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ISS Updates to U.S. Corporate Governance Policies for 2012

On November 17, 2011, Institutional Shareholder Services ("ISS"), a leading proxy advisory firm, issued updates to its Benchmark U.S. Corporate Governance Policies for the 2012 proxy season. ISS reviews and updates its policies annually, taking into account "emerging issues and trends, the evolution of market standards, regulatory changes, and feedback provided by ISS' clients." These updates will be effective for meetings held on or after February 2, 2012. We have summarized some of the more significant changes below.

Proxy Access

There are currently at least five shareholder proposals for proxy access pending for publicly traded companies. In view of the fact that the SEC has not repromulgated rules on proxy access, many commentators expect proxy access to be an area of significant activity for activist shareholders in 2012. ISS will continue to evaluate its recommendations for proxy access proposals on a case-by-case basis, while expanding the list of factors that it will consider in its analysis. These additional factors will include company-specific factors and proposal-specific factors, such as the maximum proportion of directors that shareholders may nominate each year and the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations. ISS will continue to consider the ownership threshold proposed in a proxy access proposal, but it no longer lists the rationale for a proxy access proposal as one of the considered factors. ISS has also broadened its policy to apply to management proposals for proxy access.

Response to High Levels of Say-On-Pay Opposition

One of the more significant updates is to ISS' approach for say-on-pay proposals. ISS will utilize a case-by-case approach when considering recommendations for voting on compensation committee members and say-on-pay proposals if the company's prior say-on-pay proposal received less than 70% of the votes cast. For purposes of its case-by-case analysis, ISS will take into account the following factors:

- the company's response to investors, including disclosure of engagement efforts with institutional investors regarding the issues that contributed to low support, specific actions taken to address the issues contributing to low support, and other recent compensation actions taken;
- whether the issues are recurring or isolated;
- the company's ownership structure; and
- whether the support level was under 50%, which would warrant the highest degree of responsiveness.

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Pay-for-Performance Evaluation

Previously, ISS evaluated alignment of a CEO's pay with performance by looking at whether a company's one and three year total shareholder returns are in the bottom half of its Global Industry Classification Group ("GICS") and whether the total compensation of a CEO is aligned with the company's total shareholder return over recent and long term periods. If both conditions of this test were met, ISS would generally recommend a vote against the say-on-pay proposal. Many companies criticized this approach as too limited in its analysis of performance.

ISS has updated its approach by refining its methodology. Instead of looking at a company's performance in relation to its GICS, ISS will now look at company performance relative to an ISS created peer group of 14–24 companies that are selected based on market cap, revenue (or assets for financial firms) and GICS industry group. ISS characterizes the process to pick the peer group as one "designed to select peers that are closest to the subject company, and where the subject company is close to median in revenue/asset size." ISS will also look at the relative alignment between the company's total shareholder return rank and the CEO's total pay within the peer group as measured over one and three year periods and the multiple of the CEO's total pay relative to the peer group median. In addition to the peer group analysis, ISS will also look at the absolute alignment between CEO pay and total shareholder return over the prior five fiscal years.

If the revised analysis described above shows "significant unsatisfactory" long term pay-for-performance alignment, ISS will then analyze the following qualitative factors to determine whether such items are affecting alignment of pay with shareholder interests:

- the ratio of performance to time-based equity awards;
- the ratio of performance-based compensation to overall compensation;
- the completeness of disclosure and rigor of performance goals;
- the company's peer group benchmarking practices;
- actual results of financial/operational metrics;
- special circumstances (e.g., a new CEO in the prior fiscal year); and
- any other factors deemed relevant.

It remains to be seen what impact this new approach will have on ISS recommendations on Say on Pay advisory votes. It will be particularly interesting to compare the peer groups created by ISS to the peer groups used by companies, and the impact this may have on the analysis. Many smaller or mid-cap companies have difficulty generating a peer group of 14 companies and it will be particularly interesting to see how ISS develops the applicable peer group.

ISS notes that this methodology has an emphasis on the longer term and except in "extenuating circumstances" a new CEO will not exempt the company from the analysis "as the compensation committee is also accountable when a company is compelled to significantly "overpay" for new leadership due to prior poor performance."

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Response to Frequency of Advisory Vote on Pay Results

ISS has adopted a new policy with regard to the frequency of advisory votes on executive compensation. If the board implements say-on-pay votes on a less frequent basis than the frequency that received the majority of votes cast at the most recent shareholder meeting, then ISS will recommend a vote "against" or "withhold" for the entire board. If the board implements say-on-pay votes on a less frequent basis than the frequency that received a plurality of votes, then ISS will take a case-by-case approach to its recommendation, while considering factors such as the board's rationale for selecting a lower frequency, the company's ownership structure and vote results, ISS' analysis of whether there are compensation concerns, and the previous year's support level on the company's say-on-pay proposal.

Exclusive Venue Management Proposals

Proposals to establish exclusive venue for shareholder litigation will now be evaluated by ISS on a case-by-case basis, taking into account whether the company has been materially harmed by shareholder litigation outside of its jurisdiction of incorporation, and whether the company has certain good governance features, such as an annually elected board, a majority vote standard in uncontested director elections and the absence of a poison pill, unless approved by shareholders. See our recent article on exclusive venue clauses for more information on the pros and cons of these provisions.

Dual-Class Structure

ISS has amended its approach to evaluating proposals to create a new class of common stock. Previously, it has recommended a vote against such proposals if the new class of common stock included superior voting rights, and recommended a vote for such proposals if it was intended for financing purposes with minimal dilution to shareholders and was not designed to preserve the voting power of an insider or significant holder. ISS has updated its approach to better align its policy with investors' views. ISS will recommend a vote against proposals to create a new class of common stock unless:

- the company discloses a compelling rationale, such as the company's auditor has concluded that there is substantial doubt about the company's ability to continue as a going concern or the new class of shares will be transitory;
- the new class is intended for financing purposes with minimal or no dilution to current shareholders in both the short term and long term; and
- the new class is not designed to preserve or increase the voting power of an insider or significant shareholder.

Voting on Director Nominees in Uncontested Elections

ISS has updated its approach for uncontested director elections. The previous policy called for a vote "against" or "withhold" for directors, committee members, or the entire board under extraordinary circumstances, such as material failures of governance, stewardship or fiduciary responsibilities at the company. ISS has now added an explicit reference to material failures of "risk oversight" to the list. The intention of this change is not to penalize a board for taking prudent business risks, but rather to address situations where the board has failed to oversee the company's risk management practices.

Other updates

ISS has also updated its approach to various other proposals, including incentive bonus plans and tax deductibility proposals, hydraulic fracturing, recycling, political spending and lobbying activities, workplace safety, and water issues.

