

R.R. Donnelley SEC Hot Topics Institute

**Preparing for Your Annual Report
and Proxy Statement**

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Attachments:

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Electronic Proxies

Adoption of the “Notice and Access” Option

- Effective Dates
 - Large Accelerated Filers – January 1, 2008
 - Others: Non LAFs; investment companies; opposition solicitors – January 1, 2008
- Not for M&A transactions.
- Rationale:
 - SEC discovers the internet.
 - “May” reduce costs for issuers.
 - May make it easier to engage in proxy fights.
- This is only an option, which requires decisions analysis and decision making.

Electronic Proxies

Basic Concepts

- Required notice
- Required posting
- Responses to stockholders
- Intermediaries
- Full set delivery
- Opposition solicitations
- Timing and Logistics

Electronic Proxies

Required Notices

- Must be sent to *every* shareholder.
- 40 calendar days in advance of the meeting date; 40 days prior to effectiveness of corporate action, in the case of a written consent.
- Must be filed with the SEC as “additional soliciting material.”

Electronic Proxies

Required Notices must include:

- *Prominent bold face legend.*
- Date, time, and location of meeting or the earliest date on which action may be taken in reliance on consents.
- Identification of each matter to be acted upon and the issuer's recommendation.
- List of proxy materials available on the internet; encourage access.
- Website link – but NOT the SEC's.
- Contact information.
- Access instructions.
- How to get directions to the meeting.

Electronic Proxies

Required Notices

- May be integrated with notice *required* by state law.
- May not be combined with any other document.
- May include a privacy notice.
- May include an prepaid envelope to request hard or e-mail copies of the proxy materials.
- May **not** include a proxy card.

Electronic Proxies

The Proxy Card

- May *not* be included in the notice.
- May be sent 10 days after the notice, accompanied by a copy of the notice.
- May be sent less than 10 days after the notice if it includes or is preceded by the proxy statement/annual report.
- Proxy statement/annual report must be sent in the same medium.

Electronic Proxies

Posting On the Website

- If an issuer chooses the “notice and access” option, it must post all proxy materials on a website.
- Do not use the SEC’s website.
- Must be posted by the time the notice is first sent.
- For additional soliciting materials, posting must occur when sent to shareholders or made public.
- No charge to shareholders.
- Must keep on the website through the meeting date.

Electronic Proxies

Posting on the Website (continued)

- Must be a direct click – shareholder must not have to “find” the link on a website.
- Posted material must look substantially like the hard copies.
- Must be convenient to print and to search (may require two different formats).
- Must allow anonymity of visits – check with the technical people about tracking cookies, etc.

Electronic Proxies

Responding to Shareholders—Sending Proxy Materials

- Shareholders can request hard or email copies of the proxy materials.
- Issuer must send within three business days after receipt of the request.
- First class mail or other “reasonably prompt” means.
- Delivery requirements (within three business days and by reasonably prompt means) expire one year after the meeting date.
- A request by a shareholder is binding until revoked.

Electronic Proxies

Responding to Shareholders—Providing a Proxy Card

- Must be posted on the website at the time that the notice is sent.
- Must provide a means for execution on the website when posted (electronic voting or telephone hotline).

Electronic Proxies

Intermediaries

- Reality – Broadridge owns everyone's stock of record – this is the intermediary issue.
- Intermediaries send proxy statements along to “beneficial” owners.
- Beneficial owners only instruct intermediaries how to vote.
- Issuer can require intermediaries to send the intermediary's own notice, which mirrors the option of accessing the internet materials or electing to receive hard or email copies from the intermediary.

Electronic Proxies

Intermediaries (continued)

- Caution: the intermediary has the same deadline as the issuer – 40 calendar days before the meeting or consent date.
- Intermediaries may direct beneficial owners to the issuer's website – but the intermediary must make it clear that beneficial owners still must vote through instructing the intermediary.
- Or, intermediaries can post the proxy materials on the intermediary's own website.

Electronic Proxies

Intermediaries (continued)

- Intermediary's notice must describe how shares will be voted in the absence of instructions from the beneficial owners.
- Intermediary's notice must make available an option to get hard or email copies of proxy materials for all securities in the account.

Electronic Proxies

Full Set Delivery Option

- Printing and mailing is still possible.
- Even in the print and mail scenario, a special set of “internet notices” is required:
 - These can be in the proxy materials themselves.
 - No need to “encourage” use of the internet.
 - No need to provide a hotline to vote.
 - No need to provide a way to request hard or email copies.
- No 40-day deadline.

