RR DONNELLEY

CORPORATE GOVERNANCE AND SECURITIES LAWS

A Public Company Handbook

2011 EDITION

Curtis, Mallet-Prevost, Colt & Mosle LLP
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Printed in the United States of America.

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About this Handbook

This handbook is intended to serve as a general reference guide for public company officers and directors on key securities law and corporate governance requirements applicable to public companies. Although this handbook reviews the critical requirements of the areas covered, our coverage of these areas is not exhaustive and is necessarily incomplete. In addition, many of these areas may be subject to changes in statutory and case law as well as new interpretive positions of the Securities and Exchange Commission or stock exchanges.

Although this handbook may provide information concerning potential legal issues, it is not a substitute for legal advice from qualified counsel. This handbook is not created or designed to address the unique facts or circumstances that may arise in any specific instance, and you should not and are not authorized to rely on it as a source of legal advice. This handbook does not create any attorney-client relationship between you and Curtis, Mallet-Prevost, Colt & Mosle LLP.

The opinions expressed in this publication are those of the individual authors and contributors and do not necessarily reflect the views of Curtis, Mallet-Prevost, Colt & Mosle LLP.

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About Curtis, Mallet-Prevost, Colt & Mosle LLP

About Curtis

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- Board committee matters, including committee composition, committee charters and responsibilities;
- Codes of business conduct and ethics and related party transactions policies;
- Risk management programs;
- Shareholders’ meetings and compliance with the proxy requirements under the Securities Exchange Act of 1934;
- Design of compensation plans and programs, including governance and institutional shareholder considerations;
- Compliance programs, including insider trading compliance and Section 16 compliance;
- Issuer repurchase programs;
- Disclosure policies, including compliance with Regulation FD and Regulation G;
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CORPORATE GOVERNANCE AND SECURITIES LAWS

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INTRODUCTION

Public companies are subject to an extensive and complex regulatory regime under the U.S. federal securities laws and stock exchange listing rules. This handbook provides an overview of the securities law and stock exchange reporting, disclosure and corporate governance requirements applicable to public companies and their officers, directors and large shareholders. Throughout this handbook, we use the terms "public company" and "issuer" interchangeably.

In addition to outlining the applicable laws, regulations and rules, this handbook seeks to provide practical guidance reflecting, among other things, interpretive guidance issued by the Securities and Exchange Commission, general industry practice and the authors' experience.

The past year witnessed significant legislative and regulatory developments affecting the obligations of public companies under the U.S. federal securities laws. Most notably, the Dodd-Frank Wall Street Reform and Consumer Protection Act (referred to in this text as the "Dodd-Frank Act") was signed into law by President Obama on July 21, 2010. While much of the Dodd-Frank Act is concerned specifically with the banking sector and derivatives markets, it also contains significant reforms applicable to public companies generally. These reforms include, among others:

- *"Say on Pay."* The "say on pay" provisions of the Act require public companies to hold nonbinding shareholder votes on the compensation of their named executive officers, as such compensation is disclosed in the annual proxy statements of public companies.

- *"Golden Parachutes."* Subject to certain exceptions, the Act require a public company that is seeking approval by its shareholders of a fundamental corporate transaction to submit any "golden parachute" arrangements to a nonbinding shareholder vote.

- *Proxy Access.* The Act expressly authorized the SEC to adopt rules to allow shareholders to gain access to a company's proxy statement to propose their own director nominees or to propose changes to bylaws relating to the nomination or election of directors. On August 25, 2010, the SEC adopted new rules under the Exchange Act to grant shareholders such access. The effectiveness of the proxy access rules have been stayed by the SEC pending resolution of a petition being heard in the Court of Appeals for the District of Columbia.

- *Compensation Committee Independence and Authority to Retain Advisors.* Subject to certain exceptions, the Act requires all public companies listed on a national securities exchange or association to comply with certain enhanced independence requirements for members of their compensation committees and their compensation committee advisers and consultants. In addition, compensation committees are required to have the authority to retain and obtain advice from independent compensation consultants, legal counsel and other advisers.

