



The Public Company Adviser

Our Valued Friends and Clients:

We are happy to present the inaugural edition of *The Schiff Hardin Public Company Adviser*, the quarterly newsletter of Schiff Hardin's Public Companies Group. Each quarter we will issue a collection of articles to provide information and insight on the most pressing legal issues of the day for public companies, as well as to update you on developments and to highlight some of the key work Schiff Hardin is doing in the public companies arena.

Most issues of *The Schiff Hardin Public Company Adviser* will be focused around a central theme. In this Fall 2010 Edition we focus primarily on corporate governance matters.

- **Dodd-Frank Wall Street Reform and Consumer Protection Act** — We first present a discussion of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act and its impact on public companies in the areas of corporate governance and executive compensation. Although the Act largely focuses on the financial services industry, the impact of this "game-changing" piece of legislation is far-reaching and will impact all public companies for years to come. (See Page 2)
- **Governance Risk Indicators (GRId)** — We then discuss the recently launched Governance Risk Indicators (GRId) of RiskMetrics Group, its implications for public companies and what steps you should take now in response. (See Page 6)
- **Proxy Access** — We then provide a summary of the proxy access rules recently adopted by the SEC, the implications of the rules for public companies and actions you should consider taking now to prepare for the altered landscape those rules have created. (See Page 8)
- In the **Also of Interest** section, we have highlighted a few additional developments in the public companies arena. (See Page 13)
- Finally, in the **Spotlight on Schiff Hardin** section, we provide a brief review of some of our most recent public companies work, highlight an upcoming program at Schiff Hardin and preview our Winter 2010 Edition of *The Schiff Hardin Public Company Adviser*. (See Page 15)

We hope you enjoy this first edition of *The Schiff Hardin Public Company Adviser* and find its content both informative and useful.

The Dodd-Frank Wall Street Reform and Consumer Protection Act and its Impact on Corporate Governance and Executive Compensation for Public Companies

Introduction

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). At over 2,300 pages, the Act is the most extensive financial regulatory reform in years. Although largely focused on regulating the financial services industry and capital markets, a number of provisions relating to corporate governance and executive compensation apply to all public companies. The following provides a brief overview of those sections of the Act most relevant to public companies.

A few of the provisions described below are effective immediately. In most instances, however, the Act requires further rulemaking by the Securities and Exchange Commission ("SEC") and, in certain instances, the national securities exchanges, before the provisions will become effective. In some cases, the SEC must act within 360 days, and in other cases, there is no prescribed deadline.

A number of the provisions described below expressly permit the SEC to exempt an issuer or class of issuers from the requirements imposed by the Act and require the SEC, in exercising its exemptive authority, to take into account whether the new requirements would disproportionately burden smaller reporting companies. How the SEC will exercise its exemptive authority remains to be seen.

Key Provisions

1. "Say-on-Pay" – Non-Binding Shareholder Votes on Executive Compensation

The Act requires a proxy, consent or authorization for a meeting of shareholders, for which the SEC's proxy solicitation rules require compensation disclosure, to include (1) at least once every three years, a non-binding shareholder vote to approve the compensation of the "named executive officers" (generally the CEO, CFO and three other most highly compensated executive officers), and (2) at least once every six years, a separate shareholder vote to determine whether future "say-on-pay" votes will occur every one, two or three years. Initial votes on say-on-pay and on the frequency of such votes must occur at the first annual or other shareholders meeting that occurs on or after January 21, 2011.

The Act does not expressly require the SEC to adopt rules implementing the required say-on-pay votes. The SEC may, however, adopt rules or provide guidance under its general rule-making authority.

2. Non-Binding Shareholder Votes on "Golden Parachute" Compensation

The Act also requires that any proxy or consent solicitation materials for a meeting at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed disposition of all or substantially all of a company's assets (1) contain clear and simple disclosure of any agreements or understandings that the soliciting person has with any "named executive officer" of the issuer or of the acquiring person (if the

issuer is not the acquirer) concerning any compensation that is based on, or otherwise relates to, the transaction being voted on, (2) disclose the aggregate total of all such compensation, and conditions under which it may be paid or become payable, and (3) provide for a separate non-binding shareholder vote to approve any such agreements, understandings and compensation (unless they were subject to an earlier non-binding “say-on-pay” vote on executive compensation, as described above).

These requirements apply to solicitations made under the SEC proxy rules on or after January 21, 2011. The Act expressly provides that the required disclosure is to be made in accordance with regulations promulgated by the SEC.

