (e.g., broad-based and non-discriminatory 401(k) plans or health insurance plans).

#### Revised Disclosure of Equity Awards.

In response to criticisms levied by both investors and companies against the current disclosure requirements applicable to stock awards and option awards, the Release proposes to eliminate the requirement to disclose the dollar amount of stock awards and stock options recognized for financial statement reporting purposes for the fiscal year.

Instead, the revised disclosure would require companies to disclose in the Summary Compensation Table and Director Compensation Table the aggregate grant date fair value of stock awards and option awards computed in accordance with SFAS No. 123R. The proposed rule reverts to the disclosure requirement that the SEC initially adopted in 2006. The Release indicates that if the SEC adopts this proposed amendment, it would consider requiring companies to recalculate their equity award values and total compensation amounts for fiscal 2007 and 2008 using the new methodology.

The Release also proposes to rescind the requirement in the Grants of Plan-Based Award Table to report the full grant date fair value of each individual equity award as such disclosure would be duplicative

of the aggregate grant date fair value disclosure that would be provided in the Summary Compensation Table under the revised rule. Finally, the proposed rules would no longer require companies to report in the salary and bonus columns to the Summary Compensation Table the amount of salary or bonus that a named executive officer elects to forego. Non-cash awards received by the named executive officer in lieu of salary or bonus would instead be reportable in the column applicable to the form of the award elected by the named executive officer.

### ***Accelerated Disclosure of Voting Results***

The Release proposes to transfer the requirement to disclose the results of shareholder votes from Forms 10-Q and 10-K to Form 8-K. Accordingly, in most cases, companies would be required under the proposed rule to report the results of matters submitted to a shareholder vote on Form 8-K within four business days after the meeting date. However, in a contested election of directors where the voting results are not definitively determined at the end of the meeting, companies would be required to disclose the preliminary voting results within four business days after they are determined, and file an amended report on Form 8-K within four business days after the final results are certified.

### ***Amendments to Proxy Solicitation Requirements***

The Release also proposes amendments to the SEC rules that govern the proxy solicitation process in order to improve the clarity of the rules and address interpretative issues that have arisen since their adoption. The SEC believes that the following amendments would provide greater certainty to soliciting parties, help shareholders receive timely and complete information and facilitate shareholder voting.

Clarifications to Exchange Act Rule 14a-2(b)(1). Exchange Act Rule 14a-2(b)(1) exempts solicitations by shareholders or other non-management parties who are not seeking proxy authority and do not have a substantial interest in the subject matter of the solicitation from the generally

applicable disclosure, filing and most other requirements of the proxy rules (the “Exemption”).

- *Clarification of “Form of Revocation” Definition.* The Exemption is unavailable to a person who furnishes or otherwise requests, or acts on behalf of a person who furnishes or requests, a form of revocation. The Release proposes to amend Rule 14a-2(b)(1) to expressly provide that a “form of revocation” does not include an **unmarked** copy of management’s proxy card that a person provides to other shareholders and requests be returned directly to management.
- *Clarification of Interested Persons.* The Exemption is unavailable to any person who, because of a substantial interest in the subject matter of the solicitation, is likely to receive a benefit from a successful solicitation that would not be shared pro rata by all other holders of the same class of securities, other than a benefit arising from the person’s employment with the registrant. The Release proposes to amend Exchange Act Rule 14a-2(b)(1)(ix) to clarify that a person need not be a security holder of the class of securities being solicited and a benefit need not be related to or derived from any security holdings in the class being solicited for a person to be disqualified from relying on the exemption set forth in Exchange Act Rule 14a-2(b)(i).

Expansion of Nominees Available to “Round-Out” a Short Slate. Exchange Act Rule 14a-4(d)(4) permits a person who is soliciting support for a “short slate” of nominees to round out its short slate of nominees up to the total number of director positions then subject to election by seeking authority to vote for nominees named in the registrant’s proxy statement. The current rule does not address whether nominees named in other soliciting persons’ proxy statements may be used to round out a short slate. The Release proposes to revise the rule so that a non-management soliciting person may round out its short slate by seeking authority to vote for nominees named in the registrant’s or any other persons’ proxy statements.

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The proposed rule would require a non-management soliciting person that seeks to round out its short slate with any nominee named in another non-management person's proxy statement to represent in its proxy statement that (i) it has not agreed and will not agree to act, directly or indirectly, as a group or otherwise engage in any activities that would be deemed to cause the formation of a group with the other non-management person and (ii) it is not a participant in the other non-management person's solicitation.

Addition of "Objectively Reasonable" Standard.

Exchange Act Rule 14a-4(e) requires that a proxy statement or form of proxy provide that the shares represented by the proxy be voted "subject to reasonable specified conditions."

The Release proposes to amend Rule 14a-4(e) to clarify that the reasonable specified conditions must be objectively determinable.

Clarification of Requirement to Provide Participant Information.

Exchange Act Rule 14a-12 permits a solicitation to be made before furnishing security holders with a proxy statement if, among other requirements, each written communication contains specified participant information. The Release proposes to amend Rule 14a-12 to clarify that the required participant information must be filed under cover of Schedule 14A as part of a proxy statement or other soliciting materials no later than the time the first soliciting communication is made.

***Comments Regarding Proposed Amendments and Other Issues***

There will be a 60-day comment period for submission of comments to the SEC regarding the amendments proposed in the Release. In addition to comments regarding the proposed amendments, the Release also solicits comments on the following issues:

- Whether, in light of the proposed amendments, the SEC should consider eliminating any disclosures currently required in proxy statements.
- Whether the SEC should require disclosure of the compensation paid to

each executive officer, not just the named executive officers.

- Whether the SEC should (i) eliminate the instruction that permits companies to exclude performance targets from their proxy statements if their disclosure could have a potentially adverse competitive effect on the companies or (ii) revise the CD&A to require disclosure of performance targets after the performance related to the award is measured, regardless of whether such disclosure may result in competitive harm.
- Whether the CD&A should become part of the Compensation Committee Report and whether the Compensation Committee Report should be filed rather than furnished.
- Whether the SEC should require disclosure regarding whether a member of the compensation committee has expertise in compensation matters and whether the committee has the resources to hire its own independent legal counsel.
- Whether the SEC should require additional disclosure about whether or not a company has "hold to retirement" and/or claw back provisions and if not, why not.
- Whether the SEC should require disclosure regarding internal pay ratios of a company (e.g., the ratio of the total compensation of the named executive officers, or total compensation of each individual named executive officer, to the total compensation of the average non-executive employee of the company)
- Whether the SEC should require disclosure regarding the total number of compensation plans a company has and the total number of variables in all of its compensation plans.
- Whether the SEC should require the disclosure of the amount each executive saves through tax gross-up arrangements.

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