- *Enhanced Executive Compensation Disclosures.* The Act requires public companies to disclose in their annual proxy statements information that shows the relationship between the compensation that is actually paid to executive officers and the financial performance of the company. In addition, public companies will be required to disclose certain information regarding internal pay equity, including the ratio of the median of the total compensation of all employees to the total annual compensation of the CEO.

- *Incentive Compensation Clawback Policy.* The Act directs the SEC to adopt rules prohibiting the listing of a company on a national securities exchange or association if the company has not adopted and implemented a clawback policy that meets certain minimum requirements.

- *Director and Employee Hedging Policy.* The Act directs the SEC to adopt rules requiring that public companies disclose in their annual proxy statements whether employees or directors are allowed to purchase financial instruments that are designed to hedge against or offset any decrease in the market value of equity securities held by such persons.

- *Board Leadership Structure.* The Act directs the SEC to adopt rules requiring that a public company disclose in its annual proxy statement the reasons why it has chosen either the same person or different individuals to serve in the positions of chairman of the board and CEO.

- *Whistleblower Incentives and Protections.* The Act amends the Exchange Act to provide financial incentives for whistleblowers to provide information to the SEC regarding securities laws violations by their employers, and provides new protections for employee whistleblowers who provide such information.

- *Foreign Audit Work Papers.* The Act amends the Sarbanes-Oxley Act of 2002 (SOX) to subject certain foreign public accounting firms to the jurisdiction of U.S. courts and to require such firms to produce audit work papers and related documents upon request of the SEC or the Public Company Accounting Oversight Board (PCAOB) under certain circumstances.
- *Broker Voting.* The Act prohibits brokers from voting securities at shareholder meetings on certain matters, including the election of directors and executive compensation, without voting instructions from the beneficial holders of such securities. On September 9, 2010 and September 24, 2010, the SEC approved changes to New York Stock Exchange Rule 452 and NASDAQ Rule 2251, respectively, which reflect the Act's new requirement.

As this handbook goes to publication, the SEC has yet to propose implementing rules for a number of the statutory provisions noted above. Securities laws practitioners and other compliance professionals will be monitoring the SEC's rulemaking docket with great interest during the coming months, as many of these provisions grant the SEC a great deal of discretion to determine the scope of the new reporting, corporate governance and disclosure obligations that will be placed on public companies. We discuss the SEC's proposed rulemaking schedule in greater detail in the section of this handbook entitled "The Dodd-Frank Wall Street Reform and Consumer Protection Act."

The Dodd-Frank Act is part of an ongoing shift towards increased regulatory and shareholder scrutiny of the stewardship of public companies. Given this shift, it has never been more important for public company officers and directors and the professionals that advise them to ensure that their companies have in place a robust process to consider the impact of these developments on their companies and to take the necessary actions to update and enhance their disclosures and governance practices.

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THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, which we refer to in this handbook as the Dodd-Frank Act. While the Dodd-Frank Act focuses primarily on financial regulatory reform and consumer financial protections in response to the recent financial crisis, the Dodd-Frank Act also contains a number of corporate governance and other securities laws provisions directed at public companies. This chapter provides an overview of the key corporate governance and securities laws provisions of the Dodd-Frank Act, including provisions relating to:

- shareholder approval of executive compensation arrangements (or, "say-on-pay");
- shareholder access to company proxy statements;
- the independence of compensation committees and their advisors;
- a comparison of executive compensation to company performance;
- a comparison of the compensation of the company's CEO to the compensation of all other employees;
- incentive compensation clawback policies;
- employee and director hedging policies;
- board leadership structures;
- whistleblower incentives and protections;
- foreign audit work papers;
- broker voting;
- conflict minerals, mine safety and extractive industries disclosures; and
- filing deadlines for Schedule 13D and Form 3.