The full text of the ISS U.S. Corporate Governance Policy 2012 Updates is available at http://issgovernance.com/policy/2012/policy_information.

Please contact any member of the Kaye Scholer Corporate Group for information as to the impact of these new policies on your upcoming annual stockholder meeting.

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After a review of the Special Committee process and the terms of the transaction, the Chancery Court held that the transaction was unfair to Southern Peru's minority stockholders, and fashioned a remedy requiring the controlling stockholder to give up shares approximating the difference between the fair price and the value of the 67.2 million as of the merger.

The Value of a Well Functioning, Independent Special Committee Is Highlighted by the Recent Delaware Chancery Decision, In Re Southern Peru

The recent case of *In re Southern Peru Copper Shareholder Derivative Litigation*, C. A. No. 961- CS (Del. Ch. October 14, 2011) demonstrates the value of an independent, well-functioning board or committee in negotiating an acquisition transaction. A controlling stockholder sold another company it controlled to the controlled company for $3.1 billion of the controlled company's stock (which grew to almost $3.7 billion as a result of appreciation in the controlled company's stock between signing and closing); the Chancery Court found that the target was worth no more than $2.4 billion and required the controlling stockholder to return approximately $1.3 billion of stock to the controlled company buyer. The process by which the Special Committee evaluated and negotiated the transaction was subjected to extensive criticism by the Chancery Court.

Summary

Grupo Mexico owned 54.1% of Southern Peru's outstanding capital stock and 63.08% of the voting power. Southern Peru was a NYSE-based company. Grupo Mexico also owned 99.15% of the stock of Minera, a company engaged in mining copper and other metals. Grupo Mexico's chairman was also chairman and CEO of Southern Peru. Minera was in financial difficulty, and severely cash constrained, while Southern Peru was in good financial condition and virtually debt free.

Grupo Mexico proposed that Southern Peru purchase its stake in Minera for 72.3 million shares of Southern Peru stock, worth $3.05 billion. Southern Peru formed a Special Committee to "evaluate" the transaction. Eight months later, after a lengthy negotiation, the Special Committee approved Southern Peru's acquisition of Groupo Mexico's stake for 67.2 million shares. The value on the date of announcement of 67.2 million shares was $3.1 billion, just the value that Grupo Mexico had sought; by the closing, the value of these shares had grown to $3.75 billion.

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The Special Committee's Consideration of the Minera Transaction

The resolutions establishing the Southern Peru Special Committee indicated that the "duty and sole purpose" of the Special Committee is to evaluate the [merger] in such a manner as the Special Committee deems to be desirable and in the best interests of the company," and authorized the Special Committee to engage legal and financial advisors at Southern Peru's expense. Goldman Sachs and Latham & Watkins were engaged to represent the Special Committee. The resolutions did not give the Special Committee the express power to negotiate, nor did they authorize the Special Committee to explore other strategic alternatives.

The process by which the Special Committee evaluated and negotiated the transaction was subjected to extensive criticism by the Chancery Court.

Goldman initially provided various valuation analyses of the target, Minera, including a DCF analysis, a contribution analysis, and a look through (sum of the parts) analysis. These valuations showed that Minera was worth no more than $1.7 billion. The Southern Peru stock was publicly traded, and an important assumption, never challenged, was that the block of Southern Peru shares to be issued (at this point, 85% of the then-outstanding Southern Peru stock) would yield a cash value equal to its current trading price. The initial Goldman analysis showed that the proposed Southern Peru shares to be issued were worth $3.1 billion. The Goldman analyses, which showed this significant disparity between the value of Minera and the Southern Peru stock, was never repeated during the transaction process, despite ongoing subsequent evaluation by the Special Committee of the transaction.

Instead, shortly after this initial presentation, Goldman provided the Special Committee with a DCF analysis for Southern Peru, showing that the Southern Peru fundamental value was worth less than its current market capitalization, a result that might have been due to revised assumptions for the Southern Peru DCF analysis from those used for the Minera analysis. This Southern Peru DCF analysis reportedly "comforted" the Special Committee, since the differential in value between Minera and the stock being requested was reduced under this new analysis, with the deal being shown to have Southern Peru giving $2.06 billion in value for $1.7 billion in assets. Thereafter, Goldman presented a variety of analyses valuing the two companies on a relative basis. They compared the two companies using "the same set of assumptions and methodologies, rather than comparing Southern Peru's market capitalization to Minera's DCF value."

The Special Committee made a counter proposal to Grupo Mexico for a purchase of Minera for $2 billion of Southern Peru stock (notably higher than any of the values in the initial Goldman analysis) and proposed to issue a fixed number of shares that would float up and down in value with Southern Peru's trading price. Grupo Mexico responded by proposing a price of 80 million shares, then worth the same $3.1 billion as in its initial term sheet, a proposal rejected by the Special Committee. Grupo Mexico then proposed a price of 67 million shares, a then $2.76 billion in value. The 67 million shares later rose in value to $3.06 billion. The Special Committee received more analyses presented by Goldman, comparing the two companies' market-based equity values, showing a range of values at the forward EBITDA multiple from 61 to 72 million shares, or $2.765 billion to $3.26 billion.

The Special Committee then made a counter proposal of 64 million of Southern Peru shares (then equal to $2.975 billion) in current market value. The Special Committee also proposed a 20% collar giving either side the right to terminate if the stock price for Southern Peru went outside the collar and a condition that a majority of the minority stockholders of Southern Peru vote in favor of the deal. Grupo Mexico rejected both the collar and the majority of minority voting conditions and also insisted on 67 million shares. The Special Committee finally agreed to issue 67 million shares for Minera, justifying the additional price by requiring $100 million in debt reduction for Minera and a proposed Southern Peru special dividend of $100 million. The Chancery Court notes that by these "bells and whistles," the value of what was being acquired went up and the value of the stock being issued went down.

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One of the independent directors represented a large founding stockholder that wanted to sell its shares of Southern Peru. Part of the terms for the acquisition transaction was the granting of registration rights to that stockholder. This stockholder entered into a voting agreement tying its vote on the merger to the Special Committee's recommended the merger. Another large stockholder entered into an agreement to vote in favor of the merger in exchange for registration rights, however, and this later agreement assured Grupo Mexico that it could potentially achieve the two-thirds vote requested even if the Special Committee changed its recommendation, and the director-controlled shares were voted against the merger.

The Special Committee approved the acquisition of Minera for 67.2 million shares, or $3.08 billion in value. The Goldman analyses presented at the Special Committee meeting at which the transaction was approved were relative value presentations, not standalone valuations of Minera, and showed a range of Southern Peru shares to be issued under various assumptions for Minera. The analyses used higher multiples than applicable to Southern Peru and attributed these multiples to the privately held, financially troubled Minera. Goldman issued a fairness opinion on the transaction.

