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September 2009 **www.ssd.com**

Corporate Governance Reforms and Proposed Amendments to NYSE Governance Disclosures

Several recent corporate governance reforms including the August 26, 2009 New York Stock Exchange (NYSE) proposal to amend corporate governance disclosure requirements that apply to listed companies have been proposed and implemented since the publication of two recent *Corporate Alerts.* Our *April 2009 Corporate Alert* reported on changes to Delaware General Corporate Law that provide shareholders with greater access to proxy materials with respect to nomination of directors, and we discussed proposed Securities and Exchange Commission (SEC) amendments that would provide similar shareholder access under SEC rules in our *May 2009 Corporate Alert*.

In this *Alert*, we review recently adopted proposals, along with others that appear likely to be adopted before the end of 2009.

Broker Discretionary Voting

On July 1, 2009 the SEC approved a proposed amendment to NYSE Rule 452, which will apply to annual meetings held on or after January 1, 2010. The amended Rule 452 provides that the election of directors does not constitute a "routine" matter, and therefore a broker cannot vote on the election of directors without instruction from a beneficial shareholder. Currently, Rule 452 allows brokers to exercise discretion in voting for "routine" matters,

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including voting in favor of a slate of directors recommended by the existing board in an uncontested election, if the broker has not received instructions from a beneficial shareholder at least 10 days prior to the meeting date. The adoption of amended Rule 452 is likely to have a significant impact on the annual meeting process, including revised disclosure in proxy materials describing the effect of the amended rule, and the potential for a heightened impact of activist shareholders and others who vote, due to a lower number of total shares voted on "nonroutine" matters. Companies should carefully consider steps they might take to ensure a quorum is reached, such as including at least one "routine" on every meeting agenda to ensure the presence at the meeting of broker nonvotes, which are counted for purposes of determining presence of a quorum.

"Say on Pay"

There have recently been numerous proposals which, if adopted, will give shareholders the right to have a nonbinding vote on executive compensation, or a "say on pay." One such bill, the Corporate and Financial Institution Compensation Fairness Act of 2009 (HR 3269), was approved by the House of Representatives on July 31, 2009. HR 3269 would also require that shareholders have a separate advisory vote in connection with golden parachutes. Similar legislation is expected to be considered by the Senate in September or October 2009. The effective date for application of the House bill would be six months after the SEC adopts rules implementing such legislation. If current versions of this legislation are adopted, they would become effective following the SEC's implementation of new rules. There is a chance that new rules could be in place in time for the 2010 proxy season, but more likely the rules would go into effect closer to June 2010. While only advisory to boards of public companies, say on pay would provide shareholder activists another avenue for asserting influence on companies.

CD&A

On July 10, 2009, the SEC issued proposed amendments to the current compensation and governance disclosures, which are intended to facilitate voting decisions by providing a focus on corporate accountability and by aligning the short-term incentives of management with the long-term interests of shareholders. The SEC proposes requiring additional disclosures by companies in their Compensation Disclosure and Analysis (CD&A) regarding the extent to which the company may be materially affected by risks

arising from its compensation policies and practices. The increased disclosure would also require a discussion of policies or practices for compensating employees, including non-executive officers, as they relate to risk management practices. In addition, the proposal would require increased disclosure with respect to certain stock option grants, directors and nominees for appointment as director, the board's role in risk management and the role of compensation consultants in the company's compensation policies.

Proxy Solicitation Process

The July 10, 2009 SEC proposal would also change the existing proxy rules in an attempt to facilitate shareholder communications and provide shareholders with greater access to information through the proxy solicitation process. Such amendments, if approved, would allow persons who are not seeking proxy authority, whether or not they are shareholders of the company, to solicit support for a proposal or for nominees for appointment to the board of directors. Through the use of such solicitation efforts, activist shareholders or other interested parties would be able to encourage shareholders to vote in a particular manner without the costs of a fully regulated proxy solicitation.

Proposed Amendments to NYSE Listed Company Corporate Governance Disclosures

On August 26, 2009 the NYSE filed with the SEC proposed amendments on corporate governance disclosure requirements set forth in Sections 303A and 307.00 of the NYSE's Listed Company Manual. The proposed amendments clarify some of the disclosure requirements and codify certain interpretations made since the rules were enacted. To avoid duplication and confusion, the amendments currently proposed by the NYSE also will eliminate each disclosure requirement included in Section 303A that also is required by Item 407 of Regulation S-K and incorporate directly into Section 303A the applicable disclosure requirement of Item 407. Companies whose disclosure under Item 407 is deficient would therefore also be out of compliance with the NYSE's rules, and subject to delisting. If adopted, the proposed changes will take effect on January 1, 2010.

A summary of the NYSE's proposed amendments is included below:

General Disclosure Requirements

- **Applicability of Certain Disclosure Requirements.** With respect to the controlled company exception to the applicability of Section 303A, the proposed amendments to Section 303A.00 clarify that, in order to be deemed a controlled company, more than 50 percent of the voting power for the election of directors must be held by an individual, group or another company. The proposed amendments also clarify that closed-end funds are in fact subject to Section 308A, correcting an oversight on the part of the NYSE in the current form of Section 303A.00.

- **Compliance Dates.** Companies listing on the NYSE are required to comply with all applicable requirements of Section 303A as of the date that the company's securities first trade on the NYSE. The proposed amendments to Section 303A.00 specify certain transition periods, however, for compliance with requirements related to director independence and board committees by companies listing in conjunction with an IPO, spinoff or carveout; emergence from bankruptcy; transfer from another market; ceasing to be a controlled company; or ceasing to be a private issuer. The proposed amendments to Section 303A.08 also provide a limited transition period for a foreign private issuer whose status changes under the SEC rules and as a result of such change in status becomes subject to Section 303A.08, which requires shareholder approval of equity compensation plans. The transition period will end upon the later to occur – six months from the date on which the company fails to qualify for foreign private issuer status under SEC Rule 240.3b-4 (the determination date) and the first annual meeting after the determination date. During the transition period, the listed company may continue to use discretionary plans and formula plans that were in place before the date of the status change.

