

# September "Back to School" Meeting



SOCIETY OF CORPORATE SECRETARIES  
& GOVERNANCE PROFESSIONALS

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## Today's Presenters

- **Patrick Daugherty**  
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- **Todd Pfister**  
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## September "Back to School" Meeting Discussion Topics

- President Obama's SEC Agenda: How It Will Affect You
- Best Practices for Keeping Corporate Minutes

## September “Back to School” Meeting

### President Obama’s SEC Agenda: How It Will Affect You

## *Critiques Regnant*

- The SEC *qua* its Division of Trading & Markets deferred too often and too much to the securities industry, especially the biggest firms
- A single Agency – but not the SEC – must supervise all large and/or interconnected and/or highly leveraged financial firms (“Tier I FHCs”)
- The SEC *qua* its Division of Enforcement should have caught Bernie Madoff
- No hedge fund or other investment medium of any description can be permitted to operate “unregulated”
- The SEC *qua* its Division of Corporation Finance needs to defer less to corporate managers and traditional ways of managing companies, facilitate greater involvement of shareholders

## “Financial Regulatory Reform: A New Foundation”

- *Most Obama Administration recommendations do not bear directly on the SEC or Corporate America (other than for financial firms).*
- *Those that do include:*
  - **Say on Pay** -- “we will support legislation requiring all public companies to hold non-binding shareholder resolutions on the compensation of senior executive officers . . . .”
  - **Empowered Compensation Committees** -- “we will support . . . new requirements to make compensation committees more independent.”
    - Duty and resources to hire their own consultants and counsel
    - SEC to create standards assuring independence of consultants
  - **“Better Compensation Practices”** -- “align compensation with long-term shareholder value and . . . promote compensation structures [that] do not provide incentives for excessive risk-taking.”

## Other “Changes” Sought

- **Private-Fund Adviser Registration:** “All advisers to hedge funds (and other private pools of capital, including private equity funds and venture capital funds) whose assets under management exceed some modest threshold should be required to register with the SEC. . . .”
- **Progressive Accounting Standards:**
  - **IFRS** -- “develop . . . a single set of high quality global accounting standards”
  - **Fair value** -- “Clarify and make consistent the application of fair value accounting standards, including the impairment of financial instruments”
  - **Anti-cyclical loan loss provisioning** – make “loan loss provisioning . . . more forward looking, as long as the transparency of financial statements is not compromised”

## Key Concepts

- **“Pro-cyclical”** standards and practices:
  - Certain accounting standards have had pro-cyclical effects, meaning that they have tended to ***amplify business cycles***.
  - Loan Loss Reserves:
    - During good times, loan loss reserves tend to decline because recent historical losses are low.
    - If firms were more forward-looking, then provisions would be higher earlier in the cycle and lower toward the end of the cycle.
    - This would smooth out the business cycle – a benefit.
  - Fair Value Accounting
- **“Macro-prudential”** standards and analyses
- **“Clear and simple”** investment opportunities:
  - Behavioral economics
  - How people actually behave, versus how they “should” behave
  - Complex disclosure/design can cause irrational choice or no choice (default)
  - “Clear” disclosure involves pictures (charts and graphs), not words
  - “Simple” products should be offered as default options

## Grab Bag of Ideas for the SEC

- Disclose earlier, at the “point of sale”
- Field-test new disclosure techniques
- Expand whistleblower protections
- Increase enforcement sanctions

## Key SEC DCF Initiatives

- Broker Discretionary Voting
- Executive Compensation
- Shareholder Proxy Access

