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Revisiting Your Key Corporate Governance and Disclosure Policies

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A number of important regulatory, legislative, and market developments arising since the onset of the financial crisis have made this an ideal time to revisit your key corporate governance and disclosure policies in order to determine whether changes should be made to reflect current law, standards, or best practices, and to determine whether additional policies should be implemented in light of recent events. Many of these key policies are critical to help protect the company and its employees from potential securities law violations, and to provide assurance to investors and others that the company is maintaining an appropriate “tone at the top” through the implementation of the latest corporate governance best practices.

INTRODUCTION

Much like the financial scandals that brought about the enactment of the Sarbanes-Oxley Act of 2002, the recent financial crisis has focused attention on the corporate governance and disclosure practices of all public companies. Following the enactment of the Sarbanes-Oxley Act, public companies embarked on an effort to revise or document for the first time many key corporate governance and disclosure policies, whether due to SEC disclosure requirements, listing standards or as a result of evolving standards of best practices. These policies should not be static, but rather should continually be reassessed in light of a changing legal landscape and the company’s needs. Against the backdrop of the recent financial crisis and the related legislative and regulatory responses, and given the recent initiatives by shareholders and proxy advisory firms, now is an ideal time for companies to revisit many of these policies to determine whether revisions should be made to existing policies or whether new policies are needed. In addition, when reassessing its policies, a company should not overlook the need to revisit the methodology used for communicating and training employees on the policies in order to ensure that those impacted by the policies fully understand what is required, how to comply, and the potential consequences of non-compliance.

There is no one-size-fits-all approach to corporate governance and disclosure policies. The following suggestions may or may not be applicable to your company based on its individual circumstances. Nevertheless, it is useful to compare your company’s policies to the latest standards to ensure that best practices are considered and implemented, as appropriate.

INSIDER TRADING POLICY

Background

Concerns about insider trading are by no means a new issue for public companies. In light of the mandates of the Insider Trading and Securities Fraud Enforcement Act of 1988, general corporate compliance considerations for directors seeking to fulfill their fiduciary duties, and concerns about reputational risks arising from potential insider trading claims, insider trading policies have become a mainstay of corporate compliance programs.

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Recent trends with enforcement proceedings brought by the U.S. Securities and Exchange Commission (“SEC”) and criminal proceedings brought by federal prosecutors have demonstrated a renewed interest in insider trading cases, with a particular focus in recent months on large and complex insider trading rings involving high-profile individuals. In 2009, the SEC filed 35 insider trading actions and federal prosecutors brought criminal charges involving insider trading against 31 individuals. These cases have involved parallel civil and criminal proceedings, aggressive penalties, and in some cases, an expanded scope of insider trading law. Overall, this recent insider trading activity is reminiscent of the Ivan Boesky-related scandals of the 1980s in both the scope of the investigations and the level of media attention.

One of the notable developments with these recent insider trading cases are the allegations against employees (including high profile employees) of public companies that undoubtedly had robust insider trading policies in place. This is a reminder that simply having a policy in place is not sufficient if the policy is not promoted and enforced within a company. The increased level of enforcement activity provides a good opportunity to revisit the insider trading policy, both in terms of its content and the way in which employees are trained on the applicability of the policy to them.

In addition to concerns about stepped-up enforcement efforts, the financial crisis has particularly highlighted practices that are worth revisiting in the context of insider trading policies, including the practice of allowing employees to hedge, pledge, or sell short the company’s securities, or engage in derivative transactions that have the same or similar effect. These activities can have significant consequences both for the employee and the company, and thus now warrant a closer look.

Potential Considerations for Insider Trading Policies

While there are many considerations that should be taken into account in drafting or revising an insider trading program, several key areas should be reviewed in light of recent events.