With certain exceptions, the Dodd-Frank Act requires the SEC to promulgate new regulations relating to the Act's provisions within 360 days after the Dodd-Frank Act's enactment date of July 21, 2010. Companies will need to comply with some of the Act's corporate governance provisions during the 2011 proxy season, though many of the provisions will likely not be effective until the 2012 proxy season. A notable exception to this timeline is the implementation of certain of the "say-on-pay"

provisions, which will become effective for a company's first annual or special shareholders' meeting taking place on or after January 22, 2011. In addition, certain other provisions, such as those relating to whistleblower protections, do not require any additional SEC rulemaking before taking effect. Below is a schedule identifying the effective date of each provision along with the current status of SEC rulemaking with respect to such provisions.

SEC Implementation Schedule

Dodd-Frank Provision	Effective Date	Status of Rulemaking
Say-on-Pay and Frequency of Say-on-Pay Shareholder Votes	First shareholders' meeting taking place on or after January 22, 2011	Proposed Rules – October 18, 2010
Golden Parachute Say-on-Pay Shareholder Votes	Subject to SEC rulemaking	Proposed Rules – October 18, 2010
Proxy Access	July 22, 2010	Final Rule – August 25, 2010 Original effective date stayed by SEC on October 4, 2010
Compensation Committee Independence and Compensation Committee Advisors	Subject to SEC rulemaking	Expected – December 2010 Required – no later than July 16, 2011
Executive Compensation Disclosures	Subject to SEC rulemaking	Expected – April-July 2011
Incentive Compensation Clawback Policies	Subject to SEC rulemaking	Expected – April-July 2011
Director and Employee Hedging Policies	Subject to SEC rulemaking	Expected – April-July 2011
Board Leadership Structure	Subject to SEC rulemaking	Required – no later than January 17, 2011
Whistleblower Incentives and Protections	July 22, 2010	Proposed Rules – November 3, 2010
Foreign Audit Work Papers	July 22, 2010	Not applicable
Broker Voting	July 22, 2010	Final NYSE Rule – approved by the SEC on September 9, 2010
Conflict Minerals, Mine Safety and Extractive Industries Disclosures	July 22, 2010 for Mine Safety disclosures with the conflict minerals and extractive industries disclosures subject to SEC rulemaking	Proposed Rules – December 15, 2010
Filing Deadlines for Schedule 13D and Form 3	Subject to SEC rulemaking	No expected date for proposed rule changes has been announced by the SEC

Shareholder Approval of Executive Compensation ("Say-on-Pay")

Introduction

Section 951 of the Dodd-Frank Act created new Section 14A under the Exchange Act, which requires public companies to ask their shareholders to approve certain executive compensation proposals. Section 14A also requires certain institutional investment managers to publicly disclose their votes on such proposals. The principal say-on-pay provisions of Section 14A do not require additional rule-making by the SEC to be effective. Nevertheless, as discussed in more detail below in the part of this section titled "Recent Development – Proposed Rules Implementing the Say-on-Pay Provisions of the Dodd-Frank Act," the SEC has issued two rule proposals to implement new Section 14A.

Say-on-Pay

New Section 14A(a)(1) of the Exchange Act requires each public company to hold a nonbinding shareholder vote on the compensation of the company's named executive officers, as such compensation is disclosed in the company's proxy statement. This vote, commonly known as a say-on-pay proposal, must take place at the company's first annual or special shareholders' meeting occurring on or after January 22, 2011 (which is six months after the enactment of the Dodd-Frank Act). The shareholder vote is purely advisory and will not be construed as:

- overruling a decision of the company or its board of directors;
- creating, implying or changing the fiduciary duties of the company or its board of directors; or
- restricting or limiting the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.

The SEC is expressly authorized to exempt an issuer or class of issuers from the say-on-pay vote requirement.