Southern Peru's stock appreciated almost 22% between deal announcement and closing (mostly due to increased copper prices). Although the Special Committee had the right to change its recommendation, it did not ask Goldman to issue an updated fairness opinion, despite the fact that Southern Peru had beaten its own EBITDA projections for the current year by 37%, and the Southern Peru projections on which Goldman's valuation analysis was based had been prepared by Southern Peru management, who were under at least putative control by Grupo Mexico.

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Chancery Court Criticism of the Special Committee Process

In ultimately concluding that the transaction was unfair to the minority Southern Peru stockholders, the Chancery Court criticized several aspects of the Special Committee process.

1. Failure to Act as an Arms' Length Negotiator. The Chancery Court initially criticized the willingness of the Special Committee to consider the Goldman DCF analysis of Southern Peru showing a significantly lower valuation, as a justification of the acquisition of Minera. One wonders at the Special Committee's reaction to the initial Southern Peru DCF analysis, which showed a lower valuation for Southern Peru than its current market capitalization. Instead of taking issue with the valuation [which had different assumptions than those applied to Minera previously], or expressing concern that Southern Peru's fundamental value was lower than its market value, the Special Committee was "comforted," presumably since this analysis gave it a reason to continue to consider the deal for Minera. The Chancery Court observed that if the valuation of Southern Peru offered by Goldman were credible, a properly motivated Special Committee would have been expected instead to attempt to monetize the asset [its own overpriced stock] for its stockholders, perhaps seeking to sell Southern Peru to Grupo Mexico at a premium to market, perhaps issuing a special dividend. As the Chancery Court observed, the role of a Special Committee in this circumstance is to act "like a third party negotiator with its own money at stake and with the full range of options" available to it. In contrast, the Chancery Court observed that this Special Committee [through its advisors] "began to devalue the 'give' [the Southern Peru stock] in order make the 'get' [the Minera business] closer in value." Indeed, they were "comforted by the fact that they could devalue that currency and justify paying more for Minera than they originally thought that they should."

Similarly, at a later point in the negotiations, the Special Committee agreed to increase the number of shares being offered from its proposed 64 million to the 67 million shares sought by Grupo Mexico, justifying the additional price by reference to $100 million in debt reduction required for Minera and a proposed Southern Peru special dividend of $100 million. The Special Committee itself described these "bells and whistles" [their phrase] as having the effect that "the value of what was being . . . acquired in the merger went up, and the value of the [stock being issued] in the merger went down," giving the Special Committee a reason to accept a higher merger price. Thus, the financial engineering here seems intended to produce a cosmetic fix to accommodate the transaction proposed by Grupo Mexico, and the record does not reflect an assessment by the Special Committee that the acquisition was the best transaction available to Southern Peru.

2. Failure to Insist on Right to Negotiate and Right to Consider All Available Alternatives. Here it is important to note that the fundamental failure may have been the failure to give the Special Committee clear authority to negotiate and to consider all available alternatives to the proposed transaction. Although the Special Committee did in fact negotiate, despite the authority in the resolutions to simply "evaluate" the transaction proposed, the Chancery Court observed that the Special Committee "fell victim to a controlled mindset and allowed Grupo Mexico to dictate the terms and structure of the merger." The Special Committee's failure to insist on the right to look at alternatives "took off the table other options that would have generated a real market check and also deprived the Special Committee of negotiating leverage to extract better terms." The Chancery Court thus noted the Special Committee's "blinkered approach." The Chancery Court viewed the Special Committee as "trapped in the controlled mindset where the only options to be considered are those proposed by the controlling stockholder." Certainly, the Special Committee did not seem to think of simply saying no to the acquisition at the time of the initial analysis showing the stark differential in value, nor did the Special Committee pursue any potential alternatives to the transaction at hand. It is worth noting that there were no contemporaneous minutes available — to the extent that the Special Committee did consider other alternatives; this consideration should have been reflected in the minutes and this record might in that case have demonstrated a more independent mindset for the Special Committee.

3. Failure to Achieve Collar or Majority of Minority Vote. A lesser criticism of the Special Committee noted by the Chancery Court was the failure to insist on a collar, which would have required a renegotiation for the fixed exchange ratio deal in the event of a sudden appreciation in the Southern Peru stock, which in fact materialized. Given the volatility of the stock price during the eight months of negotiation, this significant change in the value of the Southern Peru stock could not have been a complete surprise — in fact the Special Committee had not wanted a floating exchange ratio because of the volatility in the stock. Given the wide range of values for Minera generated by Goldman, and this volatility in the Southern Peru stock, one would have thought that a collar might have made some sense on the Southern Peru side. Further, the Chancery Court noted the failure of the Special Committee to insist on a majority of minority voting condition. This failure to insist on a majority of minority condition is particularly notable in light of the registration rights granted to each of two major stockholders. A majority of minority condition does create deal certainty issues, and it may be that minutes of the meetings of the Special Committee, if prepared contemporaneously, might have reflected the Special Committee's weighing of the costs and benefits of this provision.

4. The Liquidity Interests of a Stockholder Employing One of the Special Committee Members. As the Chancery Court noted, one of the Special Committee members was employed by a large holder who wanted to be a short term seller. Throughout the negotiations of the merger transaction, this stockholder negotiated registration rights allowing it to sell its shares. As noted by the Chancery Court, the Special Committee member employed by this holder did not act consistently with his employer's view — in essence a "short term seller of a company's shares caused that company to be a long term buyer." While the Chancery Court stopped short of calling this interest a conflict arising to a breach of the duty of loyalty, it is clear that this interest influenced one Special Committee member's willingness to agree to the Minera acquisition in exchange for registration rights. Indeed, the Chancery Court observes that this director "was not well-incentivized to take a hard-line position on which terms the Special Committee would be willing to accept" and was tempted to "find a way to make a deal work at a sub-optional price if that would facilitate liquidity for the stockholding employer." This potential conflict might have been ignored if the Special Committee had shown more independence, but note that the actions by the director here to negotiate the acquisition deal, given his employer's significant countervailing interest in the liquidity offered by registration rights, put the Special Committee at risk for a breach of duty of loyalty claim and consequent removal of the protection of Delaware General Corporation Law

Section 102(b)(7) exculpation under the Southern Peru charter.

5. Failure to Inform Itself and Permit the Exercise of its Right to Change its Recommendation. Despite the failure to insist on the majority of minority condition, the Special Committee had, in any case, negotiated for the right to change its recommendation. If the Special Committee had changed its recommendation, the deal may not receive the stockholder approval required, because the vote of the large stockholder employing one of the Special Committee members was in fact tied to the Committee's recommendation. This right to change a recommendation was a meaningful right; however, only if the Special Committee reviewed its recommendation post-signing. The Chancery Court was clearly disappointed that the Special Committee had evidence that the valuation on which the fairness opinion was based was potentially faulty due to Southern Peru exceeding its EBITDA projections provided by management, but chose not to seek a revised fairness opinion or to otherwise consider a change of recommendation. Thus, although the Special Committee had negotiated for rights that would have permitted it to act to protect its minority stockholders in the very circumstances that arose, it failed to exercise these rights.