Pre-clearance Requirements and Blackout Periods – Many companies have pre-clearance requirements and a trading blackout period. The pre-clearance requirements of an insider trading policy generally require directors, officers, and certain employees to pre-clear all of their trades in the company’s securities with a designated officer of the company. A trading blackout period is defined as a specific period of time when the company’s officers, executives, and certain employees are prohibited from trading in the company’s stock, except for specific exceptions. The date for beginning blackout periods may range from as early as 30 days before the end of the quarter to the end of the quarter or even, in some cases, a day or two after the end of the quarter, depending largely on the specific nature of the company’s business. Today, blackout periods will typically last until the market has had time to absorb the earnings release and reflect the information from the release in the stock price, which typically may be from one to three trading days after the earnings release. In light of recent events, companies should evaluate whether additional executive officers or employees should be covered by pre-clearance requirements and blackout periods in light of their potential direct or indirect access to material non-public information. In addition, companies should consider adopting specific procedures that would impose blackout periods on selected employees in connection with specific events, such as during the consideration of major strategic decisions, including contemplated acquisitions or dispositions, as well as potential customer wins, vendor problems, or other potential material events. In the case of special blackout periods, it is important to evaluate employees’ abilities to access potential material non-public information, and, in some cases, a blackout on trading may be appropriate for all employees and directors. In this regard, it is important for employees to understand the significant ramifications that can result from disclosing pending transactions or other special situations to co-workers, family members, or others when a blackout period has been imposed.

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Sharing Information About and Trading in Securities of Other Companies – While the focus of the insider trading program should be on trading in the company's securities, it is also important for the insider trading policy to contain provisions (or alternatively to include provisions in the code of conduct) which make clear that employees have an obligation to maintain the confidentiality of information about companies that may potentially be acquisition targets, business partners, vendors, customers, etc., when the information is derived from the company's business relationship with those entities. In this regard, employees should be advised through the policy that they should not trade in the securities of other companies based on information derived from their course of dealings with those companies.

Pledging, Hedging, Short Sales and Other Similar Activities – Significant market swings in connection with the financial crisis focused attention on the issues arising in connection with the practice of pledging shares by executives of public companies. The last time this issue received so much attention was in the midst of the WorldCom scandal, when Bernie Ebbers, the former Chairman and CEO of WorldCom, was forced to liquidate his considerable holdings of WorldCom stock as the price rapidly declined following disclosure of the scandal. The pledging of securities has, in some circumstances, raised concerns as to whether the executive's or director's interests remain aligned with shareholders through the equity awards obtained by the executive. Similar concerns are often raised with hedging arrangements or short sales of the company's securities. Additional considerations include the potential adverse public perception of executives and directors engaging in these types of transactions and the potential for liability resulting from market sales of securities subject to these arrangements. As a result, some insider trading policies include express prohibitions or restrictions with respect to pledging, hedging, short sales, and similar activities (including through the use of derivatives). Companies need to carefully consider their responses to these trends, particularly in light of the fact that there are situations where an appropriately-tailored hedging transaction may be appropriate for an individual, and potential concerns with respect to that transaction can be addressed through, for example, the adoption of a Rule 10b5-1 plan.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") requires the SEC to adopt rules requiring disclosure of whether any employee or director is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities granted as compensation or held directly or indirectly by the employee or director. This disclosure may cause companies to consider adopting policies or adding provisions to existing insider trading policies or codes of conduct to specifically address these types of transactions. Among the options that boards will likely consider include: (a) prohibiting hedging transactions for employees and directors; (b) subjecting hedging transactions to a pre-approval process; (c) restricting the types of hedging transactions that may be undertaken; or (d) continuing to permit hedging transactions without any specific policy on their use.

Confidentiality and Personal Responsibility – The policy should make clear that the imposition of any special blackout period or the fact that any intended trade has been denied pre-clearance should itself be treated as confidential information, and should only be disclosed to those persons with a need to know that information. Further, the policy should place employees and directors on notice that, in all cases, the responsibility for determining whether an individual possesses material, non-public information rests with that individual, and pre-approval of a transaction does not constitute legal advice and does not in any way insulate an individual from liability under the securities laws.

Rule 10b5-1 Plans – Rule 10b5-1 trading plans, when properly adopted, have become an effective means for insiders to continue to trade in their company's securities even when they are aware of material non-public information and even during a blackout period. An effective insider trading policy should specifically acknowledge the use of Rule 10b5-1 plans as an exception to the general prohibitions on trading while in possession of material non-public information. In light of

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recent attention paid to Rule 10b5-1 plans by the SEC's Division of Enforcement and in the course of private litigation in the courts, a company may also want to consider providing for some specific parameters for Rule 10b5-1 plans in the insider trading policy or in a separate Rule 10b5-1 Plan policy. Such parameters might include: (1) specification of when a plan may be entered into, such as only outside of a blackout period; (2) pre-approval procedures for the plan; (3) a cooling-off period before the first trade under a Rule 10b5-1 plan is permitted to occur, which might range from 14 to 90 days; (4) an admonition regarding the termination of, and the entry into new successive trading plans, as well as a mandatory waiting period following the termination of a plan before a new plan may be adopted, so as not to call into question the individual's good faith in adopting the first plan; and (5) limitations on modifications to plans, including subjecting such modifications to the same standards applicable for the termination of a plan and entry into a new plan. Companies should also consider adopting a policy requiring disclosure of the entry into Rule 10b5-1 plans, given that such disclosure may ultimately prove beneficial in the event of private securities litigation, because a court can take judicial notice of publicly disclosed plans in considering allegations of scienter.