3. Compensation Committee Independence

The Act directs the SEC to issue rules requiring national securities exchanges to prohibit the listing of any equity security of a company if its board does not have an “independent” compensation committee. In determining the definition of independence, national securities exchanges must consider (1) the source of director compensation, including any consulting, advisory or other compensatory fee paid to the director by the company, and (2) whether the director is affiliated with the company or any of its subsidiaries or their affiliates.

The Act exempts a number of companies from the independence requirement, including “controlled companies” (a listed company in which more than 50% of voting power to elect directors is held by an individual, a group or another issuer), foreign private issuers that provide annual disclosure to shareholders of reasons that they do not have an independent compensation committee, limited partnerships, companies in bankruptcy proceedings, and open-end management investment companies registered under the Investment Company Act. The Act also permits the SEC and national securities exchanges to exempt particular relationships from the independence requirements, taking into account the size of the issuer and other relevant factors.

Not later than July 16, 2011 (360 days after the effective date of the Act), the SEC is required, by rule, to direct national securities exchanges to prohibit the listing of the equity securities of any company that is not in compliance with these requirements. The rules are required to include appropriate procedures giving a company a reasonable opportunity to cure any defects in its compliance with such requirements.

4. Independence and Role of Compensation Consultants and Advisers

The SEC is required to impose, or to direct national securities exchanges to impose, additional procedural and disclosure requirements on listed companies regarding a compensation committee’s use of compensation consultants, legal counsel and other advisers (collectively, “Advisers”). The compensation committee must have the authority, in its sole discretion, to engage Advisers, and the company must provide the compensation committee with appropriate funds to pay such Advisers. While Advisers are not required to be independent, the compensation committee must consider factors affecting the independence of an Adviser before making a selection. The SEC is required to identify, by rule, factors that affect the independence of Advisers, specifically including any business or personal relationship between an Adviser and a member of the compensation committee, and certain specified types of relationships between the employer of such Advisers and the company. The factors identified by the SEC must be “competitively neutral” among categories of Advisers and preserve the ability of compensation committees to retain any or all categories of Advisers.

The SEC is required to adopt rules implementing these requirements not later than July 16, 2011. The issuer's proxy or consent solicitation materials for any meeting occurring one year after the enactment of the Act must disclose whether the compensation committee has retained, or obtained the advice of, a compensation consultant, whether the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict, and the manner in which the conflict is being addressed. It is unclear what additional disclosure will be required, given that the SEC adopted new disclosure requirements in December 2009 relating to the use of compensation consultants by the compensation committee and management.

5. Executive Compensation Disclosures

The Act requires the SEC to issue rules requiring issuers to provide, in any proxy statement or consent solicitation material for an annual meeting of shareholders of the issuer, information that shows the relationship between executive compensation actually paid and the issuer's financial performance. This disclosure may include a graphic representation of the information.

The Act also directs the SEC to require disclosure of (1) the median of the annual total compensation of all of the company's employees, excluding the CEO, (2) the annual total compensation of the CEO, and (3) the ratio of those two amounts. The Act requires "total compensation" to be determined in accordance with Item 402(c) of Regulation S-K, as in effect on the day before the enactment of the Act. As a result, in determining the median of the annual total compensation of all of the company's employees, a company must take into account, for each such employee, all of the forms of compensation required to be reflected in the summary compensation table for the company's named executive officers that the company is required under current rules to include in its annual proxy statement.

The Act does not impose a time period in which the SEC is required to adopt rules implementing these additional disclosure requirements.

6. Compensation Clawback

The Act instructs the SEC to issue rules requiring the national securities exchanges to prohibit the listing of the securities of any issuer that does not develop and implement required "clawback" policies. Specifically, any issuer that is required to prepare an accounting restatement due to its material noncompliance with financial reporting requirements under the securities laws must recover any incentive-based overpayments based on the adjusted figures from any of its current or former executives who received incentive-based compensation (including stock options) during the three-year period preceding the date on which the issuer is required to prepare that restatement. Furthermore, the issuer must disclose its policy on incentive-based compensation based on financial information required to be reported under the federal securities laws. This requirement is much more sweeping than the clawback requirement in the Sarbanes-Oxley Act. The Act does not specify a time period in which such rules must be issued.

7. Disclosure of Employee and Director Hedging

The Act charges the SEC with issuing rules requiring each issuer to disclose in any proxy statement or consent solicitation material for an annual meeting of its shareholders whether its employees or directors (or their designees) are permitted to purchase financial instruments that are designed to hedge or offset any decrease in the

market value of equity securities granted by the issuer as compensation or otherwise held by the employee or director, directly or indirectly. The Act does not require disclosure of actual hedging transactions, but instead only the issuer's policies in this regard. The Act does not specify a time period in which such rules must be adopted.

