

Considerations for Drafting the 2009 Proxy Statement

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Executive compensation continues to dominate headlines and remains at the forefront of key governance issues. While most U.S. companies are now in their third year of implementing the SEC's revised executive compensation disclosure requirements, companies still grapple with new developments and evolving situations related to directors and officers. Although the complexity of the disclosure rules often requires a detailed fact-based analysis in many cases, we provide below a brief summary of some practical considerations on several disclosure points. The SEC has not announced any current plans for widespread review and guidance of 2009 proxy statements.

CD&A

Assessment of Risk Incentives:

- » Compensation committees of institutions participating in the Troubled Assets Relief Program ("TARP") are required to evaluate and monitor incentive compensation arrangements for senior executive officers to ensure that such arrangements do not encourage those officers to take unnecessary and excessive risks that could threaten the value of the institution, and must provide a certification to that effect.
- » The most recent Treasury guidance has changed the location of the certification to now be included as part of the compensation committee report, not in the CD&A.
- » Former director of the Division of Corporation Finance, John White, stated that even companies not participating in TARP may need to undertake similar analysis and disclosures to the extent that these types of risk considerations are a material part of companies' compensation arrangements.

Retention Bonuses or Grants:

- » There are several reports that companies were more inclined in 2008 to award a one-time retention bonus or grant to offset underwater options held by executives in the current downturn. Note that the CD&A specifically requires a discussion of equity grant practices, including the determination of when awards are granted, and requires a discussion of "how and why" all compensation awards are determined.

Performance Targets

- » John White indicated in October 2008 that the disclosure of performance targets remained a primary area of SEC comment. In evaluating whether disclosure is required:
 - As a threshold matter, determine whether performance targets are material in the context of a company's executive compensation policies or decisions. If performance targets are not material, disclosure is not required.
 - If the performance targets are material, companies may omit disclosure of targets involving confidential trade secrets or information only if such disclosure would result in competitive harm. It is helpful to develop a contemporaneous written analysis that can be shared with the SEC Staff if needed to support future inquiries.
 - If there is a sufficient basis to omit disclosure of material performance targets, then disclosure as to the degree of difficulty associated with achievement of the omitted performance targets is mandatory. The SEC expects the disclosure to be sufficiently detailed as to address the criteria for determining undisclosed target levels, and also directly establish the connection between the achievement of the performance objective and the characteristics of the incentive payment to which the goal applies.

Compensation Consultants

- » While the names and nature and scope of assignment must be disclosed for all compensation consultants with any role either in the recommendation or form of executive compensation, only those consultants with a “material role” in NEO compensation must be disclosed in CD&A.
- » If no CD&A disclosure is needed, then disclosure regarding consultants may be made in the governance section.

Executive Compensation Tables

Summary Compensation Table

- » If the accumulated change in pension benefit is negative after adding and subtracting all the plans, the table should indicate “zero” rather than the negative amount. The actual amount should be disclosed by a footnote, indicating that such amount is not reflected in the sum reported in the relevant column. Negative pension amounts cannot be netted against above market earnings on deferred compensation, which is combined in the total for this column.
- » The SEC has clarified that if an NEO fully reimburses the company for a specific perquisite or other personal benefit, then it need not be disclosed nor separately identified by type. Using the example of a meal at a country club where the annual dues are paid by the company, the SEC Staff has now indicated that the cost of the meal need not be reported if it is reimbursed, whereas previously the Staff had suggested that some portion of the club dues must also be reimbursed to avoid reporting the meal.

All Tables

- » Reminder that the applicable fiscal year must be specified in the title to each table requiring disclosure as of or for a completed fiscal year.

Information for New Director Nominees

The following information will be needed about a new director nominee:

- » *Biographical information.* The nominee’s name, position, family relationships with other executives and directors and related information.
- » *Security ownership table.* Beneficial holdings by the nominee in the company’s securities must be included in the table. It is not necessary to include the individual’s holdings in the aggregate holdings of all executive officers and directors.
- » *Related person transactions.* The term “related person” includes director nominees and their immediate family members; disclosure is required for transactions involving these individuals since the beginning of the last fiscal year.
- » *Director independence.* The director nominee must be identified as independent if he or she meets the company’s independence standards.
- » *Source of nomination.* The party (or parties) who nominated the director must be disclosed – e.g., shareholders, non-management director, CEO, third party search firm, or another specified source.

Former Executive Officers

The following disclosures may be needed about former executive officers:

- » *List of NEOs.* NEOs include (1) anyone who has served as CEO or CFO during the last fiscal year and (2) up to two additional persons who would have been one of the three most highly compensated executive officers but for the fact that the person was not an executive officer at the end of the last completed fiscal year. Note that the Form 8-K rules refer to individuals named as NEOs in the company’s latest proxy statement once filed, although material compensatory arrangements are at that point unlikely for former executives.

- » *Security ownership table.* Former executive officers may be implicated if they are required to be named as NEOs, since the table requires disclosure of beneficial holdings by each individual NEO. It is not necessary to include such individual's holdings in the aggregate holdings of all executive officers and directors.
- » *Related person transactions.* Disclosure may be required because the rules cover any transactions, since the beginning of the last fiscal year, involving those who were executive officers (and their immediate family members) at the time of the transaction.
- » *Late Section 16 filings.* Disclosure may be required of any late reports by those who were executive officers at any time during the last completed fiscal year.

Former Directors and Current Directors Not Standing for Re-Election

The following disclosures may be needed for former directors, and directors not standing for re-election at the annual meeting:

- » *Director compensation table.* The SEC takes the position that the director compensation table should include anyone who served as a director during the last completed fiscal year, which includes former directors.
- » *Security ownership table.* All current directors – including those not standing for re-election – must be included in the table on an individual basis and as part of the aggregate holdings of all executive officers and directors. While the rules are not completely clear, former directors whose service has terminated are often not included in the table.
- » *Committee reports.* The SEC Staff takes the view that directors who participated in the discussion and recommendations on CD&A must be identified in the compensation committee report. The Staff notes that this is not likely to include former directors or new directors, although it may include those no longer on the committee but still on the Board. The same reasoning appears to apply to the audit committee report.
- » *Related person transactions.* Disclosure may be required because the rules cover any transactions, since the beginning of the last fiscal year, involving those who were directors (and their immediate family members) at the time of the transaction.
- » *Late Section 16 filings.* Disclosure may be required of any late reports by those who were directors at any time during the last completed fiscal year.

Communications with the Board

Because both the SEC and the NYSE contain similar requirements related to shareholder communications, although with a slightly different focus, companies should be aware that the proxy statement needs to contain all the required elements for the two forms of communications.

SEC Requirements

- » SEC rules require companies to provide a process for shareholders to send communications to the Board and, if applicable, to specific directors (or state the basis for the Board's view that it is appropriate for the company not have such a process). A website address with the information may be provided instead. Any process for filtering such communications must be disclosed, unless it has been approved by a majority of independent directors.

NYSE Requirements

- » NYSE listed companies must provide the means to communicate directly with the presiding director, or the non-management directors as a group. Companies may use the same method as that established for communicating accounting or internal control concerns to the audit committee.

Audit Committee Report

Instead of the Independence Standards Board letter, the audit committee report should now reference written disclosures and the letter from the independent accountant pursuant to applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence.

If you have any questions regarding this memorandum, please contact any of the lawyers listed below or your regular Davis Polk contact.

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