Implementing Effective Audit Procedures – Given the significance of a potential breach of an insider trading policy, it is important to establish appropriate audit procedures that will not only serve to detect potentially problematic trades, but will also serve as a deterrent against violations of the policy and federal securities laws. Today, with significant advances in technology, there are available tools that companies could use to facilitate the audit of employee trades and compliance with the policy.

Training and Awareness – Perhaps the most important element of implementing an effective insider trading program is to take all of the steps necessary to ensure that executive officers, directors, and employees understand and are aware of the policy at all times. This may involve regular training regarding the policy, the inclusion of the policy in relevant procedures manuals, and revisiting the policy periodically with employees so that they do not forget the parameters of the policy. Any changes to the policy should be promptly communicated to executive officers, directors, and employees. It is critical that any training and awareness efforts focus on the potential consequences for the individual and the company in the event of an insider trading issue.

REGULATION FD POLICIES

Background

When Regulation FD was adopted in 2000, some companies adopted formal policies to govern the conduct of communications that could potentially implicate Regulation FD. For those companies that did adopt such policies, now may be a good time to revisit those policies in light of SEC enforcement actions regarding Regulation FD and recent Compliance and Disclosure Interpretations issued by the Staff of the Division of Corporation Finance. For companies that have not adopted a policy governing compliance with Regulation FD or a more broadly applicable investor relations or public communications policy, the SEC's recent guidance and enforcement activities should act as the impetus to now adopt a formal policy and ensure that executives, directors and employees are adequately trained to comply with Regulation FD.

With respect to the SEC's enforcement efforts since the adoption of Regulation FD, several key concepts should be considered and factored into the drafting or updating of a Regulation FD policy. First, it is evident from the SEC's actions that private meetings with analysts or institutional investors are particularly fraught with risk from a Regulation FD perspective, and as a result special precautions should be considered whenever such meetings take place. It is important

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to remember that any determination as to whether or not material non-public information was communicated during a private meeting with analysts or investors will be made by the SEC in hindsight, with the benefit of looking at a myriad of external evidence, such as stock price movements or the recollections of those who were attending the meeting, each of which may suggest material information may have been conveyed at the meeting. Such evidence, in the SEC's view, could include not only the actual statements made by company representatives but also the tone, demeanor, or body language of the individual.

Another key consideration when crafting a Regulation FD policy (or revising an existing policy) is that, consistent with both past enforcement actions and the Staff's informal guidance, it should still be acceptable to reaffirm guidance privately within a relatively short time after guidance is announced publicly, as long as there have been no subsequent intervening events that would call into question the prior public guidance (e.g., the loss of a significant customer or the booking of a larger than anticipated order) or the timing of the guidance or the context in which the confirmation is made conveys additional material information; however, outside of those parameters, there may be significant risks associated with engaging in private discussions with analysts and investors regarding guidance.

With the variability of financial results driven by the recession and the financial crisis, executives have increasingly found themselves in situations where they risk violating Regulation FD by providing selective disclosure with respect to prior guidance. Analysts and investors often press for information as to management's level of comfort with prior guidance, particularly in circumstances where there is a substantial level of uncertainty about future results, raising the potential for violations of Regulation FD depending on the circumstances in which these discussions arise. As a result, companies should consider whether it is prudent to implement a "no comment" policy regarding confirmation of prior guidance, particularly in those situations where there is a heightened risk for selective disclosure regarding the prior guidance.

Further, in the course of the financial crisis, many companies have also considered whether to suspend their prior guidance or to otherwise change their guidance practices, given the many uncertainties that they face. In general, any change to guidance practices, including the suspension of current guidance, should be announced in a manner that complies with Regulation FD, preferably in the same manner in which the company typically provides guidance.