- **Disclosure Requirements.** The proposed amendments specify that if a company makes a required Section 303A disclosure in its annual proxy statement, or if the company does not file an annual proxy statement in its annual report filed with the SEC, it may incorporate such disclosure by reference from another document that is filed with the SEC to the extent permitted by SEC rules. If a listed company is not required to file a Form 10-K, then any provision in Section 303A permitting a company to make a required disclosure in its annual report on Form 10-K filed with the SEC shall be interpreted to mean the

annual periodic disclosure form that the listed company files with the SEC.

- **Corporate Governance Guidelines.** The proposed amendments to Section 303A.09 require that a listed company make its corporate governance guidelines available on or through its website. A listed company must disclose in its annual proxy statement, or in its annual report on Form 10-K if it does not file an annual proxy statement, that its corporate governance guidelines are available on or through its website and provide the website address.

- **Foreign Private Issuer Disclosure.** To avoid confusing and duplicative requirements, the proposed amendments to Section 303A.11 require that foreign private issuers that are required to file an annual report on Form 20-F with the SEC must include the statement of significant differences in that annual report. All other foreign private issuers will have the choice to either (1) include the statement of significant differences in an annual report filed with the SEC or (2) make the statement of significant differences available on or through the company's website.

- **Website Requirements.** The proposed amendments redesignate previous Section 303A.14 as Section 307.00 and clarify in the commentary that this requirement applies to companies subject to website posting requirements under any applicable provision of the Listed Company Manual, rather than just Section 303A. The new Section 307.00 will specify that companies' websites must be accessible from the United States, must clearly indicate in English the location of the documents on the website that are required to be posted and such documents must be printable in English.

Board and Officer Matters

- **Director Independence.** The proposed amendments to Section 303A.02 provide that a listed company must comply with the disclosure requirements set forth in Item 407(a) of Regulation S-K, with respect to director independence. In addition, a listed company must include any parent or subsidiary or any other company as is relevant to any determination under the independent standards set forth in Section 303A.02(b) in a consolidated group with the listed company.

- **Executive Sessions.** Rather than hold regularly scheduled executive sessions of nonmanagement directors without management, the proposed amendments to Section 303A.03 provide that a listed company may instead choose to hold regular executive sessions of independent directors only. An independent director must preside over each executive session of the independent directors. If a listed company chooses to hold regular meetings of all nonmanagement directors, it should hold an executive session including only independent directors at least once a year.

- **Code of Business Conduct and Ethics.** The proposed amendments to Section 303A.10 require that a listed company make its code of business conduct and ethics available on or through its website. A listed company must disclose in its annual proxy statement, or in its annual report on Form 10-K if it does not file an annual proxy statement, that its code of business conduct and ethics is available on or through its website and provide the website address. To the extent that a listed company's board or a board committee determines to grant any waiver of the code of business conduct and ethics for an executive officer or director, the waiver must be disclosed to shareholders within four business days of such determination (not within two to three business days of the board's determination, as currently provided in the NYSE's guidance), and such disclosure must be made by distributing a press release, providing website disclosure or filing a current report on Form 8-K.

Board Committees

- **Committee Charters Generally.** The proposed amendments require that a listed company make the charters for its nominating/corporate governance, compensation and audit committees available on or through its website. A listed company must disclose in its annual proxy statement, or in its annual report on Form 10-K if it does not file an annual proxy statement, that each committee charter is available on or through its website and provide the website address.

- **Nominating/Corporate Governance Committee.** If any function of the nominating/corporate governance committee has been delegated to another committee, the charter of that committee must also be made available on or through the company's website.

- **Compensation Committee.** The proposed amendments to Section 303A.05 require that a listed company's compensation committee have a charter that provides that the committee has direct responsibility to prepare the disclosure regarding the Compensation Committee Report required by Item 407(e)(5) of Regulation S-K.

- **Audit Committee.** The proposed amendments to Section 303A.06 clarify that Rule 10A-3(d)(1) and (2) of the Securities and Exchange Act of 1934 require that listed companies disclose reliance on certain exceptions from Rule 10A-3 and disclose an assessment of whether and, if so, how such reliance would materially adversely affect the ability of the audit committee to act independently and to satisfy the other requirements of Rule 10A-3. The proposed amendments to Section 303A.07 require that all audit committee members must satisfy the requirements of independence set out in Section 303A.02 and, unless there is an applicable exemption, Rule 10A-3(b)(1). Also, the proposed amendments clarify that if an audit committee member simultaneously serves on the audit committees of more than three public companies, the listed company's board must determine that such service would not impair the ability of such member to effectively serve on the listed company's audit committee and must disclose such determination, whether or not the listed company limits the number of audit committees on which its audit committees serve to three or less. A closed-end fund is not required to comply with the requirement to make its audit committee charter available on or through its website.

Conclusion

The many corporate governance reform initiatives currently adopted or under way will likely result in significant changes to the way public companies interact with their shareholders, and how shareholders interact with each other. It will be important for companies to be aware of such initiatives as they progress and to understand the implications of any that are adopted. Such implications will likely include changes to charter documents, shareholder communications, SEC filings and annual meeting procedures. For further information relating to the impact of any adopted legislation or the status or content of proposed legislation or rule amendments, or for advice on reacting to or preparing for such changes, please contact your principal Squire Sanders lawyer.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.