

## SECURITIES UPDATE

### Advance Planning for 2008 Proxy and Annual Report Season

October 10, 2007

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For public companies with calendar year-ends, the preparations for the proxy statement and annual report typically intensify later in the fall, continuing through the winter. While there are always issues that need to be addressed in advance—such as deciding what proposals the company wants to submit for shareholder approval—there are a number of matters of particular interest this year that companies should begin to address now to ensure that the process goes smoothly:

**E-proxy – Notice and Access Model.** As discussed in our August 24, 2007, Securities Update entitled “*E-Proxy: Understanding the New Delivery Options for the 2008 Proxy Season*,” the SEC’s new e-proxy rules allow issuers to furnish proxy statements and annual reports by posting them on a web site and providing shareholders with notice of their availability. There are several issues to consider when deciding whether your company wants to take advantage of the notice and access model (as opposed to full set delivery).

- The notice and access model requires materials to be filed with the SEC and posted on a web site at least 40 days in advance of the meeting. Consider whether

your company will be able to meet this deadline, taking into account your annual meeting date, the date on which your audited financial statements are scheduled to be completed, and the date by which you will have definitive information for all of the compensation tables. While there is a degree of flexibility in the time schedule for traditional full set delivery of proxy materials, the deadline for e-proxy filings and postings is absolute. It would be easier to postpone the annual meeting date now than to be forced to change it later if the proxy statement or annual report cannot be completed in the necessary time frame to comply with the notice and access model.

- Consult with your company’s intermediaries to determine how far in advance of the shareholders’ meeting they will need to receive your materials in order for your company to rely on the notice and access model. As a practical matter, to meet your intermediaries’ time constraints, the proxy statement and annual report will need to be completed even earlier than required by the SEC’s rules.
- Determine whether there would be any significant cost savings from using the

notice and access model, taking into account any additional costs associated with this new method and any higher per unit costs associated with a lower printing volume.

**E-proxy – Web Posting.** The new e-proxy rules also require issuers to post their proxy materials on a web site and provide shareholders with a notice of availability, whether or not the issuer is using the notice and access model. This requirement is effective on January 1, 2008, for large accelerated filers, and on January 1, 2009, for all other filers. There are several rules and requirements with regard to posting proxy materials so, whether your company is a large accelerated filer or just wants to take advantage of the notice and access model, you should check with your IT department or with an intermediary you will be using in order to establish procedures to comply with the SEC rules regarding web posting of proxy materials. Issues and rules to consider include:

- The web page hosting the proxy materials must protect the anonymity of persons accessing the site. Therefore, the web page cannot use “cookies” or other tracking features. It may be necessary to segregate this web page from the company’s main web site or to create a new web site.
- Linking to the SEC’s EDGAR site will not satisfy the web posting requirement.
- Choose a format or formats for posting materials that can be conveniently printed and that can be electronically searched. Verify that the persons responsible for delivering the electronic versions of the proxy materials—whether they work for your company or for outside vendors—understand this obligation.

**Compensation Disclosure.** Consider whether your company’s executive compensation disclosure should be revised to reflect the experience of the first year under the SEC’s new executive compensation disclosure rules. The executive compensation disclosure requirements are discussed in detail in our August 29, 2006, Securities Update entitled “*SEC Significantly Revises Executive Compensation and Related Person Disclosure Requirements.*”

- The SEC has issued comment letters to hundreds of companies concerning compensation disclosure. Themes in these comment letters include adding more analysis in the compensation discussion and analysis; providing greater focus on individual differences among named executive officer compensation and internal pay equity; supplying benchmarking detail and performance targets; disclosing more detail about the role of the CEO and any consultants in compensation decisions; and explaining how the components of change in control and termination payments are determined and clearly identifying what the total amounts of such payments would be.
- On October 9, 2007, the SEC issued a report entitled “Staff Observations in the Review of Executive Compensation Disclosure.” See <http://www.sec.gov/divisions/corpfin/guidance/execcomp-disclosure.htm>. The staff identified two principal themes from its recent review of executive compensation and related disclosure that should guide such disclosure in the upcoming proxy season. First, the staff wants the compensation discussion and analysis to be focused on *how* and *why* a company arrives at specific executive

compensation decisions and policies. Second, the staff seeks improvement in how compensation disclosures are presented, including the use of plain English and improved organizational techniques such as the inclusion of executive summaries, tables, and charts that enhance the reader's understanding. The staff report also details the various types of specific comments given to reviewed companies. For example:

- » The staff requested a significant number of companies to discuss the extent to which each compensation element affected the decisions regarding other compensation elements.
- » The staff reminded companies to discuss compensation of named executive officers, such as the chief executive officer, separately, if such compensation is materially different from that of other named executive officers.
- » The staff gave more comments concerning performance targets than any other disclosure topic, requesting that companies disclose performance targets (or demonstrate to the staff that such disclosure could cause competitive harm). The staff asked companies to explain how they use performance targets and consider qualitative individual performance.
- » The staff issued a substantial number of benchmarking comments, asking for a more detailed explanation of how companies used comparative compensation information and how that comparison affected compensation decisions.
- » The staff asserted that a significant number of companies could enhance

their compensation discussion and analysis by discussing and analyzing decisions regarding change-in-control and termination arrangements with the named executive officers.