In Release No. 34-58288 (August 1, 2008), the SEC provided three considerations for determining whether information posted on a corporate website is considered "public:" (1) is a company's website a "recognized channel of distribution"?; (2) is information posted in a manner calculated to reach investors?; and (3) is information posted for a reasonable period of time so that it has been absorbed by investors? In the context of whether a website posting satisfies the public disclosure requirement of Regulation FD following the selective disclosure of material, non-public information, the guidance from the SEC's release indicates that companies must consider whether website postings are "reasonably designed to provide broad, non-exclusionary distribution of the information to the public." In conducting this analysis, a company must examine the first two factors referenced above, and also must consider whether its website is capable of meeting the simultaneous and prompt timing requirements under Regulation FD once a selective disclosure has been made. Companies have continued to struggle with applying the SEC's guidance in practice, given the difficulty in making judgments about the nature of a company's website. As a result, practices have not significantly changed regarding how information is disseminated in order to make the information public or to comply with Regulation FD's public disclosure requirement.

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Potential Considerations for Regulation FD Policies

A Regulation FD policy (or a broader investor relations policy) should address in a comprehensive manner, the procedures for dealing with situations where a potential Regulation FD violation could occur. Key provisions of an effective Regulation FD policy include:

Controlling the Flow of Material Non-Public Information – Regulation FD is focused on the communication of material non-public information to specified persons or institutions that could use that information; therefore the core of an effective Regulation FD policy is the control of the flow of information within the company and in communications outside of the company. An important aspect of controlling information is substantially limiting the number of officers, directors, or employees that are authorized to speak publicly on behalf of the company, and to make clear that no other officers, directors, or employees should have any communication with any of the persons or institutions enumerated in Regulation FD. Implementation of this policy could mean, for example, limiting the authorized persons specified in the Regulation FD policy to the CEO, the CFO, and one or more members of the board of directors, as well as the person or persons involved in investor relations and public relations.

Another key element for controlling the flow of material non-public information is to establish a “central clearinghouse” for the information by appointing a compliance officer for the purposes of the policy. The compliance officer should be responsible for administering and directing compliance with Regulation FD and the policies and procedures set forth in the policy. Any questions relating to compliance with Regulation FD should be directed to the compliance officer, and the policy should provide that all public disclosures should be approved by the compliance officer or someone designated by the compliance officer. The compliance officer should also designate other officers or senior-level employees in each department or operating group to be responsible for ensuring that the compliance officer is aware of developments within that department or group that may be material. The best practice is to appoint an executive officer or officer as the compliance officer, and the compliance officer function need not necessarily be performed by the general counsel or other in-house counsel. When the compliance officer is not within a company’s legal function, it is important that the policy provide that determinations as to materiality and disclosure should be made by the compliance officer in consultation with the company’s internal and external legal counsel.

Further, companies should be cognizant when implementing their Regulation FD policy and overall disclosure controls and procedures that disclosure of material information is required only in situations where there is an affirmative disclosure obligation, which could arise, for example, as a result of a duty to: (1) comply with specific SEC and securities exchange disclosure requirements; (2) disclose material information before trading in the company’s own securities; (3) correct inaccurate prior statements; (4) speak truthfully and not mislead once a statement of material fact is made; (5) comply with Regulation FD because of, e.g., an inadvertent disclosure of material non-public information; and (6) under certain circumstances, to update previous statements made about new developments. Unless one of these duties applies, United States federal securities laws generally do not require that public companies disclose material corporate developments (including material negative developments) as soon as they occur.

The Role of Directors in a Regulation FD Policy – Over the last several years, continuing concerns with corporate governance have led to greater engagement between directors and shareholders. During this time, shareholders have sought greater input into governance practices utilizing, among other practices, “vote no” and withhold campaigns against key company proposals and some or all of a company’s director nominees. With the enactment of the Dodd-Frank Act, shareholders will be able to express views with respect to executive compensation through an advisory vote on executive

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compensation beginning in the 2011 proxy season. In order to directly address the concerns of shareholders, directors are increasingly finding themselves in situations where direct communication with significant shareholders is necessary.

Concerns have been expressed as to whether this trend toward greater director involvement in direct communications with shareholders could potentially raise the risk for Regulation FD violations involving the information communicated by directors. In a recent Regulation FD Compliance and Disclosure Interpretation issued by the SEC Staff, it is noted that if directors are authorized to speak on behalf of a company and those directors plan to speak privately with a shareholder or a group of shareholders, then the company should consider implementing policies and procedures that are intended to avoid potential FD violations. The Staff suggests that some policies that should be applicable to director discussions might include a pre-clearance policy on the discussion topics with a shareholder, having the issuer's counsel participating in the meeting, or obtaining an express agreement from the shareholder(s) to maintain the disclosed information in confidence.