Summary of Special Committee Process Defects. The Chancellor sums up the mindset of the Special Committee and its banker as follows: "Throughout the negotiation process, the Special Committee's and Goldman's focus was on finding a way to get the terms of the merger structure proposed by Grupo Mexico to make sense, rather than aggressively testing the assumption that the merger was a good idea in the first place." The Chancery Court finds that the Special Committee attempted "to rationalize doing a deal of the kind the majority stockholder proposed" and agreed to give away over $3 billion worth of actual cash value "in exchange for something worth demonstrably less, and to do so on terms that by consummation made the value gap even worse, without using any of its contractual leverage to stop the deal or renegotiate its terms." The Chancellor finds that the Special Committee was not "well functioning," and that, as a result, the burden of persuasion remains upon the defendants.

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Lessons for Boards and Special Committees Generally

All boards faced with negotiating a merger can take lessons from the Chancery Court's opinion. Boards and Special Committees should consider the following "take aways":

- Consider critically the value of the "give" and "get" in a non-cash deal without regard to the other side's negotiating position; focus on the benefit to your stockholders, rather than the other side's proposal on structure and terms as the bottom line basis for negotiations. Treat the negotiations as if you are dealing with your own assets.

- If bankers provide an analysis, and subsequently change the metrics or the premises for the analysis, understand the impact of and reasons for any such changes; similarly, if an analysis is subsequently discarded, understand the reasons for the shift to another analysis. Use business judgment to evaluate which analyses give the board or committee the best insights into the valuation and in a non-cash deal, the relative value of the "give" and the "get." Reflect the decisions and the factors considered in those deliberations in the minutes.

- In the case of a Special Committee, adopt a charter authorizing negotiations, not simply evaluation, with respect to any transaction presented for consideration, and also seek and exercise the right to consider alternatives. Further, regardless of the charter, actually negotiate on behalf of the minority stockholders, and consider all reasonably available alternatives. Keep in mind that it is not necessary that the Special Committee be able to execute on any of the other alternatives, so long as it has the right and obligation to consider them, and also the ability to make recommendations to the full Board with respect to them. The absence of this right may indeed have inadvertently "blinkered" the Special Committee in Southern Peru.

- Understand and attempt to use negotiating leverage to your advantage. This is particularly important in a controlled company setting, where the Special Committee is called upon to exhibit independence and arms' length bargaining. The process is as important as the outcome. Consider in particular the power to "just say no" to a transaction, and avoid being carried away by deal fever for a particular deal.

- Consider the economic impact of and practical leverage provided by various deal terms (such as collars, fixed versus floating exchange ratios, change of recommendation). Be aware of changes in facts that suggest that a change in deal terms is warranted, and use the leverage provided by negotiated deal terms to your advantage throughout the transaction.

- Avoid having Special Committee or Board members with potential or actual conflicts negotiating the deal terms. Make adequate disclosure of all conflicts and discuss ways to mitigate the conflicts if necessary.

- Where possible, Boards and Special Committees should require that minutes of their meetings be prepared in a timely manner and close in time to the actual meeting. The Chancery Court's analysis was hampered by the lack of minutes and the fact that the minutes had not been prepared close to contemporaneously with the meetings.

All in all, the directors in Southern Peru come away looking at best "less than adroit" and at worst conflicted. Directors will avoid this result by negotiating vigorously at arm's length with their main goal being to act in the best interest of the stockholders (or in a controlled company setting, the minority stockholders).

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In good news for boards of directors of Delaware corporations, the Delaware Chancery Court upheld the viability of the business judgment rule for board decisions on executive compensation, notwithstanding the politically charged atmosphere on this topic.

In Defense of Compensation Decisions and Risk Taking: An Analysis Through the Lens of *In re Goldman Sachs Group, Inc. Shareholder Litigation*

Executive compensation and compensation for senior investment bankers have recently become the subject of much debate, study and, in some cases, ire, as the economy in the United States and globally heads for a potential double dip recession. The "Occupy Wall Street" protests have pitted the "99%" against the "1%" in what the media has described as the growing divide between "Main Street" and "Wall Street." Regulators and lawmakers have responded to the compensation issue by drafting new rules, regulations and laws. In January 2011, the Securities and Exchange Commission adopted the "Say on Pay" rules for public companies, requiring those companies to conduct a separate shareholder advisory vote to approve the compensation of executives. On October 27, Regis Corp. received more than 71% opposition to its pay practices — the greatest level of dissent by stockholders for a company's pay for executives since the advent of the U.S. advisory vote on executive compensation. Given the economic, social and regulatory environment, it comes as little surprise that a case such as *In re Goldman Sachs Group, Inc. Shareholder Litigation*, challenging the compensation practices at Goldman, would come before the Delaware Court of Chancery. In good news for boards of directors of Delaware corporations, the Delaware Chancery Court upheld the viability of the business judgment rule for board decisions on executive compensation, notwithstanding the politically charged atmosphere on this topic.

Summary

Southeastern Pennsylvania Transportation Authority and the International Brotherhood of Electrical Workers Local 98 Pension Fund sued the Board of Directors of Goldman for breach of fiduciary duty in approving Goldman's compensation structure. The plaintiffs argue that the Board approved a compensation plan that created a divergence of interest between Goldman's management and its stockholders. The plaintiffs also assert that the compensation paid pursuant to the compensation plan constituted corporate waste. The complaint alleges that the levels of compensation paid by Goldman were unconscionable, as they were significantly higher than the levels of compensation at Goldman's peer firms on a per employee basis. Finally, the plaintiffs contend that the Board failed to monitor the risky and illegal practices that occurred at Goldman from 2007 through 2009, and that the compensation structure led to overly risky business decisions and unethical and illegal practices, which the Board had a responsibility, but failed, to oversee and monitor.

Vice Chancellor Glasscock, in his first opinion sitting on the Delaware Chancery Court, considered these claims and dismissed each of them. He held that:

- the Board did not breach its fiduciary duties in setting compensation[1],
- there could be no finding of corporate waste with respect to the compensation that was paid, and
- the Board did not consciously or in bad faith disregard its duty to monitor Goldman's operations.