8. Broker Voting of Securities

The Act amends the Exchange Act to revise broker voting requirements. Any exchange member that is not the beneficial owner of a security registered under Section 12 of the Exchange Act, and that has not received voting instructions from the beneficial owner, may not grant a proxy to vote the security with respect to the election of a member of the board of directors, executive compensation matters, or any other "significant matter," as determined by the SEC. These amendments will prohibit broker discretionary voting on any "say-on-pay" matters or the approval of "golden parachute" compensation.

9. Proxy Access

The Act gives the SEC authority to issue rules requiring that a solicitation of a proxy, consent or authorization by an issuer include shareholder-submitted director nominees. This provision does not mandate proxy access, but rather clarifies that the SEC has the authority to mandate proxy access if it so chooses. The SEC adopted proxy access rules on August 25, 2010. See "The Newly Adopted Proxy Access Rules and Implications for Your Company" on page 8.

10. Disclosures Regarding Board Chairperson and CEO Positions

The Act requires the SEC to issue rules requiring an issuer's annual proxy statement to disclose whether and why the issuer chose to combine or separate the positions of chairperson of the board and CEO. The SEC amended the proxy disclosure rules in December 2009 to require issuers to disclose their reasons for adopting their form of board leadership structure, including whether to separate chairperson and CEO positions. It is not clear what, if any, new disclosure will be required beyond the SEC's current rule.

Practical Insights

Even though final rules have not yet been adopted, there are some actions you can take now in light of the new law, including:

- Consider future compensation decisions in light of the fact that you will most likely have a say-on-pay vote at your 2011 annual meeting.
- Review whether any current compensation committee members might have any affiliations that would raise issues if the independence criteria are tightened.
- Review any current relationships between your company and any advisers to the compensation committee.
- Consider whether you should adopt or modify policies prohibiting or limiting hedging and pledging of shares and amend any insider trading policies.
- Although the actual adoption of changes should likely be delayed until specific rules are issued, consider preparing an inventory of plans that will likely need to be revised to provide for the required compensation clawback.

The RiskMetrics Group Governance Risk Indicators (GRId) and its Implications for Public Companies

Earlier this year, RiskMetrics Group (formerly Institutional Shareholder Services, or ISS) introduced its Governance Risk Indicators ("GRId") for public companies in the United States, Canada, U.K., France, Germany, Netherlands and Sweden. The GRId replaces RiskMetrics' previous Corporate Governance Quotient ("CGQ") — as of June 2010, CGQ is no longer in effect. RiskMetrics claims to have introduced GRId as a response to the recent financial crisis, asserting in its GRId FAQs¹, "We recognize that governance requirements, disclosures and company practices continue to evolve and investors are paying more attention than ever to how the companies they invest in are governed." Like the CGQ, GRId purports to measure a company's corporate governance-related risk using a specific methodology and scoring system. This article provides a refresher on the GRId methodology, its continuing implications for U.S. public companies, and some insights on how public companies should build an annual review of the GRId data and its impact on the public's evaluation of companies' governance practices into their best practices.

Methodology

GRId analyzes a company based on RiskMetrics' own proxy voting and other governance policies, as opposed to analyzing the company with respect to the practices of its index or industry peers, which was the CGQ methodology. For a U.S. company, the GRId evaluation is developed by asking a total of 63 questions in four categories: audit (six questions), board of directors (14 questions), shareholder rights (15 questions) and compensation (28 questions)². RiskMetrics derives answers to its questions for a particular company from the company's public filings with the Securities and Exchange Commission ("SEC"). Once RiskMetrics has compiled answers to the questions, point values are assigned for each answer from -5 to +5, with 0 being a neutral score satisfying RiskMetrics' defined standards and the positive numbers indicating an even greater alignment with such standards. Based on such scores, RiskMetrics assigns a level of concern, low (color coded green), medium (yellow) or high (red) with respect to the company's governance-related risks. This system of scoring differs from the single numerical score provided under CGQ.

There is a further weighting component to the GRId scoring system, which makes certain questions more significant than others. For example, each of the 28 compensation questions is weighted no more than 5% of the total, except the company's change-in-control severance trigger, which represents nearly 23% of a company's total compensation GRId score. In response to this question about change-in-control, points would be assigned as follows: (a) no change-in-control agreement is +3 points; (b) a single trigger or no information is -5 points; (c) a modified single trigger in an agreement that was amended or entered into the last year is -5 points;

¹ <http://www.riskmetrics.com/sites/default/files/FAQ-GRId-corporate.pdf>

² Within the four categories of questions, there are further subcategories. For example, the questions in the board of directors category are further subdivided into three subcategories: board composition, composition of the committees and board practices.