Pre-approval of Presentations – The policy should provide that pre-approval is required for any presentations to analysts or investors, no matter what the forum, and that the content of any such presentations be approved by the compliance officer. Further, requests for information, comments, or interviews made to officers, directors, or employees should likewise be presented for consideration by the compliance officer (subject to some limited exceptions for normal course communications). Review and pre-approval of presentations may also be necessary in situations beyond the typical analyst presentations that are often viewed as creating the most significant risks from a Regulation FD perspective. For example, when presentations are made to groups such as customers, vendors, distributors, etc., those parties may also be investors in the company, and therefore the potential for Regulation FD violations could arise. For this reason, it is important that legal counsel be aware of all upcoming presentations so that the prospect for a potential FD situation can be evaluated.

Communication with Analysts – An effective Regulation FD policy should provide that earnings guidance is not to be provided to securities analysts, unless the guidance is provided strictly in accordance with the Regulation FD policy. The policy should also specify that, in general, the company should not review analyst reports, and that any review actually undertaken by the company or individuals acting on its behalf should be limited to historical items and similar factual matters. The Regulation FD policy should also make clear that any updates to the previously disclosed material non-public information should be done only through the procedures set forth in the Regulation FD policy. The Company should consider whether a strict “no comment” policy should be adopted with respect to requests from analysts or investors to update guidance or to affirm guidance. To the extent the company does not adopt a strict “no comment” policy, the company and its counsel should carefully consider how such updates are to occur and what specifically will be communicated in the update.

Social Media – The proliferation of social media, including blogs, Twitter, Facebook, LinkedIn and other similar outlets, raises particular concerns with regard to potential Regulation FD issues. Companies need to consider whether they should specifically address the use of social media in Regulation FD policies, including whether prohibitions, restrictions or editorial oversight should be implemented to govern the use of social media by those persons authorized to speak for the company. This remains an evolving area that must be continually monitored, as the methods for interacting with shareholders, analysts and others are rapidly changing.

Ongoing Compliance Monitoring – Given the need to quickly disclose information that may have been inadvertently released contrary to the prohibition in Regulation FD, vigilant monitoring of a company's communications, trading activity, and communications by market participants is necessary at all times. A company's Regulation FD should specifically

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contemplate procedures that can be implemented to monitor for unusual trading activity in the company's securities, analyst and investor communications, and market rumors to determine if any corrective disclosure is necessary. Once a potential Regulation FD violation is identified, the compliance officer, company counsel, and senior management should meet to determine what actions must be taken, including the release of information or corrective disclosure, and potentially self-reporting to the SEC.

Training – Much like an insider trading policy, it is critical that a Regulation FD policy be adequately communicated to officers, directors, and employees, and that those individuals understand the application of the policy and the potential consequences for noncompliance. An appropriate “roll-out” of the Regulation FD policy is likely to include regular training regarding the policy, the inclusion of the policy in relevant procedures manuals, and the periodic “refreshers” regarding the policy for executive officers, directors, and employees so that they are fully aware of the scope of the policy and will be sensitive to reporting any potential violations or concerns to the compliance officer.

EXECUTIVE COMPENSATION POLICIES

Background

Concerns with compensation practices at financial institutions involved in the financial crisis quickly spawned concerns more broadly with compensation practices at all public companies, thus giving rise to a need to revisit or establish new policies focused on executive compensation and the process by which executive compensation is determined.

While the concerns with executive compensation are wide-ranging, some very particular concerns have been articulated as a result of the financial crisis, and potential means of addressing those concerns have thereafter been advocated by investors and government officials. These concerns focus on whether the compensation of executive officers is tied with the long-term interests of shareholders, whether the company has the ability to recoup compensation that was paid based on erroneous financial results or that was paid without adequately taking into account the time horizon for risk, excessive perquisite compensation or other compensation elements that are not driven by performance, generous severance and post-employment compensation, and the independence of compensation consultants in the compensation-setting process.