Breach of Fiduciary Duty

The plaintiffs contend that the Board of Directors of Goldman approved the compensation structure in bad faith and breached its fiduciary duties by failing to properly analyze and rationally set compensation levels for Goldman's employees. To prevail on these claims, the plaintiffs must allege facts that create a reasonable doubt as to whether the Board's approval of Goldman's compensation scheme was approved in good faith. The plaintiffs argue that the Board breached its fiduciary duties because the compensation structure created a divergence of interest between Goldman's management and its stockholders. The plaintiffs noted that the compensation plan is a "positive feedback loop" where employees of Goldman reap the benefits of engaging in risky behavior in order to maximize yearly net revenue — and their annual bonus — but the stockholders bear the losses.

Vice Chancellor Glasscock noted that the plaintiffs allege only that the Board's compensation scheme does not perfectly align the interests of the management and its stockholders and that a different compensation metric would have yielded a better result. He states that while this may be correct, it is irrelevant. He writes: "***this observance does not make the Board's decision self-evidently wrong, and it does not raise a reasonable doubt that the board approved Goldman's compensation structure in good faith***."

To prevail on a breach of fiduciary duty claim, the plaintiffs must also prove that the Board was not adequately informed when making the decision regarding compensation. Since the Board (1) considered other investment bank comparables, (2) varied the total percent and dollar amount awarded as compensation from 2007 to 2009 and (3) changed the total amount of 2007 compensation (in response to public outcry), the Vice Chancellor concluded that the plaintiffs' allegations suggested only that there were other metrics not considered by the Board that might have produced better results and not that the Board was not adequately informed. The plaintiffs alleged that the Board (1) did not analyze or assess the extent to which management performance, as opposed to the ever-growing shareholder equity and assets available for investment, has contributed to net revenue and (2) should have used other compensation metrics, such as those used to calculate compensation levels at hedge funds. In response, the Vice Chancellor writes: "***the business judgment rule . . . only requires the board to reasonably inform itself; it does not require perfection or the consideration of every conceivable alternative***."

The plaintiffs contend that the Board of Directors of Goldman approved the compensation structure in bad faith and breached its fiduciary duties by failing to properly analyze and rationally set compensation levels for Goldman's employees.

Waste

To support a waste claim, the plaintiffs must show that the Board's decision was "so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests." Vice Chancellor Glasscock goes on to describe corporate waste as "an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade" and, with respect to compensation, "***an amount so disproportionately large to the contribution of management . . . as to be unconscionable***." The plaintiffs argue that the compensation was so extravagant that it constituted corporate waste. In their complaint, the plaintiffs did not identify a particular individual or person who received excess compensation; instead, the complaint focused on the average compensation received by

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[1] Goldman employs a "pay for performance" philosophy with respect to compensation and sets aside a specified percentage of net revenue each year to cover compensation. For the years 2007, 2008 and 2009, the percentage of net revenue set aside for compensation equaled 44%, 48% and 36%, respectively, totaling $20.2 billion in 2007, $10.9 billion in 2008 and $16.2 billion in 2009.

Goldman's 31,000 employees. The plaintiffs stated that the average compensation per employee at Goldman is two to six times higher than that of its peers. In addition, if compared to a hedge fund, Goldman's compensation scheme would amount to 2% of net assets and 45% of net income instead of the 2% of net assets and 20% of net income typically found at a hedge fund. Nonetheless, Vice Chancellor Glasscock concludes that the plaintiffs' complaint failed to present facts that demonstrate that the work done by Goldman's 31,000 employees was of such limited value to the corporation that no reasonable person in the directors' position would have approved their levels of compensation or that the compensation was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration."

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Duty to Monitor

The plaintiffs assert that the Board breached its duty to monitor as required under *Caremark*.[2] The plaintiffs identified several transactions in which Goldman profited by taking positions opposite to the clients it was investing with, advising and financing. The plaintiffs argue that these unethical trading practices in search of short term revenues were harmful to the company. Among these trades was the infamous Abacus transaction.[3] As a result of the Abacus transaction, the SEC charged Goldman with fraud. Goldman settled the case by agreeing to pay a $535 million civil penalty and disgorging the $15 million in profits it made on the transaction.

In most *Caremark* claims, the Board's liability is due to a failure of the Board to oversee corporate conduct leading to violations of law. As the Abacus trade was the only transaction pled by the plaintiffs that involved any SEC action or civil penalty, Vice Chancellor Glasscock stated that this transaction did not on its own demonstrate the ignorance of "red flags" on the part of the directors that might lead to reasonable apprehension of liability for the Board under *Caremark*. Vice Chancellor Glasscock determined that the conduct of the traders at Goldman involved *legal* business decisions and not violations of law. He acknowledged that Goldman's compensation structure in its trading business put it in potential conflicts of interest with its own clients and that several of the trades described by the plaintiffs in the complaint exhibited "disloyal and unethical trading practices." However, he concluded that "***[l]egal, if risky, actions are within management's discretion to pursue and though the transactions involved risk, including risk of damaging the company's reputation, these are not 'red flags' that would put a board on notice of <u>unlawful</u> conduct***." Vice Chancellor Glasscock goes on to write that "***reputational risk exists in any business decision***," and that although the securitization and selling of mortgages is risky and although Goldman profited from the decline of the mortgage market at the same time that it sold mortgage related products to its clients, it is "not illegal or wrongful per se." Since the Board did not consciously fail to monitor the conduct of the company's employees in a sustained or systemic manner so as to establish the lack of good faith necessary for liability, Vice Chancellor Glasscock concluded that they were not sufficient pleadings of wrong doing or illegality to establish a *Caremark* claim.

Vice Chancellor Glasscock takes the opportunity to consider the issue of whether a board's *Caremark* duties include a duty to monitor business risk. Assuming a duty to monitor business risk exists, the Vice Chancellor concluded that no reasonable inference can be made from the pleadings that the Board consciously disregarded its duty to be informed about Goldman's business risk. In Vice Chancellor Glasscock's view, the essence of the plaintiffs' argument on this matter is that the Board should be "personally liable for making (or allowing to be made) business decisions that, in hindsight,

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[2] *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

[3] In the Abacus transaction, John Paulson, a Goldman client and hedge fund manager, had a role in selecting the mortgages that would ultimately be used to back a collateralized debt obligation (CDO). Paulson took a short position that would profit if the CDO fell in value. Goldman sold the long positions to other clients without disclosing Paulson's involvement.

turned out poorly" for Goldman. In quoting *In re Citigroup Inc. Shareholder Derivate Litigation*, 964 A. 2d 106, 131 (Del. Ch. 2009), he continues "***[o]versight duties under Delaware law are not designed to subject directors, even expert directors, to personal liability for failure to predict the future and to properly evaluate business risk***." Vice Chancellor Glasscock regards "***evaluat[ing] the trade-off between risk and return" as "[t]he essence of . . . business judgment***." *Citigroup*, 964 A.2d at 131. He determined that the Board kept itself reasonably informed and fulfilled its duty of oversight in good faith. "***And it is good faith, not a good result, that is required of the board***."