Practice Tip: Companies should revisit their shareholder communications programs in anticipation of the "say-on-pay" vote. In addition, companies should review their compensation programs and consider whether their compensation programs include any features (such as tax gross-ups) that might result in a negative vote recommendation by proxy advisory firms, such as RiskMetrics. Finally, companies should review their compensation disclosures and assure that these disclosures are clear and understandable. In particular, companies should assure that their Compensation Discussion and Analysis discloses the relationship between executive compensation and company performance. The inclusion of an executive summary in the Compensation Discussion and Analysis section should be included to assist readers. Where applicable, the executive summary should highlight any recent changes made to the company's compensation practices to align with best practices.

Section 14A(a)(2) of the Exchange Act also requires that companies submit to their shareholders, at least once every six years, a vote on a separate resolution to determine whether to have say-on-pay votes every year, every two years or every three years. This separate vote on the frequency of say-on-pay proposals must also initially be held at the first annual or special shareholders' meeting occurring on or after January 22, 2011. Some companies have already voluntarily adopted say-on-pay votes at the request of their shareholders or for corporate governance reasons. In addition, Section 111(e) of the Emergency Economic Stabilization Act (EESA) of 2008 required certain public companies to adopt say-on-pay votes as a condition to receive funding under the Troubled Asset Relief Program (TARP). Voluntary say-on-pay adopters will need to comply with the new Dodd-Frank Act requirements for the frequency of say-on-pay votes, even if they have adopted annual say-on-pay proposals. The SEC has stated, however, that it will not object if companies with outstanding TARP liabilities do not comply with the frequency of say-on-pay vote requirements so long as they are in full compliance with the say-on-pay provisions of the EESA.

The Dodd-Frank Act does not specify the exact design of the frequency vote on say-on-pay (that is, whether it should be a multiple choice vote with all options or an up or down vote on a single option). The SEC has proposed that shareholders be able to check a box to vote for any of the options, including to hold the vote every year, every two years, every three years or to abstain. See "Recent Development – Proposed Rules Implementing the Say-on-Pay Provisions of the Dodd-Frank Act" below.

Nevertheless, existing rules provide that company proxy cards may only include choices to approve, disapprove or abstain from voting on an item (usually, marked “FOR”, “AGAINST” or “ABSTAIN”). Therefore, the SEC has stated that it will not object prior to the implementation of final rules if a company provides shareholders with options consistent with the proposed rule. In addition, if proxy service providers are not capable of handling four multiple choice options in a company proposal, the SEC will not object if companies include only votes for every year, every two years or every three years and omit the option of shareholders to abstain from voting on the proposal.

Golden Parachutes

New Section 14A(b) of the Exchange Act requires public companies that are seeking the approval of their shareholders for an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all their assets to disclose any compensation arrangements they have with their named executive officers (or with those of the acquiring company, if they are not the acquiring company) that are based on or otherwise relate to the transaction. Such arrangements are often referred to as “golden parachute arrangements.” The golden parachute disclosure must include the aggregate total amount of the compensation concerning any type of compensation that is related to the transaction. Public companies are also required to submit such arrangements to a nonbinding shareholder vote, unless the arrangements have previously been subject to a vote by the shareholders. The golden parachute disclosure and voting provisions are subject to rule-making by the SEC and will only be required with respect to shareholder meetings where applicable corporate transactions are being approved.

Like the shareholder say-on-pay vote, the shareholder golden parachute vote will be nonbinding and purely advisory to the company and its board of directors. Likewise, the golden parachute vote will not be construed as:

- overruling a decision of the company or its board of directors;
- creating, implying or changing the fiduciary duties of the company or its board of directors; or
- restricting or limiting the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.

As with the say-on-pay vote, the SEC is authorized to exempt an issuer or class of issuers from the golden parachute vote requirement. For information about the

exemptions proposed by the SEC in its proposed rules implementing the say-on-pay provisions of the Dodd-Frank Act, see the section below entitled “Recent Development – Proposed Rules Implementing the Say-on-Pay Provisions of the Dodd-Frank Act.”