The following are policies that, in light of the developments referenced above, a company may want to consider revising or implementing:

Stock Ownership Guidelines – As a result of concerns that executive officers' interests are not properly aligned with shareholders' interests, many companies have adopted stock ownership guidelines for executive officers and directors. Companies are now considering raising the required stock ownership levels in these guidelines. Some companies have also adopted more stringent requirements known as “hold to retirement” or “hold through retirement” policies, which require that executive officers hold a substantial portion of their equity compensation to or through their retirement from the company.

With highly volatile stock prices over the past two years, companies with stock ownership guidelines specifying a fixed dollar amount of holdings have in some cases had to revisit their policies as the value of executive officers' holdings declined. Companies have, in some instances, implemented stock ownership guidelines based on a fixed number of shares as opposed to dollar amounts, or have reserved discretion to the Compensation Committee to adjust dollar value guidelines or deadlines to take account of market conditions.

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Clawback Policies – Clawback policies (and similar provisions in executive compensation arrangements) are being adopted with increasing frequency, as companies seek to ensure that executives are not in a position to keep compensation that was awarded to them based on what later turns out to be erroneous financial results. Section 304 of the Sarbanes-Oxley Act originally focused significant attention on clawback policies, and now the presence of broader clawback provisions as part of the TARP legislation and the Dodd-Frank Act (which will be applicable to all listed companies), has reignited interest in clawbacks as an effective means for discouraging inappropriate conduct. In the current climate, even those companies that have previously adopted clawback policies and provisions need to re-evaluate those measures, because the triggering events may be too narrow and fail to deal with circumstances where it turns out—well after compensation decisions have been made—that the executive has engaged in conduct which ultimately harms the company and shareholders.

Perquisite Policies – Recent economic and financial pressures have driven many companies to review every aspect of their budget. In light of continued investor criticism, it has become increasingly more difficult for companies to justify the need for expensive perquisites as an element of compensation, particularly when fundamental business needs cannot be funded. These heightened cost concerns come at a time when perquisites are increasingly being cut back, and federal legislation and investment policies are targeting many perquisites, including the highly criticized use of aircraft by companies that accepted TARP funding. Given these fundamental shifts in attitude, compensation committees are increasingly reviewing policies with respect to perquisites to consider whether perquisites should be maintained and whether, and to what extent, it may be appropriate for the company to discontinue particular perquisites or to require repayment of the cost of perquisites.

Severance and Post-employment Benefits – The Dodd-Frank Act's requirement for an advisory vote on golden parachute payments in connection with any shareholder vote on a merger or other extraordinary transaction, as well as investor concerns about the size of severance and post-employment benefits, both focus attention on policies with respect to severance, change-in-control, and other post-employment compensation arrangements. In the past few years, companies have been revisiting provisions of employment and change-in-control agreements, replacing single trigger change-in-control provisions with double trigger provisions, so that benefits will only accrue upon both a change-in-control and a qualified termination of employment. Companies have also considered eliminating or limiting pension enhancements, tax gross-ups, severance benefits, and evergreen employment contracts. Moreover, some companies have adopted sunset provisions on severance and change-in-control benefits, recognizing that the need for such benefits presumably decreases the longer an executive stays with the company.

Compensation Consultant Independence – A lively debate has continued over the last several years as to whether business done by compensation consultants outside of their consulting with the company or compensation committee impairs the independence of the consultant. In December 2009, the SEC adopted rules requiring disclosure of fees paid to compensation consultants when they provide executive compensation consulting or additional services. The Dodd-Frank Act will require listing standards which provide that consultants or legal counsel ("Advisors") retained by compensation committees of publicly listed issuers to advise on executive compensation may only be selected after an issuer has taken into consideration independence factors to be established by the SEC. The legislation requires that such independence factors include: (a) provision of other services by the person who employs the compensation Advisor; (b) the amount of fees received as a percentage of an entity's total revenue; (c) policies designed to prevent conflicts of interest; (d) any business or personal relationship of the Advisor with a member of the compensation committee; and (e) any stock of the issuer owned by an Advisor. In light of these developments, companies have begun to adopt specific

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policies designed to reduce potential conflicts of interest with compensation consultants. Such policies may prohibit the provision of additional services to the company, may provide that some de minimis level of services may be provided, and/or establish a process for pre-approval of any additional services. These policies also may require that compensation consultants provide a certification to the company as to their independence to help support the company's disclosure controls and procedures relevant to this issue.