> *Vice Chancellor Glasscock concluded that "[l]egal, if risky, actions are within management's discretion to pursue and though the transactions involved risk, including risk of damaging the company's reputation, these are not 'red flags' that would put a board on notice of unlawful conduct."*

Lessons Learned

- ***The Business Judgment Rule carries the day***. Vice Chancellor Glasscock reiterated throughout the opinion that as long as the directors of a corporation do not breach their fiduciary duties, judges are "ill-suited by training (and should be disinclined by temperament) to second-guess the business decisions of those chosen by the stockholders to fulfill precisely that function." Even in the case of Goldman, a company that since January 2007 has lost over $40 billion of market capitalization while at the same time paying its employees over $70 billion of compensation, Vice Chancellor Glasscock confirmed that directors and officers can pursue corporate opportunities (including the compensation of employees) in any way that, in the exercise of their business judgment on behalf of the corporation and within the boundaries of fiduciary duty, they see fit.

- ***A board has broad discretion in setting compensation***. Vice Chancellor Glasscock's opinion serves as a reminder that boards of Delaware corporations have great latitude under the business judgment rule to set general compensation rules. To prevail, a plaintiff would need to establish a reasonable doubt that the board acted in good faith, the board's conscious disregard of its duties and the board not being reasonably informed. Vice Chancellor Glasscock notes that "[t]he decision as to how much compensation is appropriate to retain and incentivize employees, both individually and in the aggregate, is a core function of a board of directors exercising its business judgment." In quoting *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000), a Delaware Supreme court case upholding the approximately $130 million compensation package of Michael Ovitz, former president of the Walt Disney Company, Vice Chancellor Glasscock reiterates that "[i]t is the essence of business judgment for a board to determine if a particular individual warrant[s] large amounts of money." The opinion confirms that Delaware courts will grant deference under the business judgment rule to reasonably informed boards acting in good faith in the decisions they make in setting general compensation guidelines.

- ***Risk taking and the duty to monitor under Caremark.*** The Board of Directors of Goldman did not breach its duty to monitor under *Caremark* because it implemented a system of reporting and controls for fraud and illegal activity and did not systematically or in a sustained manner fail to exercise its oversight. Although the actions of the employees of Goldman did lead to SEC sanctions, the Court did not find a lack of a duty to monitor based on a single transaction. In addition, the Court did not read a duty to monitor risk into a board's duties under *Caremark*. As such, this case supports the proposition that risk-taking is within the purview of the board's businesses judgment, even if such risks involve a risk of loss either financially or reputationally.

- ***Delaware corporations should include the exculpation provisions under 8 Del. C §102(b)(7) in their charters***. Section 102(b)(7) of the Delaware General Corporation Law allows corporations organized under the laws of the State of Delaware to include in their charters a provision that exculpates such corporation's directors from liability with respect to actions taken by those directors in their capacity as directors of the corporation as long as such actions are not taken in “bad faith.” While the case does not revolve around the issue of the *8 Del. C.* §102(b)(7) charter provision, it should be noted that for each claim, Vice Chancellor Glasscock took into account the fact that Goldman’s charter contained this exculpation provision. As a result, the plaintiffs’ burden of proof was increased, making it easier for the Vice Chancellor to dismiss the case with prejudice at the pleading stage.

Vice Chancellor Glasscock’s opinion serves as a reminder that boards of Delaware corporations have great latitude under the business judgment rule to set general compensation rules.

- ***Vice Chancellor Glasscock’s first opinion gives practitioners insight into his views of the DGCL.*** In his first opinion as a newly appointed Vice Chancellor in the Delaware Court of Chancery, Vice Chancellor Glasscock gives us a glimpse into his theory of corporate law. He believes the Delaware General Corporation Law is “enabling in nature” and that directors and officers have broad discretion to act as they find appropriate. He believes that Delaware case law sets restrictions on the more permissive DGCL and requires directors and officers to act as faithful fiduciaries to the corporation and its stockholders. Within the confines of Delaware case law and fiduciary duty, Vice Chancellor Glasscock confirms that corporate actors are free to pursue corporate opportunities in any way they see fit “in the exercise of their business judgment.” Perhaps in the most telling line of the opinion, he writes: “[f]reedom to pursue opportunity on behalf of the corporation . . . has made the corporate structure a supremely effective engine for the production of wealth.” For Vice Chancellor Glasscock, so long as individuals act in accordance with their fiduciary duties, judges are not trained to and should not revisit the business decisions of directors and officers elected by the stockholders to make those decisions. His belief is that “[c]ourts are ill-fitted . . . *ex post*, to judge appropriate degrees of business risk.”

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Although Section 304 grants the SEC the authority to exempt persons from the clawback requirements, the SEC has not issued any formal guidance clarifying what situations would warrant an exemption.

SEC Continues to Obtain No-Fault SOX Clawbacks

In November 2011, the Securities and Exchange Commission (the "SEC") reached a settlement with Maynard Jenkins, the former CEO of CSK Auto Corporation ("CSK Auto"), pursuant to which Mr. Jenkins agreed to return $2.8 million in incentive compensation and stock profits that he received while CSK Auto was engaging in accounting fraud, even though Mr. Jenkins was not alleged to have participated in the fraud. This settlement represents the third case in which the SEC has obtained a clawback under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") from a CEO or CFO who was not alleged to have personally engaged in the misconduct that led to the filing of misstated financials.

Background

Section 304 of Sarbanes-Oxley provides that in the event an issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, as a result of misconduct, the CEO and CFO of the issuer must reimburse the issuer for (1) any bonuses or other incentive-based or equity-based compensation received during the one-year period following the filing of the misstated financials, and (2) any profits realized from the sale of the issuer's securities during such one-year period. Although Section 304 grants the SEC the authority to exempt persons from the clawback requirements, the SEC has not issued any formal guidance clarifying what situations would warrant an exemption.

CSK Auto and Beazer Homes Cases

Prior to the CSK Auto case, the SEC had sought to use Section 304 only in cases in which a CEO or CFO were themselves alleged to have engaged in the misconduct resulting in the noncompliance with the financial reporting requirements. However, in 2009 the SEC filed a civil claim against Mr. Jenkins seeking to compel him to reimburse CSK Auto for over $4.1 million in compensation and trading profits he received following CSK Auto's filing of fraudulent financials. Although the SEC had previously charged four former CSK Auto executives with perpetrating the accounting fraud and CSK Auto with filing false financial statements, Mr. Jenkins was not a defendant in any of these cases.