Investment Advisors

New Section 14A(d) of the Exchange Act requires every institutional investment manager subject to Section 13(f) of the Exchange Act (that is, those institutional investment managers exercising investment discretion over $100 million or more of U.S. public company equity securities and certain other securities) to annually disclose their votes on the say-on-pay, golden parachute and frequency of say-on-pay proposals.

Recent Development – Proposed Rules Implementing the Say-on-Pay Provisions of the Dodd-Frank Act

On October 18, 2010, the SEC released two proposed rules designed to implement Section 14A of the Exchange Act. The first proposed rule would implement and provide guidance on how public companies should include the advisory proxy votes related to executive compensation in their proxy materials. The other proposed rule addressed the manner in which institutional investment managers must disclose proxy votes on the Section 14A advisory executive compensation proposals.

Shareholder Approval of Executive Compensation and Golden Parachute Compensation

Say-on-Pay Proposals.

Under proposed Rule 14a-21(a), public companies would be required to include a say-on-pay proposal in their annual proxy statement (or other proxy statement or consent solicitation statement including executive compensation disclosures) at least once every three years. The proposed rule does not mandate specific language for the proposal. However, the rule does specify that the vote must relate to all executive compensation disclosed in the proxy statement, whether in the compensation tables, the Compensation Discussion and Analysis or in the narrative to the compensation tables. Non-management director compensation is not required to be subject to a say-on-pay vote. Companies holding say-on-pay votes will need to discuss the vote in their proxy statement, including a brief description of the nonbinding nature of the vote.

The SEC also proposes to amend the executive compensation disclosure rules to require the Compensation Discussion and Analysis to address whether and how the

compensation committee has considered the results of say-on-pay proposals and how that consideration affected its compensation policies and practices. Smaller reporting companies, which are not required to include a Compensation Discussion and Analysis in their proxy statements, would be exempt from this disclosure requirement. All of the other say-on-pay provisions would apply to smaller reporting companies. However, because they are already subject to annual say-on-pay votes under TARP, public companies with outstanding liabilities under TARP would be exempt from the say-on-pay and frequency of say-on-pay vote requirements until those liabilities have been repaid.

> **Practice tip:** Companies should consider amending their compensation committee charters to provide that the committees need to take into consideration the results of the say-on-pay votes in making determinations with respect to their compensation policies and practices.

Under proposed Rule 14a-21(b), public companies would be required to include the frequency of say-on-pay votes in their annual proxy statements that include executive compensation disclosures at least once every six years. The Dodd-Frank Act had not addressed exactly how companies were to hold this vote, including whether companies should allow shareholders to choose from all of the options (that is, from every year, every two years or every three years or to abstain) or whether companies could propose a particular frequency of the vote and have shareholders vote for or against that proposal. In addition, it was not clear whether voting would be by a plurality or majority or whether the vote would simply be advisory. Proposed Rule 14a-21(b) would clarify that the vote would only be advisory (nonbinding on the board of directors), and proposes that the shareholders should be allowed to choose from all of the multiple options.

> **Practice tip:** Companies should review their bylaws to ensure that the bylaws allow multiple choice votes at shareholders' meetings.

Similar to the requirements of the proposed rule relating to the say-on-pay proposal, companies holding the frequency vote will need to discuss the vote in their proxy statement, including a brief description of the nonbinding nature of the vote. The board of directors of a company can make a recommendation to shareholders about the frequency of the vote, but the recommendation should make it clear that shareholders have the option to select from all of the choices and are not being asked

to approve or disapprove the board's recommendation. In addition, although the vote would be nonbinding, companies would be required to disclose in their next annual report on Form 10-K or quarterly report on Form 10-Q their decision on how frequently to hold the say-on-pay proposal in light of the results of the frequency vote. As a benefit, companies that adopt a policy on the frequency of say-on-pay votes that is consistent with the vote of the plurality of their shareholders would be able to exclude from their proxy statements any shareholder say-on-pay proposals or shareholder proposals on the frequency of say-on-pay.