Electronic Proxies

Opposition Solicitations

- Opposition solicitations may use the same general “notice and access” model.
- Exceptions:
 - 40-day deadline is modified to the later of 40-days or 10 days after the issuer first sends out a proxy statement or internet notice.
 - Need only to include “known” agenda items (because opposition solicitation may launch first).
 - Must explain what authority proxy will have if not all agenda items are subject to the opposition solicitation.
 - May selectively solicit.

Electronic Proxies

Timing and Logistics Issues

- 40 days is not 40 days – working with the intermediaries.
- Coordinating website logistics with intermediaries.
- Will you really save money?
- How to estimate demand for hard copies.
- What if you significantly underestimate hard copy demand?

Electronic Proxies

Timing and Logistics Issues

- Managing fulfillment – making sure that you can respond to shareholder requests on time.
- Moving your company’s proxy timetable back to accommodate the new notice requirement.
- Even if you stick with the “old fashioned” way of doing things, there are changes to be made to your materials and procedures.
- Revising the D&O questionnaire.

Lessons from the 2007 Proxy Disclosures

The SEC Comment Letters on 2007 Proxy Statements

- Division of Corporation Finance task force has sent or is sending an expected 300 comment letters.
- Although the comments are company specific, a number of comments are common to many letters.
- Comments primarily address CD&A's.
- Comments also relate to compensation tables, related footnote and narrative disclosure, director compensation, and related party transaction disclosure.

Lessons from the 2007 Proxy Disclosures

General Themes Reflected in the Comments

- The CD&A must provide more quantitative and qualitative analysis—general descriptions of the compensation program and its elements are not enough.
- CD&A's must disclose in detail how and why compensation decisions are made.
- CD&A's must place compensation decisions and the compensation awarded in context as necessary for investors to understand the issuer's compensation program.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Compensation Decisions

- More detailed disclosure required of the parties involved in compensation decisions and their roles and responsibilities in making those decisions.
 - The compensation committee.
 - The full board of directors.
 - Executive officers, especially the CEO.
 - Compensation consultants.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Compensation Decisions

- Disclosure required of CEO's role in compensation decisions.
- Disclosure required of whether CEO may attend or call compensation committee meetings or meet with the committee's consultants.
- When compensation consultants are used, disclosure is required of the nature/scope of their assignment and the material instructions or directions given to them.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Compensation Decisions

- More disclosure needed of the particulars of the decision-making process.
 - If tally sheets are used, disclose how used, the items in the sheets impacting a named executive officer's (a "NEO") compensation and the weight given each item.
 - Disclose factors considered in approving various elements of compensation awarded and the amount awarded.
 - Disclose why the committee considered elements of compensation appropriate.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Compensation Decisions

- If compensation is benchmarked against a peer group, disclose the targets used and discuss in detail how targeting is done.
- Identify members of all peer groups and survey sources used for benchmarking purposes.
- Discuss the compensation committee's exercise of discretion to increase/decrease awards or payments (particularly if performance-based).

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Compensation Decisions

- Disclose how the compensation committee evaluates internal pay relationships among executives and other employees.
- Discuss whether the committee considers how an executive's compensation compares to other employees' compensation.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Compensation Paid

- Disclose as to each element of each NEO's compensation:
 - why it was awarded;
 - why its amount was awarded;
 - how it was determined to be awarded;
 - the factors considered in awarding it and its amount;
 - why the total of all elements was awarded; and
 - why the compensation committee considered each of the elements appropriate.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Compensation Paid

- Disclose the quantitative and qualitative aspects of each NEO's performance considered in setting the NEO's compensation, including weight given each aspect.
- Disclose each NEO's performance assessments, experience and responsibility considered in setting, and that determined, the compensation paid.
- If compensation paid falls outside any targeted range for an element, discuss why the payment made was outside the range.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Differences in Compensation

- Provide comparative analysis of all NEO's compensation.
- If the CEO's compensation differs significantly from the next most highly compensated NEO, disclose reasons for the difference.
- Where NEO's of the same rank have significantly different compensation, disclose reasons for the difference.
- Disclose any differences in the application of the company's compensation policies between the NEO's.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Performance Targets

- Disclose performance targets or provide (supplementally) justification for not disclosing performance targets as being competitively sensitive information.
- Where targets not disclosed, provide more detailed disclosure of the difficulty in achieving the targets.
- Disclose if the targets are “real” or easily achieved.
- Disclose factors considered in setting performance targets.

Lessons from the 2007 Proxy Disclosures

Common Comments/CD&A/Severance or Change-in-Control Payments

- More analysis of these payments is required.
- Disclosure required of:
 - how the amounts of the payments are determined.
 - how these payments fit in the overall compensation program and affect other compensation decisions.
- Quantitative disclosure and analysis of these payments is required.