The SEC and Mr. Jenkins reached a tentative settlement in March 2011. According to reports, the tentative settlement was for less than half of the $4.1 million the SEC sought in its complaint. However, the SEC Commissioners rejected the proposal, and it was reported that the rejection resulted from two contrasting viewpoints — one that the proposed settlement amount was too low and the other that the case should not have been brought in the first instance. Eight months later, on November 15, 2011, the parties reached a final settlement, pursuant to which Mr. Jenkins agreed to return $2.8 million of the $4.1 million originally sought by the SEC.

The CSK Auto case follows the settlement of two similar "no-fault" cases against the CEO and CFO of Beazer Homes USA Inc. ("Beazer"). Similar to the CSK Auto case, the SEC had already brought enforcement actions against Beazer and the person who had committed the accounting fraud (Beazer's chief accounting officer). The SEC brought the lawsuits against the CEO and CFO of Beazer in 2011 and announced the settlement of the suits on the same day the suits were filed. The CEO and CFO agreed to reimburse Beazer for $6,479,281 and $1,431,022 in cash, respectively, and the CEO also agreed to reimburse Beazer for the value of 40,103 restricted stock units and 78,763 shares of restricted stock. These amounts represented all of the incentive compensation that the CEO and CFO received in respect of the fiscal year for which Beazer's financials were misstated as well as their trading profits during that period.

> *Dodd-Frank has its own clawback requirements, which are broader than Section 304 in some respects and narrower in others. For example, the Dodd-Frank clawback requirements are triggered regardless of whether there is misconduct.*

Implications

The CSK Auto and Beazer cases represent a contrast to the SEC's early enforcement actions under Section 304 of Sarbanes-Oxley, which were limited to cases in which a CEO or CFO was alleged to have personally engaged in misconduct. The CSK Auto case, in particular, sends mixed signals, as the SEC Commissioners' rejection of the initial settlement offer and the ultimate settlement for only roughly two-thirds of the amount in controversy suggests that there are diverging viewpoints within the SEC regarding whether Section 304 should be applied in "no-fault" cases.

It remains to be seen how the SEC may change its interpretation of Section 304 of Sarbanes-Oxley in light of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Dodd-Frank has its own clawback requirements, which are broader than Section 304 in some respects and narrower in others. For example, the Dodd-Frank clawback requirements are triggered regardless of whether there is misconduct. Also, under Dodd-Frank only the portion of incentive compensation that would not have been paid under the correct, restated financials can be recovered, whereas under Section 304 all incentive compensation paid and trading profits realized in the 12-month period following the filing of misstated financials can be recovered. These distinctions could result in a situation where the SEC would seek recovery under Section 304 from a CEO or CFO who did not engage in misconduct in order to maximize the recovery amount, even though an argument could be made that recovery under Dodd-Frank would be more appropriate in the absence of CEO or CFO misconduct. The SEC is scheduled to issue proposed rules implementing the Dodd-Frank clawback requirements by the end of 2011. See our recent article for our thoughts on the types of issues companies should be considering in revising or developing clawback policies prior to the SEC's issuance of clawback rules under Dodd-Frank.

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Website Requirements for Public Companies

A company's website is an essential marketing tool. When launching a website, a company painstakingly reviews and critiques its content, with the goal of having the website portray the company in the best possible light for customers, investors, prospective employees and partners, and other stakeholders.

When companies go public, they typically perform a thorough legal review of their websites. Public company websites must meet certain legal requirements. The Securities and Exchange Commission (the "SEC"), security exchanges, such as the New York Stock Exchange (the "NYSE") and the Nasdaq Stock Market ("Nasdaq"), and often a company's corporate governance documents require that companies' websites include certain documents and information. However, since these website posting rules are scattered across various regulatory schemes, once a company goes public, keeping the website in compliance and up to date can be an arduous process. A public company should be aware of which website rules and regulations are applicable to it and perform a periodic legal review to ensure that the website complies with these rules and regulations.

Below is a summary of certain website posting rules. This article is intended simply to illustrate the type of information that may be required on a company's website. Specific companies, and particularly companies in regulated industries, may be subject to additional rules and regulations concerning website content not covered here.

A public company should be aware of which website rules and regulations are applicable to it and perform a periodic legal review to ensure that the website complies with these rules and regulations.

Website Accessibility

NYSE companies are required to maintain publicly accessible websites that are accessible from the United States and clearly indicate in the English language the location of the documents the NYSE requires to be posted on the websites. In addition, such posted documents must be available in a printable version in the English language (NYSE Listed Company Rule 307.00). The SEC and Nasdaq do not have similar rules regarding website accessibility; however, all companies should consider their investment base when determining in which language(s) their website and the posted documents should be available.

Corporate Governance Documents

NYSE-listed companies are required to make available through their websites:

- ***Nominating and Corporate Governance Committee Charter*** (NYSE Listed Company Rule 303A.04),
- ***Compensation Committee Charter*** (NYSE Listed Company Rule 303A.05),
- ***Audit Committee Charter*** (NYSE Listed Company Rule 303A.07),

- ***Corporate Governance Guidelines*** (NYSE Listed Company Rule 303A.09), and
- ***Code of Business Conduct and Ethics*** (NYSE Listed Company Rule 303A.10).

Furthermore, the SEC requires a company post its ***Code of Ethics*** applicable to its principal executive officer, principal financial officer, or principal accounting officer or controller on the website (Item 406 of Regulation S-K). As an alternative, the SEC permits companies to satisfy this rule by including the code of ethics as an exhibit to its annual report or by undertaking in its annual report that it will provide a copy of the code of ethics to any person without charge.

Although Nasdaq does not have a similar website posting requirement, many companies choose to post various corporate governance documents, such as committee charters and Codes of Ethics, on their websites as a matter of good corporate governance. Keep in mind, however, that a company's corporate governance documents themselves may require website posting. For example, an Audit Committee Charter may require that it be posted on the company's website. Alternatively, a company might indicate in its annual proxy statement or annual report that the corporate governance documents are available on the website. Companies should carefully review their own corporate governance documents to ensure compliance. At this point, posting of corporate governance documents is quite common, and companies should consider what signal they are sending if they do not include these documents on the website for inspection by investors.

Companies must also be careful that the posted corporate governance documents are up to date. It is easy for a website update to fall through the cracks after changes are made to charters or governance guidelines. This is dangerous in two respects: (1) not having a current version of a policy violates the above-listed rules, regulations and policies and (2) someone within a company's organization, or outside counsel, may mistakenly rely on the website-posted document as the current version. In order to confirm that the current version of the document is on a company's website, it is helpful if the document is dated as of the date it was adopted by the board or relevant committee of the board. Most charters require an annual review, and such reviews are very helpful in keeping these governance documents consistent with any regulatory changes (such as the upcoming changes to SEC regulations relating to compensation committee independence and engagement of compensation consultants).