## Broker Discretionary Voting

- NYSE Rule 452 currently permits brokers to vote on behalf of their beneficial owner customers for certain “non-routine matters” -- including uncontested director elections -- if the customers have not returned voting instructions
- Amended NYSE Rule 452 adds to the list of “non-routine” matters the election of directors and thus prevents discretionary voting of uninstructed shares by brokers in director elections
- Applies to brokers who are members of the NYSE; hence it applies to all public companies, wherever listed
- The amended rule will be effective for shareholder meetings held on or after January 1, 2010
- Potential Effects:
  - May increase costs of uncontested elections because companies will have to spend more money to reach shareholders who previously did not vote
  - Especially problematic for small companies with high percentages of shares held by retail investors – can they get a quorum?
  - May increase influence of special-interest groups

## Executive Compensation: Overview

- Currently proposed rules would ***amend SEC executive compensation and governance disclosure rules and expand disclosure*** regarding:
  - the company's compensation policies;
  - the impact of compensation policies on the company's risk management policies and practices;
  - qualifications and backgrounds of directors and director nominees;
  - the company's leadership structure;
  - potential conflicts of interest involving the use of compensation consultants;
  - stock and option awards; and
  - shareholder voting results

## Executive Compensation: Details

- **Compensation Discussion and Analysis (“CD&A”)**
  - Disclosure in CD&A section would be augmented to include discussion of company's compensation policies and practices relative to its risk management practices and risk-taking incentives
  - Companies would need to consider the structure and application of incentive compensation policies that create inadvertent incentives for all employees (not only NEOs) to make decisions that significantly increase risk – *i.e.*, decisions that may have a material effect on the company's financial condition
- **Compensation Table Disclosures for Equity Awards:** Company would need to report stock and option awards in Summary Compensation and Director Compensation tables using aggregate grant date fair value computed in accordance with SFAS No. 123
- **Enhanced Director and Nominee Disclosures:**
  - Company would need to disclose each director's and nominee's experience, qualification, attributes and skills, given the company's scope of business
  - Company would need to disclose every public company directorship held by each director and nominee during the past five years
  - Look-back for required disclosure of bankruptcy, criminal or securities-related legal proceedings would be lengthened to 10 years

## Executive Compensation: Details

- **Leadership Structure:**
  - Company would need to disclose its leadership structure and explain why the one it has chosen is best for itself
- **Conflicts of Interest Involving Compensation Consultants:**
  - Company would need to disclose information concerning its compensation consultants and affiliates if either plays a role in **determining or recommending the amount or form of executive compensation**
  - Disclosure not required if they only recommend the amount or form of executive/director compensation in connection with consulting plans that don't discriminate in favor of executives/directors -- e.g., 401(k) plan or health insurance plan
- **Form 8-K Disclosure of Shareholder Voting Results:**
  - Company would need to report the results of shareholder votes on Form 8-K (within four business days)
- **Proxy Solicitation Process Clarifications:**
  - The proposals would clarify several Exchange Act rules relating to solicitation of proxies and granting of proxy authority
  - Amended Rules 14a-2, 14a-4 and 14a-12 would provide greater certainty to soliciting persons, help shareholders receive timely and complete information and facilitate shareholder voting

## Shareholder Proxy Access

- Currently proposed rules would require companies to include director candidates nominated by shareholders in their annual meeting proxy materials if certain conditions are met.
- The proposed rules would not apply if state law or the company's organizational documents prohibit shareholders from nominating directors.
- Shareholders could require companies to include proposals in their proxy materials that would amend organizational documents bearing on director nomination procedures and disclosures.

## Shareholder Proxy Access: Proposed Rule 14a-11

- **Eligibility Requirements for Nominating Shareholders**
  - Beneficial ownership threshold (individually or as a group): at least 1% of the voting securities of a large accelerated filer; at least 3% of the voting securities of an accelerated filer; and at least 5% of the voting securities of a non-accelerated filer
  - Continuously own the threshold amount for at least a year; sign a statement declaring intention to hold through the director election meeting; and certify that securities are not being held for the purpose of changing control or to gain more than a minority representation on the board
- **Independence Requirements**
  - Nominating shareholder(s) must disavow any relationships or agreements between (1) the nominee and the company and its management and (2) the nominating shareholder(s) and the company and its management
  - Nominees must satisfy the independence requirements of the exchange on which the company's shares are traded.
- **Notice Requirements for Nominating Shareholders**
  - Notice to be provided to the company and the SEC on a new Schedule 14N
  - Notice deadline would be the date specified in the company's advanced notice bylaw provision; if no such provision exists, then the deadline would be 120 calendar days before the date the company mailed its annual meeting proxy materials in the prior year