(d) a modified single trigger in an agreement that was not amended nor entered into the last year is -3 points; and (e) a double trigger agreement is 0 points.

In addition to asking more specific questions about corporate governance policies, GRID questions and scrutinizes a company's compensation practices more thoroughly than CGQ did. This reflects RiskMetrics' attempt to sync its ratings with RiskMetrics' benchmark proxy voting standards that it uses to formulate voting recommendations, particularly for institutional investors. The compensation questions in particular are aimed at finding out whether a company's executive and equity compensation programs reflect inappropriate pay practices or could potentially lead to excessive risk-taking, such as guaranteed bonuses and high severance packages for executives. Unlike CGQ, GRID takes into account unique market factors of a particular country in conducting the analysis, rather than having a uniform approach for companies regardless of the company's country of origin. According to RiskMetrics, the GRID methodology will be updated annually in conjunction with RiskMetrics' policy updates, and company GRID scores are updated monthly.

Implementation

One of RiskMetrics' purported goals in creating GRID was transparency of criteria for its scoring. With this emphasis on transparency and the similarities between GRID and RiskMetrics' own policies, RiskMetrics wants its policies to be generally accepted as best practices. Through GRID, RiskMetrics is aiming to discourage governance practices that it deems high-risk. Furthermore, with its weighted scoring system and questions that focus on highly specific governance issues, RiskMetrics appears to want GRID to prevent a company from hiding certain practices behind a good overall rating.

While institutional investors may see governance-risk scores as a convenient reference for a company's overall governance health, it is just one factor for a board to consider in looking at the company's governance. A consideration of how governance policies and practices advance shareholder interests must not be overlooked by focusing solely on the governance score. In addition, governance decisions are influenced by the company's business, industry, regulators and competitors, among other considerations, and the board should not base all its decisions on getting a favorable GRID score at the expense of taking into account other interests and factors that relate to governance decisions.

As has always been the case, a board must use its own judgment and consider the company's own circumstances to establish governance and other policies that are appropriate to the company's business and market.

Practical Insights

As the 2011 proxy season approaches, companies' GRID scores will again take on significance for existing shareholders, proxy advisors and other shareholder rights groups. The following are a few action items you should consider undertaking with respect to GRID:

- Ensure you are familiar with the GRID criteria and methodology and review your corporate governance practices, particularly in light of any recent changes to your proxy disclosures under revised rules, to determine how RiskMetrics' evaluation of your company's practices may change under the new system for the 2011 proxy season.

- If you have not done so already, take the necessary steps to gain access to the GRIId data available online and review it for accuracy. If you do not already have access to RiskMetrics' online data, you can request a log-in number by contacting RiskMetrics at support-corporate@riskmetrics.com or (301) 556-0570. Since this data is based upon publicly available information, it may not take into account all corporate governance practices or other relevant information, particularly in light of enhanced proxy disclosures or governance practices adopted in 2010. To the extent you note any inaccuracies, contact RiskMetrics immediately to attempt to resolve the issues. Also consider establishing a protocol under which this data will be accessed and reviewed on a regular basis to note inaccuracies and information that is not up-to-date. A consideration of how governance policies and practices advance shareholder interests must not be overlooked by focusing on solely the governance score. In addition, governance decisions are influenced by the company's business, industry, regulators and competitors, among other considerations, and the board should not base all its decisions on getting a favorable GRIId score and at the expense of taking into account other interests and factors that relate to governance decisions.
- Make sure you are providing thorough corporate governance disclosure in SEC filings and review the information provided in your proxy in conjunction with the GRIId guidelines to consider whether additional information should be disclosed. The absence of certain governance disclosure, for example an equity holding period, can result in negative GRIId scores.
- Even though the GRIId system does not explicitly evaluate companies in relation to their peers, it is still important to understand RiskMetrics' viewpoint as to the "local market best practices" against which RiskMetrics will measure your governance practices. Keep in mind that practices that are widespread among your peers may not be favored by RiskMetrics on a "best practices" basis. Ensure you understand RiskMetrics' position on best practices and how your company fits within that model, as this is the new measuring stick upon which RiskMetrics' scores are based under the GRIId system.

The Newly Adopted Proxy Access Rules and Implications for Your Company

The Securities and Exchange Commission ("SEC") adopted on August 25, 2010, new "proxy access" rules requiring public companies to permit shareholders or groups of shareholders, under the circumstances discussed below, to include their director nominees in the companies' annual meeting proxy statements and forms of proxy. These rules represent a significant change from the prior regulatory regime in which shareholders were generally required to fund the cost of preparing and delivering their own proxy materials in order to obtain the necessary votes for shareholder director nominees.

