

Effective and Pending Initiatives for the Upcoming Proxy Season

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U.S. public companies preparing for the 2010 proxy season will encounter a number of new regulatory developments, most of which occurred in 2009 in response to the financial crisis and economic environment. Many additional potential developments are pending. We have briefly summarized significant new and pending initiatives below. Please contact us if you would like additional information or guidance.

Changes to Voting in Director Elections

Effective January 1, 2010, New York Stock Exchange ("NYSE") Rule 452 will be amended to prohibit brokers from voting shares of shareholders holding their shares in "street name" in all director elections without specific voting instructions from the shareholder. Brokers have historically had discretion to vote uninstructed shares in uncontested elections and have almost always cast them in favor of management's director nominees. This change applies to both NYSE and Nasdaq-listed companies.

Mid and small-cap companies, which tend to have more retail shareholders, will have to take a more proactive approach to their voting processes in the upcoming proxy season. To assess the impact of the loss of broker discretionary votes on the overall number of votes that will be cast, a company can look at the number of votes cast with respect to a recent non-discretionary proposal and compare that with the number of votes cast in the director election at the same annual meeting.

The vote change can have the most significant effect on a company's ability to obtain a quorum of shareholders present at the meeting and on the director vote for a company requiring a majority vote for directors. Because shares that brokers do not vote are not considered present at the meeting for quorum purposes, all companies should make sure that at least one agenda item (i.e. ratification of accountants) may be voted on by brokers without specific voting instructions in order to assure a quorum.

Also, losing the broker discretionary vote will mean increased influence from institutional shareholders, making it important for companies to know whether any of their directors are vulnerable to "vote no" or "withhold vote" campaigns and the extent to which their institutional shareholders follow the voting policies of proxy advisory firms such as RiskMetrics Group and Glass Lewis. This can be particularly problematic for companies requiring a majority vote for directors.

Executive Compensation Disclosures

In July 2009, the SEC proposed rules which, among other things, would require expanding the disclosure already required in the Compensation Discussion and Analysis section of the proxy statement. Specifically, the proposed rules would require companies to discuss and analyze their overall compensation policies and practices for all employees, including non-executives, if the incentives created by them could create a risk that would have a material effect on the company as a whole. Thus, compensation committees must now understand not only the risks posed by their named executive officers' and senior executives' incentive-based compensation, but also those posed by the company's non-executive compensation policies.

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The proposed rules would also require new disclosures on the independence of, and potential conflicts of interest involving, compensation consultants that provide advice to the board or compensation committee on executive or director compensation if the consultants also provide other services to the company.

Expanded Director Qualifications Disclosure

The July 2009 SEC proposals would also require companies to provide proxy disclosure for each director and director nominee in addition to the basic biographical information currently found in most proxy statements. Specifically, companies would have to disclose the particular experience, qualifications, attributes and skills that qualify each director or director nominee to serve on the board of directors and each committee on which such director will serve in the upcoming year.

We expect the SEC to take final action in time for the 2010 proxy season. If adopted as proposed, we advise that companies evaluate and update as necessary their Directors' and Officers' Questionnaires, board membership criteria and processes for identifying and evaluating both director candidates and incumbent directors.

Update on Proxy Access

The SEC continues to consider a number of issues raised in comment letters submitted in response to its most recent proxy access proposal, including whether the final rule should (1) mandate federal proxy access; (2) allow companies to opt-out of proxy access based on shareholder vote; or (3) treat proxy access proposals under the current SEC shareholder proposal regime. While the SEC will not consider final rules on proxy access until some time in 2010, it is still expected to adopt some form of proxy access in the foreseeable future. At that time, companies may need to revisit provisions in their bylaws or codes of regulations dealing with director elections.

Risk Management and Oversight

Risk management and oversight continue to be "hot buttons" for the SEC. Boards of directors should consider how to perform their risk oversight responsibilities more effectively in light of the recent financial crisis and adopt a risk oversight structure that is appropriate to identify and oversee the major risks facing the company in light of its overall business strategy and operations. Understanding the interplay between these risks and the company's business may require additional director education on such matters.

The most popular options for allocating the risk oversight function are (1) delegating it to a committee of the Board (the audit committee has been by far the most popular choice); (2) creating a new risk committee; or (3) making it the responsibility of the whole board. The SEC's July 2009 rule proposals would require companies to disclose which of these methods they have in place, whether the persons overseeing risk management report directly to the Board as a whole or to a committee and how the Board or that committee monitors risk.

Focus on Board Leadership

The July 2009 SEC proposals would, if adopted, also require companies to disclose their overall leadership structure and explain why that structure is appropriate in light of their business operations and risk profile. This proposed disclosure is not intended to influence a company's decision about its own leadership structure or mandate a one-size-fits-all approach; however, companies would be required to disclose whether they have a combined Chairman/CEO and whether they have designated a lead director.

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Separately, the Shareholder Bill of Rights Act of 2009, currently being considered in Congress, would require U.S. public companies to have an independent Chairman.

Update on Say on Pay

An advisory shareholder vote on executive compensation (known as "say-on-pay") is currently being considered in several pieces of Congressional legislation. It is unlikely that any of them will be implemented in time for the 2010 proxy season, but the rise in shareholder say-on-pay proposals and the blueprint provided by the 400 TARP companies that held say-on-pay votes in 2009 increase the likelihood that companies could face pressure to act voluntarily.

If you would like additional information about the issues addressed in this Advisory, please contact:

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