Lessons from the 2007 Proxy Disclosures

Common Comments/Other Areas

- **Compensation Tables:** Disclosure needed of valuation assumptions for equity awards.
- **Director Independence:** Disclosure needed of any specific transactions considered under independence standards.
- **Related Party Transactions:** More detailed disclosure needed of related party transaction review policies and their application.

Lessons from the 2007 Proxy Disclosures

Observations

- Some comments appear to seek justification, not just explanation, of compensation decisions—a push for internal pay equity?
- Some comments suggest that task force members view compensation decisions as being made with an almost mathematical precision.
- Some comments reflect a misunderstanding of the company's process or program as disclosed and may require education of the commenting task force member.

Lessons from the 2007 Proxy Disclosures

Responding to the Comments

- Comments generally may be addressed in future filings.
- Some comments require additional information to be provided in the response letter or supplementally.
- No blanket requirement for amendments to 10-K's.
 - 10-K/A could be required if the SEC believes responsive information must be disclosed currently.
 - Issuers should assess whether any comment identifies a material omission that must be addressed currently.
- Comment and response letters will be made public not less than 45 days after the SEC completes its filing review.

Lessons from the 2007 Proxy Disclosures

Going Forward

- The SEC is to release its summary report on its review in fall of 2007.
 - The report and, perhaps, rule amendments may provide better guidance on the SEC's expectations.
- The comment letters and the anticipated report, as well as Corp Fin's other Item 402 guidance, will shape and give greater definition to the real meaning of principles-based disclosure in the CD&A's.

Lessons from the 2007 Proxy Disclosures

Preparing for the 2008 CD&A

- Educate the company's compensation committee and HR department as to the expectations for any additional disclosure the company must make to comply with the comments, even if you did not get a comment letter.
- If there is a facet of the company's compensation decisions or the decision making process you do not want to see in print, consider making changes before the next compensation setting.
- Review compensation committee and other record keeping to be certain you capture all information necessary to provide the additional disclosure and detail required.

Lessons from the 2007 Proxy Disclosures

Preparing for the 2008 CD&A

- Review your use of tally sheets and their contents in light of the disclosures required.
- If you do not use tally sheets, consider doing so.
- Socialize disclosures of reasons for significant differences in pay among your NEO's and potential NEO's.
- Review the scope of the compensation consultants roles and the instructions and directions provided to them prior to next compensation setting.
- Reconsider the exclusion of any performance targets from the CD&A.

Proposed Shareholder Access Rules

- The SEC has proposed competing rules on shareholder access.
- The objective: determining if shareholders will be able to use the company's proxy statement to solicit votes for their nominees for director.
- The prevailing rule could be effective prior to the 2008 proxy season, but the adoption process may be protracted.
- It is unclear which rule will prevail as Chairman Cox voted in favor of proposing both rules. Commissioner Campos' resignation further clouds matters.
- Comments due to the SEC by October 2, 2007.

Proposed Shareholder Access Rules

- One proposed rule (*see Release 34-56160*) would affirm that Rule 14a-8(i)(8) permits exclusion of a shareholder's proposal for a by-law amendment providing shareholder access.
- Confirms the SEC's long-standing position that Rule 14a-8(i)(8) permits exclusion of such proposals.
- Intended to override the Second Circuit's 2006 ruling in *AFSCME v. American International Group*.

Proposed Shareholder Access Rules

- The alternative is a set of proposed rules and amendments to Schedules 13G and 14A (*see Release 34-56161*).
- Certain of the rules would permit shareholders to propose a by-law amendment that would create shareholder access.
 - The proposing shareholder (or group of shareholders):
 - Must have owned more than 5% of the company's stock for at least one year.
 - Must be eligible to file a Schedule 13G; and
 - Must have filed a Schedule 13G including disclosures about the proponent's relationships with the company.

Proposed Shareholder Access Rule

- Additional disclosure would be included in the proxy statement regarding relationships between the proponent of the by-law amendment and the company.
- If a by-law amendment proposal is adopted, shareholders would include nominees in the company's proxy statement as provided in the by-law provision.
- The by-law provision need not require nominating shareholders to own more than 5% of the company's stock in order to include a nominee unless required by state law or the company's charter.

Proposed Shareholder Access Rules

- Additional disclosure would be included in any proxy statement including shareholder nominees for director regarding:
 - relationships between the nominating shareholder and the company; and
 - disclosure regarding the shareholder nominees.

Proposed Shareholder Access Rules

- The proposed rules favoring inclusion would also permit the operation of electronic shareholder forums by shareholders or the company.
- The forums would be used to facilitate communication among shareholders and between shareholders and the company.
- Solicitations of votes (but not proxies) on matters to voted on at a shareholders meeting could occur on a forum up to 60 days prior to the announced date of the meeting.