New Rule 14a-11

Eligibility Requirements for Nominating Shareholders. New Rule 14a-11 provides, among other things, that in order to include a director nominee in the company's proxy materials:

- A nominating shareholder or shareholder group must own securities constituting at least 3% of the securities entitled to vote in the election of directors.
- Securities eligible to be counted towards the 3% threshold must have been continuously held for at least three years as of the date the nominating shareholder or shareholder group provides notice of its intent to use Rule 14a-11 on Schedule 14N (discussed below), and such securities must be held by the nominating shareholder or shareholder group through the date of the meeting at which directors will be elected.
- The nominating shareholder or shareholder group must certify that it is not seeking to change control of the company.

The nominating shareholder or shareholder group must have both voting and dispositive power over any securities used to satisfy the ownership test. A nominating shareholder may count shares that have been loaned, so long as the nominating shareholder has the right to recall, and agrees to recall, the securities upon being notified that its nominee will be included in the company's proxy materials. Shares that have been sold short or that have been borrowed for purposes other than a short sale may not be counted.

Eligibility Requirements for Director Nominees. Under Rule 14a-11, an eligible nominating shareholder or shareholder group may nominate, as director nominees, only such persons whose candidacy or, if elected, board membership does not violate applicable law or the rules of any national securities exchange or national securities association (other than rules regarding director independence) to which the company is subject. The nominating shareholder or shareholder group must represent that, to the best of its knowledge, the director nominee meets any *objective* criteria for independence under the applicable rules of any national securities exchange or national securities association. The nominating shareholder or shareholder group will also be required to represent whether or not, to the best of its knowledge, the director nominee meets the director qualifications set forth in the company's governing documents. The failure of the director nominee to meet company-imposed qualifications, however, cannot serve as a basis for excluding the shareholder nominee from the proxy materials.

Maximum Number of Nominees Required to Be Included. The company will be required to include in its proxy statement and form of proxy only the greater of one shareholder nominee or a number of nominees equal to 25% of its total number of directors. Any director previously elected as a shareholder nominee under Rule 14a-11, whose initial term of office extends beyond the date of the annual meeting for which the Schedule 14N is being filed, will count against the cap. If the company receives director nominations from more than one eligible shareholder or shareholder group under Rule 14a-11, the company is required to include the nominee or nominees of the eligible shareholder or shareholder group holding the highest percentage of the company's voting securities. This represents a substantial change from the SEC's proposed rules under which priority would have been based, instead, on the order of receipt of the related Schedule 14N.

New Schedule 14N

In order for a shareholder or shareholder group to use Rule 14a-11, it must deliver to the company and file with the SEC, through EDGAR, its notice of intent to use 14a-11 on new Schedule 14N no earlier than 150 days before the anniversary of the mailing of the prior year's proxy statement and no later than 120 days before that date. The new Schedule 14N will provide disclosure about the nominating shareholder or shareholder group and its share ownership and each director nominee sufficient to demonstrate eligibility to use Rule 14a-11, as well as disclosures similar to the disclosures currently required in a contested election of directors. A shareholder seeking to form a nominating group under the 3% rule discussed above may use a new exemption from existing proxy rules adopted for such solicitations as new Rule 14a-2(b)(7), which will require the filing of a notice on Schedule 14N as soon as the shareholder starts communicating with other shareholders.

The nominating shareholder or shareholder group may also include, in the Schedule 14N, a statement in support of each nominee. The statement may not exceed 500 words per nominee.

Limited Bases for Excluding Shareholder Nominees

A company receiving a timely notice on Schedule 14N must generally include in its proxy statement information concerning the nominating shareholder or shareholder group and their director nominees, including the nominator's statement in support, and include the director nominees on its proxy card. It may exclude the shareholder nominee *only* if:

- the nominating shareholder or group or the director nominee fails to satisfy the eligibility requirements of Rule 14a-11, or
- including the nominee would result in the company's exceeding the maximum number of shareholder nominees that it is required to include.

In a change from the proposed rules, the company may not exclude from its proxy materials a nominee or a statement in support of a nominee on the grounds that the Schedule 14N (including the supporting statement) contains materially false or misleading statements. Under the rules, the nominating shareholder or shareholder group, and not the company, will be solely liable for any false or misleading statements made in the proxy statement based on information included in the Schedule 14N. According to the SEC, disputes concerning whether information is false or misleading are better handled through disclosure or, if necessary, private litigation.

The final rules include detailed procedures that a company must follow if it proposes to exclude a shareholder nominee from its proxy materials based on a determination that the nominating shareholder or shareholder group or its nominee has failed to satisfy the requirements of Rule 14a-11. Those procedures include notice to the nominating shareholder or shareholder group and the SEC and possible reliance on the staff's no-action procedures.

