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REPORT

Director Independence

Director Independence Is Significant Issue In Approved NYSE Proposals, Attorney Says

The New York Stock Exchange's amendments to its corporate governance listing standards contain relatively straightforward corporate governance changes, except when it comes to the more complex issue of director independence, a corporate law attorney told BNA in a recent interview.

The rule changes—filed Aug. 26 and approved by the Securities and Exchange Commission Nov. 25—amend the NYSE's corporate governance listing standards as proposed by the NYSE and will take effect on Jan. 1, 2010.

The NYSE rule changes do not generate new issues, but they do highlight the topic of director independence, Patrick G. Quick, a partner at Foley & Lardner in Milwaukee, Wis., told BNA on Dec. 8.

The amendments clarify various disclosure requirements, incorporate applicable SEC disclosure requirements into the NYSE listing standards, and codify certain staff interpretations, according to a Dec. 4 Gibson, Dunn & Crutcher LLP publication on the amendments.

Amendments Correspond to SEC Regulations. The amendments eliminate the disclosure requirements currently included in the NYSE corporate governance listing standards that are also required by SEC Item 407 of Regulation S-K—which requires disclosure about director independence and certain other aspects of a company's corporate governance practices, according to the publication.

Though the rule changes related to Item 407 may seem redundant, they will permit the NYSE to ''take action (including delisting) against companies with deficient Item 407 disclosure, as these companies will also be deemed out of compliance with NYSE rules,'' the publication said.

In regard to a current NYSE listing standard related to audit committees and their determination of committee member independence, the amendments clarify that ''both the determination and disclosure are required whether or not a company limits the number of audit committees on which its directors may serve to three or less,'' the publication said.

Furthermore, the amendments also allow companies to disclose certain issues on their websites, instead of in their proxy statements, the publication said. The changes eliminate the requirement that companies ''make hard copies of their governance documents available in print on request in light of the fact that the documents are available on company websites,'' it said.

Director Independence Addressed in Amendments. The NYSE amendments require—as in SEC Item 407—that companies disclose the descriptions, for each director, of any transactions, relationships, or arrangements that the board considered in determining that the director is independent, the publication said.

The amendments eliminate the current NYSE standards that allow boards to adopt and disclose categorical standards to assist them in assessing independence, the publication said. ''However, we expect that the boards of many companies will continue to maintain these [categorical] standards, because they provide a useful tool for assessing director independence,'' it said.

Also, the NYSE's amendments clarify that ''interested parties'' who are not shareholders must also be provided with a method to communicate with the company's presiding director, or the non-management or independent directors as a group, the publication said.

This particular change is not unexpected, according to Quick, as many individuals are interested in ensuring that directors do not have any relationship with a company whatsoever to protect director independence and deter bias.

Director Relationship Disclosure May Invite Trouble. One significant problem with the new NYSE amendments lies with the requirement that companies must disclose almost every single one of a director's existing relationships, Quick said.

''In some situations, certain shareholders may overreact to any mention of a relationship in a proxy statement,'' Quick said.

The fact that the proxy advisor firm RiskMetrics has ''provided some comfort to many companies with its latest interpretation of what the group considers to be a relationship that will undermine independence,'' somewhat addresses this problem, Quick said.

''However, it remains that not all shareholders hold the same standards as RiskMetrics when it comes to director independence,'' Quick said.

Companies Should Maintain Investor Relations. To address disclosure and other governance issues, many companies are making themselves more available to shareholders in various ways, according to Quick. ''While companies are open to communicating with shareholders, it is important that shareholders reciprocate interactions,'' he said.

It is possible that companies may see shareholders voice some surprising independence related issues, Quick said. ''While maintaining a dialogue with shareholders is crucial, companies must try to avoid becoming overly distracted,'' he said.

Also, ''NYSE companies should review their proxy disclosures and governance documents (including committee charters and D&O questionnaires), to determine whether any section references to the NYSE listing standards need updating,'' the publication said.

Companies also should consider whether they will eliminate disclosures about the filing of CEO certifications and stop providing hard copies of governance documents upon request, the publication said. However, companies may want to continue providing hard copies as a matter of good investor relations, it said.

Boards Struggle with CEO Succession Disclosure. Public company boards continue to express frustration about other disclosure issues including the exposure of CEO succession planning details as described in a recent SEC legal bulletin, Quick told BNA.

The SEC's Division of Corporation Finance in an Oct. 27 legal bulletin stated that companies generally may not rely on Rule 14a-8(i)(7) to exclude a proposal on CEO succession planning (7 CARE 1283, 10/30/09).

Many boards are not comfortable with CEO succession planning because it tends to involve sensitive personnel issues, Quick said.

''For example, in the context of compensation disclosure where the SEC has pushed for information about how discretionary bonuses are determined, boards have not been excited about having to reveal sensitive personnel issues in public filings,'' Quick said.

CEO succession disclosure generally includes revealing a CEO's planned retirement date, the board's considerations regarding the situation, and board's list of potential candidates, Quick said. ''I may be wrong, but this disclosure may not reveal worthwhile or specific information,'' he said.

''My speculations on this issue are based on what I have heard from companies thus far. This topic, of course, is still in the early stages of development,'' Quick said.

By Tina Chi

The Gibson Dunn publication is available at http://gibsondunn.com/publications/Pages/SECApprovesAmendmentsToNYSECorpGovernanceListingStandards.aspx.

The staff bulletin is available on the SEC's website at http://www.sec.gov/interps/legal/cfslb14e.htm.

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