

## Newly Adopted Proxy Disclosures Address Risk Oversight, Compensation and Corporate Governance Matters

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On December 16, 2009, by a 4-to-1 vote, the Securities and Exchange Commission (SEC) adopted a number of changes to its proxy disclosure rules that will be effective for the 2010 proxy season.<sup>1</sup>

### *Effective Date*

The new rules have an effective date of February 28, 2010.<sup>2</sup> While the new rules only apply to filings made on or after February 28, 2010, the new method of reporting for equity awards applies to companies with fiscal years ending on or after December 20, 2009. We anticipate that most calendar year-end companies will likely voluntarily comply with the new rules even if they plan on filing before February 28, 2010.

### *Compensation Risk Disclosure*

Under the new rules, a company will be required to discuss its compensation policies and practices for employees generally, not just executive officers, if the policies and practices create risks that “are reasonably likely to have a material adverse effect on the company.” The new rules are intended to elicit disclosure about incentives in a company’s compensation policies and practices that would be most relevant to investors. In this context, the SEC Staff indicated that a company can take into consideration items such as internal controls or “claw backs,” as well as other items that the company believes could mitigate the probability or materiality of an adverse effect. This disclosure will not be part of the CD&A, but will be a separate item within a company’s executive compensation disclosure. The new rules contain

illustrative examples of the type of policies and practices that could lead to required disclosure.

This compensation risk disclosure is not required for smaller reporting companies.

### *Equity Awards Valuation*

Companies will now be required to report stock awards and option awards using the full grant date fair value for each award made during the covered year, computed in accordance with FASB rules, with a special instruction for performance-based awards. Performance-based awards will be reported with a grant date value based on the probable outcome of the performance condition as of the grant date. The potential maximum value for performance-based awards, assuming the highest level of performance conditions is probable, must be reported in a footnote to the applicable table.

In the Summary Compensation Table and the Director Compensation Table, the aggregate grant date fair value amounts will be reportable, and in the Grants of Plan-Based Awards Table, individual grant date fair value amounts will be reportable. Companies with fiscal years ending on or after December 20, 2009 must present recomputed information for the preceding years included in the Summary Compensation Table.

### *Disclosure Regarding Compensation Consultants*

The amended rules require enhanced disclosure of fees paid to compensation consultants that provide advice to the

<sup>1</sup>The complete 129-page final rule release is available on the SEC’s website. See Release No. 33-9089 (December 16, 2009), available at: <http://www.sec.gov/rules/final/2009/33-9089.pdf>

<sup>2</sup>The adopting release has left some transition issues unresolved, such as when a company files its preliminary proxy materials prior to February 28, 2010 but its definitive proxy materials are filed after that date. We expect that the SEC Staff will provide further guidance on these transition issues shortly.

board of directors or its compensation committee, and also provide other services to the company. For example, where the board of directors engages a consultant for advice on compensation and the consultant provides other services to the company in excess of \$120,000 during the year, disclosure of the following is required: (a) the fees paid for advising on compensation as well as the amount paid for the other services; (b) whether management recommended or engaged the consultant for the other services; and (c) whether the board of directors approved the other services.

Where management engages a consultant for advice on compensation, and the board of directors and the compensation committee do not, and the consultant provides other services to the company in excess of \$120,000 during the year, disclosure must be made of the fees paid for advising on compensation as well as the amount paid for the other services.

Additional disclosure rules address the circumstance when both the board of directors (or the compensation committee) and management have engaged compensation consultants. Disclosure for consultants that work with management is not required if the board of directors or the compensation committee has its own consultant and the two consultants are different.

Services that involve only consulting on broad-based plans that do not discriminate in favor of executive officers or directors, or the provision of general information, such as a survey, or information customized based on parameters not developed by the compensation consultant, will not be executive compensation consulting services covered by the rule.

#### ***Director and Nominee Qualifications***

The amended rules require disclosure concerning the specific experience, qualifications, attributes and skills of each board member and nominee that led the board of directors to conclude that the person should serve as a director. This disclosure applies to both directors who are standing for re-election and those who will continue to serve following the annual meeting. The SEC Staff, however, did not eliminate the current disclosure requirements regarding the specific

minimum qualifications and specific qualities or skills used by a nominating committee in evaluating candidates. The SEC Staff noted that this allows investors to compare and evaluate the skills and qualifications of each director and nominee against the standards established by the board of directors or the nominating committee.

Further, disclosure is required about directorships at public companies and registered investment companies held by each director at any time in the past five years (as opposed to only current directorships, under the current rules). Legal proceedings must now be disclosed for the prior ten years (as opposed to five years, under the current rules), including proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity, proceedings and settlements based on violations of federal or state securities, commodities, banking or insurance laws and regulations and disciplinary sanctions or orders imposed by an exchange or other self-regulatory organization.

#### ***Diversity Considerations in the Director Nomination Process***

The new rules require disclosure of whether a nominating committee (or the full board of directors, if applicable) considers diversity in identifying director nominees. If there is such a policy, the company must disclose how it is implemented and how the nominating committee (or the full board of directors, if appropriate) assesses the effectiveness of the policy.

“Diversity” is not defined in the new rules. Rather, since each organization has its own culture, each company must define what diversity means to its organization.

#### ***Board Leadership Structure***

Companies will be required to disclose their board leadership structure, including whether the chief executive officer and chairman positions are combined. If one person serves as both chief executive officer and chairman, the company must disclose if it has a lead independent director, and, if so, such person’s responsibilities and role in leadership of the board of directors. The company must

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also explain why it believes the adopted structure is the most appropriate at the time.

#### ***Risk Oversight***

Companies will be required to disclose the extent of the board of directors' role in the risk oversight of the company, including what that role is and how the board of directors administers this function.

#### ***Reporting of Annual Meeting Voting Results***

The SEC is adding a new item to Form 8-K requiring that voting results, from annual shareholder meetings as well as special meetings of shareholders, be disclosed within four business days after the meeting. If a company does not have final numbers within the required time period, it must timely file the preliminary voting results it has and then file an amendment once the final voting results are known. Under certain conditions, an exception is provided for reporting results of contested elections.

#### ***Action Items in Light of the New Rules***

- Determine whether the board of directors or the compensation committee has conducted a risk assessment of compensation arrangements that could lead to behavior and actions by employees that are reasonably likely to have a material adverse effect on the company, and whether there are any mitigating factors.
- Determine the grant date fair value amounts of equity awards for each fiscal year to be reported in the Summary Compensation Table or the Director Compensation Table.
- Update the form of directors' and officers' questionnaire to obtain the new information required with respect to past legal proceedings, past directorships, and the qualifications of directors and director nominees.
- Determine whether the board of directors or the nominating committee has evaluated each director's and each nominee's qualifications for service as a director of the company. If not, determine and implement an appropriate process in light of the disclosures required to be made.
- Collect the necessary information regarding compensation consulting fees and fees for other services rendered by compensation consultants to the board of directors, the compensation committee and/or management.
- Determine whether the board of directors or the nominating committee has evaluated the appropriateness of the current board leadership structure. If not, determine and implement an appropriate process in light of the disclosures required to be made.
- Determine whether the board of directors or the nominating committee has evaluated any diversity policy implemented by the board of directors in respect of board composition, including assessing the effectiveness of such policy. If not, determine and implement an appropriate policy in light of the disclosures required to be made.
- Determine the board of directors' role in the risk oversight of the company, and if minimal, determine and implement an appropriate process in light of the disclosures required to be made.

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