EMERGENCY SUCCESSION PLANNING

Background

The past three years have been marked by increasingly rapid turnover in the position of CEO, as well as other senior management positions. This turnover has in some cases happened very quickly, particularly when associated with scandals, potential illegal activity, the loss of investor confidence, or other crisis events. At the same time, there has been increasing media scrutiny of the loss of senior executives (even if on a temporary basis) due to illness, incapacity, or death. Further, succession planning has become increasingly of interest to investors, and the SEC Staff recently focused additional attention on the topic of succession planning with Staff Legal Bulletin No. 14E, which indicated that shareholder proposals addressing CEO succession issues would no longer be excludable as "ordinary business."

In considering an overall succession plan for a company and the relationship of that plan to the company's strategic needs, it is often too easy to forget about the potential for significant unexpected occurrences that could alter the make-up of management overnight and have a profound effect on the company's short-term valuation and long-term plans. As a result, an emergency succession plan remains a critical component of any company's overall management succession process. While not all public companies have implemented emergency succession plans, the implementation of such plans appears to be on the rise.

The principal purpose of an emergency succession plan is to ensure that decisions about successor appointments are made in advance of an unexpected event, such as the illness, incapacity, death, resignation, or termination of the CEO or other critical members of senior management. Given that these unexpected occurrences could potentially have an adverse impact on a company's stock price, ongoing operations, and short-term and long-term prospects, it is important that the board establish defined lines of succession that can be quickly implemented when necessary.

The board should carefully consider the design and operation of an effective emergency succession plan well in advance of ever needing to implement the plan, and the board should then review the plan at least annually and more frequently when there is an orderly change in management or in the event of some significant event.

An emergency succession plan may be very different from the company's long-term succession plan. It may be that case that different executive officers or directors are identified to succeed a CEO or other executive officers on an interim basis as compared to the long-term succession plan, because an effective emergency succession plan is designed to ensure a seamless transition of management during a crisis situation, rather than seeking to meet the company's long-term strategic objectives.

Potential Considerations for Emergency Succession Plans

In designing an effective emergency succession plan, it is important that the plan address a number of key areas.

Oversight – A committee of the board, such as the compensation committee or the nominating and corporate governance

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committee, is typically vested with responsibility for the emergency succession plan. While that committee is deemed responsible for the plan, the full board should remain responsible for any appointments (including permanent or interim appointments) under the plan.

Scope – An effective emergency succession plan contemplates not only succession in the event of unexpected occurrences such as death, disability, and resignation or removal under unexpected circumstances, but also succession in the event of temporary, unplanned absences (which may be defined as exceeding a specific time period, e.g., six months), such as when an individual expects to be out of the office on an extended basis, for example due to a treatable illness.

Appointments – A plan should provide that, unless otherwise specified by the board, all appointments will be made on an interim basis, so as to preserve flexibility for the board to make permanent appointments at the time of the succession event, particularly in situations where the established lines of succession are consistent with long-term succession plans. Generally, plans will afford the board discretion to ascertain the term of any interim appointments, the scope of authority of successors, and the compensation for successors under the emergency succession plan and other company policies. An emergency succession plan should also provide that appointments made by the board occur within a very short time period, so as to minimize the amount of uncertainty associated with the succession event. A time period of two business days after the notice of a succession event is received may be reasonable, although a different period may be appropriate depending on a company's individual circumstances.

Coverage – While many emergency succession plans focus on the succession of the CEO, it may also be appropriate to provide in the plan for the succession of other executive officers, particularly when other specified executive officers (such as the president or CFO) are slated to succeed the individual serving as CEO. In order to preserve maximum flexibility upon the occurrence of a succession event, it is often appropriate to identify two or three executive officers who are designated as successors, in order to address the potential that more than one executive officer could be subject to the unexpected event at one time.

Preserving Flexibility – While an effective emergency succession plan is designed to provide an important level of certainty for the board when a crisis arises, it is critically important that the board preserve flexibility to adapt its actions with respect to management succession to the particular situation that the board faces. Even with an emergency succession plan in place, the board will need to look at the overall circumstances arising in connection with the unexpected occurrence, and should carefully consider the planned succession in light of those circumstances. For example, a board could face a situation where they need to “clean house” in the face of some illegal conduct that has involved the CEO and those slated to succeed the CEO under the emergency succession plan.

Confidentiality – It is recommended that the terms of an emergency succession plan remain confidential, with access limited to the board and a limited group of employees who have a need to know about the existence of the plan in order to carry out the plan in the event of an unexpected occurrence. While there is no requirement to publicly disclose the existence or terms of an emergency succession plan, a company may want to consider revising its corporate governance guidelines and proxy statement disclosures to note the existence of an emergency succession plan, so that investors and proxy advisory firms can be assured that the board is attentive to this critical issue.