Rule 14a-8

In addition to adopting new Rule 14a-11, the SEC amended Rule 14a-8(i)(8), which previously permitted a company to exclude from its proxy materials shareholder proposals relating to the nomination or election of directors or procedures for such

nominations or elections. The SEC has substantially narrowed the scope of that permitted exclusion so that it is limited to proposals relating to specific nominees or directors or proposals that could affect the outcome of an upcoming election of directors. Rules regarding shareholder eligibility to submit shareholder proposals under Rule 14a-8 have not changed.

As a result of the amendments to Rule 14a-8(i)(8), shareholders may now seek to include, in a company's proxy materials, proposals to amend a company's governing documents to establish procedures, or to amend existing company procedures, relating to shareholder nominations of directors. Such proposals could therefore include, for example, a proposal to establish an alternative means by which shareholders might require the company to include information about director nominees in the company's proxy materials.

The SEC has made clear, however, that no procedure established under a company's governing documents may supersede, or otherwise restrict the rights of shareholders to rely on, Rule 14a-11. As a result, a company may have the right to exclude a shareholder proposal that seeks to limit the availability of Rule 14a-11, not under amended Rule 14a-8(i)(8), but on the grounds that such a proposal is contrary to the proxy rules and may be therefore excluded under Rule 14a-8(i)(3).

Effectiveness

The newly adopted rules will be effective 60 days after they have been published in the Federal Register. The new rules will therefore apply to a company in the next proxy season only if the effective date occurs at least 120 days before the first anniversary of the date of mailing of the company's proxy statement for its annual meeting last year. Thus, the new rules will be effective for many companies for the 2011 proxy season.

Public companies that qualify as "smaller reporting companies," as defined under Rule 12b-2 under the Exchange Act (generally, reporting companies with a public float of less than \$75 million), will not be subject to Rule 14a-11 until three years after the effective date.

Practical Insights

Given the likely application of these new rules to your company for the 2011 proxy season, you should begin considering these changes now and how they will impact your practices and procedures. The following are a few issues about which you should begin to think critically and a few possible action items to consider as you head toward next year's proxy season:

- *Actively Engage Major Shareholders and Shareholder Groups.* In light of the new rules, engagement and active communication with your major shareholders takes on heightened significance. You should actively monitor your shareholder base to determine potential or likely shareholder groups that may seek to take advantage of the proxy access rules. Taking a proactive approach, seeking to anticipate particular shareholder concerns and addressing those concerns may help to head off potential nominations under the new rules. Management should consider steps to educate key shareholder groups as to the company's policies and practices as a means to help avoid such shareholder nominations.

- *Monitor Schedule 14N Filings.* A company may get a sense as to shareholder groups that are forming by monitoring the use of new Schedule 14N. As noted above, a new exemption from the proxy rules for solicitations relating to formation of nominating groups requires filing of copies of written communications by a shareholder seeking to solicit participation in a group. Consider whether you should actively engage such soliciting shareholders and attempt to allay concerns in advance of an actual shareholder nomination.
- *Consider Bylaw Changes.* You should review your bylaw provisions in light of the new proxy access rules. In particular, consider how any advance notice provisions for shareholder proposals align with the new rules. Companies should also review and evaluate any director qualifications in the bylaws. Such director qualification requirements, which are an issue of state law, are not negated by the new proxy access rules. A failure to satisfy reasonable director qualification requirements in the bylaws will not prevent a shareholder nomination from proceeding under the new rules, but may prevent the nominated director or director slate from serving. The SEC's release did not provide an in-depth discussion on this point, but noted that Item 5 of Schedule 14N will require disclosure of whether, to the best knowledge of the nominating shareholder or group, a nominee meets the company's director qualifications, if any, as set forth in the company's governing documents. The release noted that the company may choose to provide disclosure in its proxy statement about whether it believes a nominee satisfies the company's director qualifications, as is currently done in a traditional proxy contest and that the SEC believes this would be important disclosure for shareholders.
- *Consider Changes to Governance Policies and Committee Charters.* Companies may need to revise provisions of the nominating and governance committee charters to take account of new oversight responsibilities for the review of shareholder nominees. Companies may also wish to revisit certain corporate governance and director policies to ensure confidentiality and control of public dissemination of information for those cases where shareholder nominees have close ties to particular special interests or shareholder rights groups.
- *Consider Board Size.* Boards of directors should consider the size of the Board and how it relates to the 25% cap on proxy access nominees under the new rules. The rules provide that the cap rounds down to the closest whole number of nominees below 25% (with a minimum of one nominee). Thus, a company with a seven-member board will face a maximum of one nominee, while an eleven-member board will face a maximum of two nominees. The board should consider its optimal size in relation to such factors as independence, qualifications and committee membership.
- *Consider Director Qualifications and Evaluation.* The December 2009 proxy disclosure enhancements concerning director qualifications and evaluations take on additional significance under the new proxy access rules. With the implementation of the new rules and the potential for increased shareholder nomination campaigns, it becomes even more important now to engage in a comprehensive and candid assessment of current director qualifications and board characteristics to ensure that individual directors or the board in general are not easy targets for a "vote against" campaign under the proxy access rules.

