

SEC Adopts Enhanced Compensation and Corporate Governance Proxy Disclosure Rules for 2010 Proxy Season – Answers to Our Viewer's Questions

On January 20, members of our Benefits & Compensation Group and Public Company Representation Group presented a live webcast on the enhanced compensation and corporate governance proxy rules adopted by the SEC for the 2010 Proxy Season. A replay of this webcast can be viewed by clicking [here](#).

Below are the questions asked by our viewers during the webcast and our panels' answers. If you have any further questions concerning this webcast or if we can be of any help, please feel free to contact the panelists directly. Their contact information appears at the end of this document.

EFFECTIVE DATES AND SCOPE OF THE NEW RULES

Q-1: If you have already filed your proxy this year under the old rules but you want to file a registration statement later in the year that will incorporate information by reference (S-3 or S-4, not an S-1) will there be any issue incorporating the proxy filed under the old rules in the new registration statement?

A-1: If an issuer's fiscal year ends before December 20, 2009, its 2009 Form 10-K and related proxy statement can be filed under the old rules. Such an issuer will not be required to comply with the new rules until it has filed its Form 10-K for fiscal year 2010. Any registration statements filed prior to the fiscal year 2010 Form 10-K may also be filed under the old rules. If an issuer's fiscal year ends on or after December 20, 2009, generally any registration statements filed on or after February 28, 2010 must comply with the new rules; however, in the case of a registration statement on Form S-3, compliance with the enhanced proxy rules will be determined at the time that the incorporated by reference Form 10-K and definitive Proxy Statement were filed. Therefore, if an issuer whose fiscal year ends on or after December 20, 2009 files its 2009 Form 10-K and definitive proxy statement prior to February 28, 2009 without complying with the enhanced proxy rules, then the issuer may file a registration statement on Form S-3 after February 28, 2010 without otherwise complying with the new enhanced proxy disclosure rules.

Q-2: Can a company that is not subject to the rules this year voluntarily comply with the new rules?

A-2: Yes, issuers not subject to the new rules for 2010 can nevertheless still comply with them on a voluntary and discretionary basis. Generally, an issuer can comply with some of the new disclosure rules without complying with all of the new rules. However, an issuer may only comply with the new rules with respect to the Summary Compensation Table and Director Compensation if it also complies with all of the changes to Regulation S-K that apply to the particular form that is being filed.

Q-3: How do you suggest we disclose election results if our meeting is to take place on 2/16/10 but we will not file our Form 10-Q until March?

A-3: If the shareholder meeting takes place before February 28, 2010, no Form 8-K reporting is required under the new rules. Shareholder meetings on or after February

28, 2010 must comply with the rules. For a meeting prior to February 28, 2010, where the Form 10-Q or 10-K is due after February 28, 2010, the results of the meeting should be reported in the "Other Information" item of the Form 10-Q or 10-K because the "Submission of Other Matters to a Vote of Security Holders" item of Forms 10-K and 10-Q will be deleted effective February 28, 2010.

Q-4: Do the new rules apply to foreign private issuers?

A-4: No. The enhanced proxy disclosure rules have been implemented primarily through amendments to Items 401, 402 and 407 of Regulation S-K and through similar amendments to Schedule 14A proxy statements. Foreign private issuers are not subject to the SEC's proxy rules and none of the relevant amended Items of Regulation S-K are included in the forms, reports and registration statements that foreign private issuers are required to file with the SEC.

Q-5: If you file 10-Ks but don't have public equity so you don't do proxy statements, is there a new Form 10-K to show which of the new requirements (like the board leadership structure, diversity, etc.) go in the 10-K vs. the proxy statement?

A-5: The only change to Form 10-K as part of the enhanced proxy disclosure rules is the deletion of Item 4 in Part I ("Submission of Other Matters to a Vote of Security Holders"), which has been moved to Form 8-K. The other enhanced proxy disclosure rule changes have been implemented through amendments to Items 401, 402 and 407 of Regulation S-K. The references to these Items in Form 10-K did not require any changes and, as such, they have not been changed.

BOARD STRUCTURE AND RISK OVERSIGHT

Q-6: Which SEC rule / S-K Item number addresses the Board's "risk oversight" role?

A-6: Item 407(h) of Regulation S-K addresses the Board leadership structure and role in risk oversight. Item 7 of Schedule 14A was amended to cross-reference the information required under Item 407(h) of Regulation S-K.