Public Filings

The SEC requires that companies post certain filings made with the SEC on their websites. For example, companies must post on their websites all Forms 3, 4 and 5 filed under Section 16(a) of the Act (Section 16a-13 of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) and all materials included in their Notice of Internet Availability of Proxy Materials (generally, the Form 10-K and the Proxy or Information Statement) (Rule 14a-16 of the Exchange Act). In addition, the NYSE requires that listed companies make available on or through their websites their annual reports that include audited financial statements (NYSE Listed Company Manual 203.01).

Companies must also be careful that the posted corporate governance documents are up to date. It is easy for a website update to fall through the cracks after changes are made to charters or governance guidelines.

In addition, if a company does not post on its website its annual, quarterly and current reports and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, pursuant to Item 101 of Regulation S-K, the company must explain in its public filings why it did not post the documents and whether it will provide electronic or paper copies of its filings free of charge upon request.

Companies should pay particular attention to the website posting requirement for XBRL filers. The SEC requires that companies post their XBRL data on their website (Item 601 of Regulation S-K) by the end of the calendar day on the earlier of the date the data is submitted or is required to be submitted, and, if the electronic filer is not an open-end management company registered under the Investment Company Act of 1940, the XBRL data must remain accessible on that website for at least a 12-month period. Companies should contact the third-party vendors that prepare their XBRL data to obtain their XBRL files. It is important to note that Companies are required only to post the XBRL files on their websites; the users of the XBRL data are responsible for obtaining the tools needed to convert the data. While there is no requirement that companies post their Form 10-Qs on their website, since companies must post the XBRL data for their 10-Qs, they should consider posting the full Form 10-Q for clarity's sake.

Code of Ethics Waivers

Item 406 of Regulation S-K of the Exchange Act and Item 5.05 of Form 8-K provide a registrant the option of waiving the reporting of its code of ethics as applied to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or to persons performing similar functions on its website instead of through a Form 8-K, if:

- the required information is posted to the registrant's website within four business days following the date of amendment or waivers; and
- the registrant has disclosed in its most recently filed annual report its Internet address and intention to provide disclosure in this manner.

If the registrant elects to disclose this information on its website, such information must remain available on the website for at least a 12-month period. Following the 12-month period, the registrant must retain the information for a period of not less than five years and, upon request, furnish to the SEC a copy of the information. Both the NYSE and Nasdaq contain similar website disclosure requirements (NYSE Listed company Manual 303A.10 and Nasdaq Marketplace Rule 5610).

Director Independence

There are also various disclosure requirements regarding director independence under the NYSE and Nasdaq company rules and Regulation S-K that must be made on a company's website.

For example, if a company uses its own definitions for determining whether its directors and nominees for director, and members of specific committees of the board of directors, are independent in accordance with Item 407 of Regulation S-K, it must post such definitions to its website and provide its website address in any SEC filing which requires Item 407(a) Regulation S-K disclosures (for example, a proxy statement). In the alternative, a company may include a copy of these policies in an appendix to its proxy statement or information statement that is provided to securityholders at least once every three fiscal years or if the policies have been materially amended since the beginning of the company's last fiscal year. If a current copy of the policies is not available to securityholders on the company's website, and is not included as an appendix to its proxy statement or information statement, the company must identify the most recent fiscal year in which the policies were so included in satisfaction of this requirement.

In addition, pursuant to NYSE Listed Company Manual Rule 303A.02, a director cannot be deemed "independent" if he or she has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than $120,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service). However, contributions to tax-exempt organizations are not considered payments if the listed company discloses, either on or through its website or in its annual proxy statement (or, if the company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC), any such contributions made by the company to any tax-exempt organization in which any independent director serves as an executive officer if, within the preceding three years, contributions in any single fiscal year from the listed company to the organization exceeded the greater of $1 million or 2% of such tax-exempt organization's consolidated gross revenues. If this disclosure is made on or through the listed company's website, the listed company must disclose that fact in its annual proxy statement or annual report, as applicable, and provide the website address.

Furthermore, pursuant to Nasdaq Marketplace Rules 5605(d)(3) and 6605(e)(3), if a company's board of directors appoints a non-independent member to the Compensation Committee or Nominating Committee, it must disclose on its website the nature of the director's relationship with the company and the reasons for the board's determination to appoint the member to the committee. As an alternative to posting this information on the company's website, the company may make the disclosure in the proxy statement for the next annual meeting subsequent to such determination (or, if the company does not file a proxy, in its Form 10-K).

Pursuant to NYSE Listed Company Manual Rule 303A.07, if an audit committee member simultaneously serves on the audit committees of more than three public companies, the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and must disclose such determination ***either*** on or through the listed company's website or in its annual proxy statement or, if the listed company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC. If this disclosure is made on or through the listed company's website, the listed company must disclose that fact in its annual proxy statement or annual report, as applicable, and provide the website address.

Executive Sessions

Pursuant to NYSE Listed Company Manual Rule 303A.03, if one director is chosen to preside at all of a company's executive sessions, his or her name must be disclosed ***either*** on or through the listed company's website or in its annual proxy statement or, if the listed company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC. If this disclosure is made on or through the listed company's website, the listed company must disclose that fact in its annual proxy statement or annual report, as applicable, and provide the website address. Alternatively, if the same individual is not the presiding director at every meeting, a listed company must disclose the procedure by which a presiding director is selected for each executive session, again either on the website or in the annual proxy statement or annual report.

NYSE Listed Company Manual Rule 303A.03 also requires that listed companies disclose a method for interested parties (not just shareholders) to communicate directly with the presiding director or with those directors as a group, either on or through the listed company's website or in its annual proxy statement or, if the listed company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC. If this disclosure is made on or through the listed company's website, the listed company must disclose that fact in its annual proxy statement or annual report, as applicable, and provide the website address.

Unit Details

Both the NYSE and Nasdaq listing rules require that issuers of units disclose on their websites certain details about the units. Specifically, pursuant to NYSE Listed Company Manual Rule 202.05, the issuer of income deposit securities traded as a unit must provide information regarding the terms and conditions of the components of the unit (including information with respect to any original issue discount or other significant tax attributes of any component), and the ratio of the components comprising the unit on its website. Furthermore, Nasdaq Marketplace Rule 5225(a)(3) requires that issuers of units disclose on their website, or if a website is not maintained, in their annual report provided to unit holders, information regarding the terms and conditions of the components of the unit (including information with respect to any original issue discount or other significant tax attributes of any component), the ratio of the components comprising the unit, and whether a component of the unit is separately listed on Nasdaq.

Conclusion

As technology advances and more and more investors and shareholders look to the Internet as their main source of information about companies, the rules requiring website disclosure will evolve and expand. This article is not intended to be a comprehensive list for all time, but rather to serve as a starting point for companies to begin their own website review and compliance programs. Please contact us for further information or if you need any additional guidance in reviewing your website.

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