- *Be Ready.* Companies should understand that the new rules may lead to more proxy contests and increased shareholder activism. Shareholder rights groups and other activist shareholders may be more likely to threaten shareholder nominations as a means to bring about changes in corporate policy or other concessions. In general, it is important to think critically about how these new rules may impact your particular company and formulate a comprehensive strategy for addressing the various risks and contingencies that they may bring about.

Also of Interest

On July 14, 2010, the SEC issued a Concept Release soliciting comment on various aspects of the U.S. proxy system – often referred to as “proxy plumbing.” (“Concept Release on the U.S. Proxy System,” Release No. 34-62495). The release sought comment on the following areas: over-voting and under-voting of shares; voting confirmation; proxy voting by institutional securities lenders; proxy distribution fees; issuer communications with shareholders; retail investor participation; data-tagging proxy-related materials; the relationship between voting power and economic interest; the role of proxy advisory firms; dual record dates and “empty voting.” Comments are due by October 20, 2010. A copy of the release can be found on the SEC’s Web site at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>.

There has been some recent controversy regarding Section 9291 of the newly enacted Dodd-Frank Wall Street Reform and Consumer Protection Act. The section provides an exemption for the SEC from the Freedom of Information Act (“FOIA”) with respect to information obtained during “surveillance, risk assessments, or other regulatory and oversight activities.” Some have expressed concerns that the provision gives the SEC overly broad powers to avoid public disclosure obligations otherwise required under FOIA. Lawmakers have quickly responded with the introduction of legislation intended to repeal or limit the scope of Section 9291. In an attempt to forestall concern, SEC Chairman Mary Schapiro recently sent letters to both the Senate and House of Representatives clarifying the SEC’s position that Section 9291 does not provide the SEC with a blanket exemption from FOIA and emphasizing that the provision is needed to ensure that the SEC is able to collect highly sensitive and proprietary information from regulated firms in a timely manner. The SEC has further committed to issuing guidance to its staff to ensure that the provision is only used as intended and lawmakers have promised hearings on the impact of the provision. We will continue to monitor developments on this issue.

In mid-August, the SEC issued two releases seeking comment on certain topics related to its work plan to consider incorporating International Financial Reporting Standards (“IFRS”) into the financial reporting system for companies in the United States. One release requests comments on a number of potential contractual and corporate governance issues. The other release seeks comment on U.S. investors’ current knowledge of IFRS and preparedness of U.S. companies for incorporation of IFRS into the U.S. financial reporting system and other issues concerning preparedness and education of U.S. investors as to IFRS. Comments on the releases are due by October 18. Copies of the releases can be found on the SEC’s Web site at <http://www.sec.gov/rules/other/2010/33-9134.pdf> and <http://www.sec.gov/rules/other/2010/33-9133.pdf>.

In the wake of adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act, one issue that quickly became a subject of debate was a provision of the Act requiring a registrant to obtain the written consent of a Nationally Recognized Statistical Rating Organization (“NRSRO”) in order to disclose in a registration statement or prospectus (or documents incorporated by reference into registration statements or prospectuses) that NRSRO’s credit rating of any class of debt securities, convertible debt securities or preferred stock of the registrant. In response to this provision of the Dodd-Frank Act, certain NRSROs have stated that they will not consent to the use of their ratings in Securities Act registration statements and prospectuses since by doing so it would expose them to potential Section 11 liability for material misstatements or omissions.

At the core of the issue is Rule 436(g) under the Securities Act, which was repealed by the Dodd-Frank Act. Rule 436(g) provided an exception to Rule 436(a) under the Securities Act by providing that credit ratings assigned to a class of debt securities, a class of convertible debt securities or preferred stock by an NRSRO are not considered part of a registration statement prepared or certified by an expert within the meaning of Sections 7 and 11 of the Securities Act. Therefore, prior to the repeal of Rule 436(g), issuers did not need to obtain an NRSRO’s consent in order to provide ratings information in a registration statement or prospectus.