Q-7: Should the board make an affirmative finding regarding its structure of having joint CEO/Chair in light of the disclosure?

A-7: Item 407(h) of Regulation S-K requires disclosure of why the issuer has determined that its leadership structure is appropriate given the specific characteristics circumstances." Therefore, we think that the best practice is that there should be an affirmative finding of the board and of any board committee (such as the corporate governance committee) with responsibility for making recommendations to the board on board governance matters. Interestingly, Item 407 does not specifically require that this determination be made presently, or annually. We think that a determination made in the past that complies with the requirements of Item 407 (including consideration of the issuer's specific characteristics and circumstances) should be enough. Still, because this determination will be disclosed annually in the issuer's definitive proxy statement, we think that the better view is that the board and any relevant board committee should confirm its view of the appropriateness of the issuer's board leadership structure annually in connection with the re-election of directors and re-appointment of the board chair.

Q-8: Where the role of CEO and Chair are split, is there any need to disclose "reasons" for the structure? Is it sufficient to simply state that the Chair and CEO are separate?

A-8: In all cases (whether or not the CEO and Chair are split) the company must include a brief description of the Board's leadership structure and the disclosure must "indicate why [the company] has determined that its leadership structure is appropriate given [its] specific characteristics or circumstances."

Q-9: If Board does consider structure each year (with regard to CEO/Chair), should governance guidelines and committee charters be amended to provide for this?

A-9: There is no requirement that such a change be made, and companies may determine that it falls under oversight of compliance with applicable rules. On the

other hand, some companies may determine it is appropriate to provide a convenient reminder of actions that the board should take.

Q-10: Is it common, and/or would you recommend, when listing the other public company boards that your directors sit on – to also list the specific committees on which they sit on those other public boards?

A-10: Item 401(e)(2) of Regulation S-K does not require that an issuer's disclosure with respect to a director's or director nominee's other public company directorships address such director's or nominee's board committee assignments. We do not think that it is necessary to add this disclosure. We note, however, that such specific board committee experience, to the extent it was relevant to the board's decision to nominate such individual to be a director (or to the nominating committee's decision to recommend such nomination to the board), may need to be disclosed pursuant to Item 401(e)(1) of Regulation S-K.

PAY RISK

Q-11: Where does the "material adverse effect" disclosure go?

A-11: The SEC has recommended that this disclosure be presented in the same location as the issuer's other Item 402 disclosure.

Q-12: What is an example of a "compensation practice/policy that is reasonably likely to have a material adverse effect on the registrant?"

A-12: New Item 402(s) of Regulation S-K provides the following non-exclusive list of situations that may trigger disclosure: "compensation policies and practices: at a business unit of the company that carries a significant portion of the registrant's risk profile; at a business unit with compensation structured significantly differently than other units within the registrant; at a business unit that is significantly more profitable than others within the registrant; at a business unit where compensation expense is a significant percentage of the unit's revenues; and that vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the registrant from the task extend over a significantly longer period of time." The list of examples is only illustrative, and depending on facts and circumstances, other compensation policies and practices may also require disclosure.

Q-13: If we run through a process looking at the risks posed by our compensation programs and determine such risks are not reasonably likely to have a material adverse effect on the company, do you recommend disclosing anything or remaining silent?

A-13: While negative disclosure is not required, many companies may make such a disclosure or make other disclosures with respect to their practices and policies with respect to pay risk. Making such disclosures provide a company with an opportunity to demonstrate how and why it came to the conclusion that its compensation policies and practices are not reasonably likely to have a material adverse effect on the company, which many companies did in 2009 even in before the final rules. Moreover, a failure to discuss pay risk disclosure may signal to investors that a company has not considered compensation risk. If negative disclosure is made, consideration should be given to structuring it as a forward-looking statement under the Private Securities Litigation Reform Act of 1995 "safe harbor" for such statements.

Q-14: Do you have a sample of this "negative disclosure" which might be best in the comp committee report?