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## Shareholder Proxy Access: Proposed Rule 14a-8 Amendment

- Companies would no longer be able to exclude from their proxy materials shareholder proposals that attempt to amend their organizational documents governing nomination procedures or disclosures related to shareholder nominations
- Current eligibility provisions of Rule 14a-8 would continue to apply -- continuously hold at least \$2,000 in market value or 1% of the voting securities for 1 year before submitting the proposal

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## What's Next?

- Proxy voting, particularly refinements to “e-proxy” (electronic shareholder voting); liberalizing shareholder communications to permit distribution of educational materials without being deemed a proxy solicitation; attention to proxy advisory firms
- Attention to Forms 13D and 13G; expanding coverage to include short positions
- Attention to credit rating “shopping”
- Improvements in ABS disclosure and registration
- Rulemaking in response to forthcoming legislation

## September “Back to School” Meeting

### Best Practices for Keeping Corporate Minutes

## Purposes of Corporate Minutes

- Inform
- Protect
- Demonstrate Compliance with Procedural Matters
- Demonstrate Compliance with Legal Obligations
- Comprehensive vs. Minimalist Minutes
  - Aim to strike appropriate balance
  - Avoid creating negative implication of no discussion

## Legal Background

- Fiduciary Duties Owed by Directors
  - Duty of Care
  - Duty of Loyalty
- Business Judgment Rule
- SOX
- *Disney* and other case law
  - Problems associated with brevity, inconsistency with subsequent recollection of officers and the like

## Suggested Best Practices for Minute Taking

- Well prepared and detailed minutes are now a must
  - The “old school way” is no longer prudent (“mark-up” last year’s minutes)
  - Avoid *Disney* problems (i.e., no record of deliberations)
  - Not transcripts though (do not go “overboard”)

## Suggested Best Practices for Minute Taking (cont'd.)

- Minutes should reflect:
  - Agenda reviewed
  - Advance information/drafts and/or summaries of subject documents provided and reviewed
  - Topics discussed
  - Reports/presentations given
  - Analysis provided (especially financial)
  - Expert advice given
  - Active deliberations and general nature of debate (without specifics or individual attribution)
  - Thorough Q&A sessions (typically without specifics or individual attribution)
  - Directives provided or follow-ups requested
  - Resolutions adopted/votes taken

## Suggested Best Practices for Minute Taking (cont'd.)

- Reflect both substance and process
  - Process is equally as important as substance
  - Minutes should reflect that the Board has met its duty of care
- Send draft minutes out within two weeks for comment by all directors
  - While meeting is still “fresh” and both you and the directors can still remember

## Suggested Best Practices for Minute Taking (cont'd.)

- Think of how you'll draft your minutes when you send out the advance Board books and then conduct the meeting (and act accordingly)
  - The end result often can drive the upfront process
  - Both procedure and substance are critical
- In drafting, think about how your minutes will look if they are “exposed” in the media or court
  - Think about how a plaintiff would read your minutes (without having attended the meeting) and use them against you

## Additional Considerations

- Attorney-Client Privilege
  - Generally speaking, reflect fact of privileged discussion but not substance
- Meeting Participant Notes
  - After approval of minutes, collect and destroy
- Executive Sessions
  - Detailed minutes unnecessary, assuming no action taken
  - Keep written record of participants and date, time, location and duration of session
- Minute Taker
  - Important function
  - Familiarity with governance principles
  - Attentive to detail
  - Involve General Counsel or outside counsel

## September “Back to School” Meeting

### Questions & Answers

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