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RELATED PARTY TRANSACTION POLICIES

Background

Related party transaction policies have been a particular area of focus since the SEC's 2006 changes to the executive compensation and related party transaction disclosure rules, which for the first time required issuers to describe the material features of a company's policies and procedures for the review, approval, or ratification of related party transactions. The SEC rules specify examples of information that may need to be disclosed regarding such policies and procedures, including the types of transactions covered by the policies and procedures, the standards to be applied pursuant to the policies and procedures, the directors or groups of directors with responsibility for applying the policies and procedures, and whether the policies and procedures are in writing or otherwise evidenced. In addition, the disclosure requires the identification of any related party transactions occurring since the beginning of the last fiscal year for which the policies or procedures did not require review, approval, or ratification, or where the policies and procedures were not followed.

Related party transactions, and the board's involvement in oversight of related party transactions, have been of interest to the SEC's Division of Corporation Finance and Division of Enforcement in recent years, and it is likely that, in the aftermath of the financial crisis, disclosure regarding related party transactions and the board's level of involvement in reviewing and approving such transactions will continue to be an area of focus.

Potential Considerations for Related Party Transaction Policies

Some of the potential areas that companies may want to consider in connection with related party transaction policies are as follows:

Integration with the Board's Risk Management Policies – With an increased focus on risk oversight, and given the unique potential risks presented by related party transactions, it is increasingly important for the board to consider how the related party transaction review and approval policy fits with the board's oversight of risk management policies and the company's code of conduct. In this regard, the board should consider whether the appropriate committee of the board is responsible for oversight of related party transactions and whether sufficient information regarding these transactions and the approval process is provided to the board on a regular basis.

Scope of the Policy – It is often useful to have the related party transaction policy cast a wider "net" than specifically picking up only the transactions contemplated by the definition included in Item 404(a) of Regulation S-K. In this regard, some policies do not utilize a materiality qualifier in defining "related party transaction" for the purposes of the policy, so that a broader group of transactions is brought to the attention of the board without interposing management's determinations as to materiality of the transaction or a related party's interest.

Parameters – It is helpful for the related party transaction policy to specify the parameters under which transactions will be considered, such as whether the board will specifically consider whether the terms of the transaction are no less favorable than terms generally available to an unaffiliated third party under similar circumstances. The policy may also specify the information that should be provided regarding the related party transaction and how that information is to be provided to the designated committee or to the board. Other factors may also be specified, such as the extent of the related party's interest in the transaction or the expected benefits of the transaction for the company.

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Pre-Approvals – In order to facilitate effective implementation of the policy, it is often advisable to designate specific transactions as pre-approved, such as transactions that are specifically identified in exceptions noted in instructions to Item 404(a) of Regulation S-K, or transactions meeting certain quantitative thresholds for which the board has determined that individual approval for each transaction is not necessary. The policy may also vest pre-approval authority with a particular director (such as the chair of the committee tasked with overseeing the related party transaction policy) for specified transactions. A pre-approval approach is usually preferable to providing exceptions to the policy for certain transactions from the policy, given the potential disclosure consequences of not subjecting certain transactions to review, approval or ratification.

Recusal – The policy should mandate that no director who is a related party involved in a transaction subject to the policy should participate in the discussion or approval of the related party transaction, except to the extent that it is necessary for that director to provide information about the transaction.

Follow-up – It is critically important that once an effective related party transaction policy is in place, the company and board continue to follow the policy on a consistent basis with respect to all potential related party transactions, and that appropriate disclosure controls and procedures are implemented to ensure that any transactions reportable under Item 404(b) of Regulation S-K are identified and reported when necessary. For ongoing related party transactions, it may be appropriate for the policy to provide that the board will review and assess the ongoing relationships on a periodic basis (at least annually), to determine if the transaction remains within the guidelines and is consistent with what the board originally approved.

CONCLUSION

The financial crisis, the recently enacted Dodd-Frank Act, and increasingly active shareholders focused on governance and compensation issues have made it all the more important to now have the most up-to-date key corporate governance and executive compensation policies. Please feel free to contact Morrison & Foerster LLP if you need any assistance with evaluating your policies in light of new requirements, perspectives, and best practices.

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