A-14: Though not currently required by the new proxy rules to do so, some companies have already begun disclosing whether or not their compensation policies and programs present a risk to the company. When the new proxy rules are effective, many companies may adopt similar approaches in making negative disclosures in connection with pay risk. Current examples include: Air Products and Chemicals, Inc., on page 29 of its [2009 proxy statement](#); Jack in the Box, on page 34 of its [2009 proxy statement](#); Microsoft, on page 20 of its [2009 proxy statement](#); Brooks Automation, on page 20 of its [2009 proxy statement](#); Becton Dickinson, on page 23 of its [2009 proxy statement](#); ADC Telecom, on page 18 of its [2009 proxy statement](#); Monsanto, on page

23 of its [2009 proxy statement](#); and Analog Devices, on page 15 of its [2009 proxy statement](#).

Q-15: Which Board Committee should assess compensation risk? Should the Company's Compensation Committee or Audit Committee head up the evaluation of company's compensation risks? What exactly is the role of the HR Comp Committee (vs. management) in reviewing or "signing off" on the risk assessment of non executive pay programs?

A-15: Each company should follow its general process for analyzing risk and reporting to the Board, with additional consideration given to the effect of its compensation policies and practices on incentivizing risk. This means having the management Risk Committee involved, with possible delegation to HR/Benefits professionals to do the analysis, with the help of outside advisors. At most companies, these management conclusions generally are then reported to the Audit Committee, which is generally in charge of the Management Discussion and Analysis risk analysis and reporting. However, given the important compensation design elements with respect to pay risk, special oversight responsibility should probably be delegated to or coordinated with the Compensation Committee.

Just as important as drafting disclosure regarding pay risk (if not more important,) is making sure that the company has thoughtfully and comprehensively analyzed all of its incentive pay plans to determine their possible impact on enterprise risk and the company's internal controls and plan design features which mitigate the possible risks, and has carefully documented its work on this analysis.

Proxy disclosure questions and draft language should generally be reviewed by the management Disclosure Committee, other officers, the Compensation Committee, and other Board committees.

Q-16: To the extent a company has Pay Risk and is making forward-looking statements in their proxy, are you advising companies to put in safe harbor language in the proxy statement (in addition to having such a section in the 10-K)?

A-16: Yes.

SUMMARY COMPENSATION TABLE

Q-17: Can you clarify the timing of equity awards reported? Do you report based on the fiscal year in which they were granted or for the year to which they relate?

A-17: Awards are reported in the Summary Compensation Table based on the fiscal year in which they are granted (rather than the year to which they relate). Post-fiscal year grants can be discussed in the CD&A.

COMPENSATION CONSULTANTS

Q-18: What if the Comp Committee engages the consultant and meets with them but management still works with them and primarily gives them their "to do" list?

A-18: The consequences will turn on what is in the "to do" list and the amount of the services charged for the work on it. The best practice is for the Compensation Committee to control the terms of the consultant's engagement and work directly with the compensation consultant to issue "to do" lists or approve lists prepared by management.

Q-19: Would consulting services related to the Company's evaluation of whether to do a stock option exchange for underwater options be exempt from new comp consulting rules?

A-19: The result in this case may depend on how the exchange is structured. Since option exchanges often exclude executives and directors by their terms, consulting related to such an exchange might not fall under the new rules. However, if executives or directors are included in the exchange and the consulting services are under the direction of the compensation committee, there may be basis for excluding those fees.

Q-20: If the company changed compensation consultants during the course of the year, are the applicable compensation consultant disclosures required regarding both

firms?

A-20: Although the rules do not explicitly address this issue, the rules should apply on a per-consultant basis with respect to un-affiliated compensation consultants. In other words, whether disclosure is triggered should be determined separately with respect to each un-affiliated consultant, each with its own \$120,000 threshold.

Q-21: What exactly is an executive? Is it broader than Section 16 executive officers?

A-21: Neither the rules nor any published guidance address this issue. The conservative, advisable approach at this time is likely to consider a broader group of executives than the Section 16 officers.

Q-22: If comp consultant advises on annual bonus program for all employees, for purposes of the \$120k calc should we attempt to pro rate their related fees for executives vs. non-executives?

A-22: Neither the rules nor any published guidance address this issue. While pro ration might seem appropriate, the conservative approach would be to include the full value of any consulting services that relate at all to “determining or recommending the amount or form of executive and director compensation.”

MISCELLANEOUS

Q-23: Where can the RiskMetrics Group “poor pay practices” list be found?

A-23: Discussions of RiskMetrics’ poor pay practices can be found under Q1.3 and Q1.4 of the [RiskMetrics Group 2010 Compensation FAQs](#) or as a part of [RiskMetrics’ 2010 policy updates](#).

The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney whom you normally consult.



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