- » Overall, the staff issued relatively few comments with respect to compliance with required compensation tables disclosure.
  - » In some cases, the staff commented on compensation committee reports that did not meet all the requirements of the rules.
  - » With respect to related person transaction approval policies, the staff asked a number of companies to provide a statement that their policies and procedures are in writing and, if not, to explain how they evidence their policies and procedures.
  - » In reviewing corporate governance disclosure, the staff requested clarification as to the role of executive officers in determining the amount and form of executive officer and director compensation and as to the nature and scope of assignments and material instructions given to compensation consultants.
- The SEC Division of Corporation Finance has published executive compensation compliance and disclosure interpretations on these and other matters, which were most recently updated on August 8, 2007. See <http://www.sec.gov/divisions/corpfin/cfguidance.shtml#regs-k402>.

**Shareholder Proposals.** While shareholder proposals for inclusion in a company's proxy statement may not arrive until later in the year, now is a good time to reflect on how

your company would respond if it were to receive one.

- Shareholder proposals for 2008 are particularly likely to include executive compensation matters such as linking pay to performance and “say on pay”; corporate governance issues such as declassifying the board of directors, splitting the offices of chairman and chief executive officer, and majority voting for directors; and social, environmental, and political concerns such as global warming and political contributions.

**Shareholder Access.** Shareholder access to issuer proxy statements is an area that may see regulatory action.

- This summer, the SEC issued two competing proposals for comment. One proposal primarily would codify an existing SEC staff interpretation, permitting issuers to exclude from proxy statements shareholder proposals that would relate to a nomination or an election for directors. The alternative proposal would permit 5 percent shareholders to submit for inclusion in an issuer’s proxy statement by-law amendments that would mandate procedures to allow shareholders to nominate board of director candidates.
- The comment period on these proposals closed on October 2, 2007. Initially, the SEC indicated that it would adopt a final shareholder access rule in time for the 2008 proxy season. To do so, the SEC would likely need to approve and issue its final rule in November. It is not clear whether that will happen. The reaction to the proposals has become very political.

Two of the SEC commissioners favoring the shareholder access through by-law amendment proposal have announced their departures, and there have also been congressional hearings on this subject.

- This is a topic to monitor as the 2008 proxy season approaches.

**Risk Factors.** Consider whether your company needs to update the risk factor section of its annual report on Form 10-K (or an earlier quarterly report on Form 10-Q).

- Examine whether disclosure regarding the risks of global warming or climate change should be added or enhanced. Increasing attention is being paid to disclosure issues in this area. For example, the New York attorney general has subpoenaed five energy companies as part of an investigation to determine if they have properly disclosed the financial risks of carbon dioxide emissions. A group of state officials, institutional investors, asset managers, and environmental groups has petitioned the SEC seeking “an interpretive release clarifying that material climate-related information must be included in corporate disclosures under existing law.”
- Determine whether new disclosure should be added with respect to exposures resulting from subprime mortgages and the related credit crunch. More generally, consider whether there are other risks with respect to the credit markets.
- If your company’s risk profile changed in relation to foreign currency translations, prepare or modify the appropriate risk factors.

- Ascertain whether mark-to-market requirements for existing debt affect your company's risk profile this year, giving rise to new or different risk disclosures.
- Consider whether there are any new developments specific to your company or industry that merit an additional or revised risk factor.
- Corresponding language may need to be added to the factors identified in the forward-looking language disclosure.

**Related Person Transactions.** Review your related person transaction approval policy description from last year's proxy statement, and consider whether it is sufficiently detailed.

- The discussion should describe the procedures that the company uses and the standards that it applies.
- If the policy has not been reduced to writing, consider doing so now. As noted above, in comment letters, the SEC has asked companies to disclose whether their related person transaction approval policy is in writing.

**NYSE Rule 452 – Broker Discretionary Voting.** One issue that now seems unlikely to affect the 2008 proxy season is the NYSE's proposal to amend Rule 452 to eliminate broker discretionary voting for the election of directors.

- As currently in effect, Rule 452 treats the election of directors as a routine matter, permitting brokers to vote in their discretion on the election of directors if they have not received instructions from the beneficial owner of the shares within 10 days of the scheduled meeting.

- Because brokers frequently vote for the candidates nominated by the company's board of directors, the NYSE's proposed rule change removing broker discretion on voting for directors could have the effect of lowering the percentage of votes in favor of a board's slate of nominees.
- The NYSE recently informed listed companies that it has been advised by SEC staff that the amendment to Rule 452 will not be approved in time for the 2008 proxy season.

**Shelf Registration Statements.** Under Rule 415 pursuant to the Securities Act of 1933, automatic shelf registration statements as well as any shelf registration statement filed pursuant to Rule 415(a)(1)(vii), (ix), or (x) may only be used for three years from its effective date. Beginning December 1, 2008, no registration statement in any of these categories may be used if it has been effective for more than three years.

- While technically not a proxy season matter, determine whether your company will need to file a new shelf registration statement at the end of 2008 or the beginning of 2009 (which it will need to do if it wants to retain the flexibility to use a shelf registration statement that will be at least three years old by then).
- If your company will need to file a new shelf registration statement in this time frame, as you develop your corporate calendars for the upcoming year, schedule board approval for filing the new registration statement, and obtain director signatures, at an appropriate board meeting.

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