In order to provide clarity on these issues, the SEC recently issued a set of Compliance and Disclosure Interpretations to summarize the SEC staff’s position on certain questions, including the following:

- *Consents Required* — Other than companies subject to Regulation AB, issuers would need to provide a consent from a ratings agency if ratings information (other than issuer disclosure-related ratings information as discussed below) is included in or incorporated by reference into a registration statement or post-effective amendment becoming effective after July 22, 2010 or a prospectus or prospectus supplement (including documents incorporated therein by reference) filed after July 22, 2010.
- *Issuer Disclosure-Related Ratings Information* — If the NRSRO’s credit ratings are provided in Securities Act registration statements or Section 10(a) prospectuses of a company not subject to Regulation AB as part of a disclosure related to (i) changes to a credit rating, (ii) the liquidity of the registrant, (iii) the cost of funds for a registrant or (iv) terms of agreements that refer to credit ratings (defined as “issuer disclosure-related ratings information”), a consent from the NRSRO is not required. Common examples of such disclosures cited by the SEC staff include risk factor disclosures and the discussion of ratings with respect to the company’s access to capital in the Management’s Discussion and Analysis of Financial Condition and Results of Operations.
- *Shelf Registration Statements* — Issuers not subject to Regulation AB with registration statements on Form S-3 or F-3 that were declared effective before July 22, 2010, and either include or incorporate by reference ratings information (whether or not limited to issuer disclosure-related ratings information) may continue to use the registration statement until the next post-effective amendment to the registration statement (if no subsequently incorporated periodic or current report contains ratings information that is not limited to issuer disclosure-related ratings information). Such post-effective amendments would include annual

reports on Forms 10-K, 20-F and 40-F. Thus, after the next annual report is filed, the issuer can no longer use the registration statement that discloses ratings information (other than issuer disclosure-related ratings information) without a consent.

- *Free Writing Prospectuses* — Consent would not be required in free writing prospectuses compliant with Securities Act Rule 433 or in a term sheet or press release compliant with Securities Act Rule 134 that includes ratings information. These documents are not considered “registration statements” or “prospectuses,” and therefore the consent requirement would not apply. If, however, any of these documents are filed as a prospectus pursuant to Rule 424 and contain ratings information, a consent would be required.

Spotlight on Schiff Hardin

Members of our Public Companies Group recently represented the Chicago Board Options Exchange, Incorporated (“CBOE”) in its approximately \$3 billion demutualization transaction, in which CBOE converted from a member-owned Delaware non-stock corporation to a Delaware stock corporation and wholly-owned subsidiary of a new parent holding company, CBOE Holdings, Inc. We also represented CBOE Holdings, Inc., CBOE’s new parent corporation, in its \$390 million initial public offering. The demutualization and IPO closed concurrently on June 18, 2010.

Schiff Hardin represented CBOE in connection with its formation and the creation of its options trading market in 1973, and attorneys from Schiff Hardin were on the CBOE’s trading floor to witness the trading of the first options contract ever traded on an options exchange. We have continued to represent CBOE since that time. Schiff Hardin played a fundamental role in structuring the demutualization and IPO; in advising the board of directors; in litigating and settling complex ownership issues; in coordinating separate registration statements for the demutualization and IPO through the review process at the SEC’s Division of Corporation Finance; in assisting CBOE with certain CBOE rule filings; in seeking no-action relief from the SEC’s Office of Mergers and Acquisitions with respect to novel tender offer issues; in facilitating a secondary offering process that involved more than 1,300 potential selling stockholders; in addressing novel tax issues; and in working with state securities regulators in every U.S. jurisdiction and with securities counsel in foreign jurisdictions around the world. The transactions drew upon the expertise of lawyers from a wide variety of Schiff Hardin practice areas, including Corporate and Securities, Securities and Futures Regulation, Litigation, Employee Benefits and Executive Compensation, Intellectual Property, and Tax.



Please join us at Schiff Hardin's GC Roundtable for a presentation and discussion about updates on recent Corporate Governance Reforms and Proxy Trends, including the impact of the Dodd-Frank Act on public companies.

Thursday, September 23, 2010

2:00 – 5:00 p.m.

Roundtable presentation and discussion about
Corporate Governance Reforms and Proxy Trends

5:00 – 6:00 p.m.

Reception and Dinner
at the Metropolitan Club

Schiff Hardin's Reception and Conference Center
66th Floor of the Willis (Sears) Tower
Chicago, IL 60606

Register by September 21!

Stay tuned for the next edition of *The Schiff Hardin Public Company Adviser* coming in December. The Winter 2010 Edition will include Schiff Hardin's annual review of proxy statement issues and a number of articles designed to get you ready for the 2011 annual meeting season.



The Public Company Adviser

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