Practice tip: Proxy rules require the filing of a preliminary proxy statement whenever the company includes a proposal other than the election of directors, ratification of auditors, approval or amendment of an equity compensation plan or a shareholder proposal included pursuant to Rule 14a-8. Therefore, under current SEC rules, companies that include a management say-on-pay proposal or frequency of say-on-pay proposal in their proxy statements would need to file their proxy statements in preliminary form with the SEC. The SEC previously exempted TARP companies from this requirement and is proposing to exempt all companies from the requirement of filing a preliminary proxy statement solely because of a say-on-pay or frequency of say-on-pay vote. In addition, until the SEC passes final rules, the SEC has stated that it will not object if issuers do not file a preliminary proxy statement solely because of the say-on-pay and frequency of say-on-pay vote proposals.

Golden Parachute Proposals.

The proposed rules, which are required for the implementation of the golden parachute say-on-pay voting requirement to be effective, would expand the disclosure requirements relating to golden parachute arrangements. Specifically, the proposed rules would require new tabular and narrative disclosure on golden parachute arrangements in any proxy statement or consent solicitation where shareholders are being asked to approve a merger, acquisition, consolidation or proposed disposition of all or substantially all of the assets of a public company. The rules would also require this disclosure in filings for similar types of transactions, including going-private transactions under Rule 13E and in tender offers. Under the proposed rules, the soliciting issuer would be required to disclose all golden parachute arrangements between:

- the target company and the target company's named executive officers,

- the target company and the acquiring company's named executive officers, and
- the acquiring company and the target company's named executive officers.

The golden parachute say-on-pay vote would only apply to arrangements between the soliciting company and its named executive officers (or with the named executive officers of the acquiring company, if it is not the acquirer). As provided in the Dodd-Frank Act, companies are not required to seek shareholder approval of any golden parachute arrangements that had previously been subject to a say-on-pay vote. In order to take advantage of this exception, public companies would need to have included the new tabular and narrative disclosures in their most recent annual proxy statements that included a general say-on-pay proposal.

Practice tip: Under the proposed rules, in order to take advantage of the exception to the golden parachute vote, it would not be sufficient for companies to have included only the current disclosures required by the SEC with respect to compensation payable in connection with a change in control or termination of service, as the new tabular and narrative disclosure requirements for golden parachutes are in addition to and different than the disclosures required under existing rules. Rather, companies would be required to include the additional golden parachute tabular and narrative disclosure in their proxy statements which include say-on-pay proposals. In addition, the exception applies only to the extent that such golden parachute arrangements were previously disclosed and had not been modified. If any arrangements were modified or entered into after the last say-on-pay vote where such arrangements were properly disclosed, the modified or new arrangements (but not the previously approved terms or arrangements) would be subject to a golden parachute say-on-pay vote. It is not expected that companies will include the additional disclosures needed to avail themselves of this exception. In particular, the inclusion of such disclosures could be interpreted by investors as an indication that the company is contemplating a change in control transaction. In addition, the inclusion of such disclosures might focus shareholders on a company's golden parachute arrangements when evaluating their regular say-on-pay vote.

Investment Manager Reporting of Proxy Votes on Executive Compensation

Proposed Rule 14Ad-1 would implement the say-on-pay disclosure provisions of the Dodd-Frank Act with respect to institutional investment managers. The proposed

rule would require disclosure on Form N-PX of the Section 14A say-on-pay votes cast by institutional investment managers subject to Section 13(f) of the Exchange Act with respect to any securities over which they have sole or shared voting power. The information to be included in the Form N-PX relating to the Section 14A votes includes, among other things, information about the issuer, a description of the matter voted on, the number of shares able to be voted and the number actually voted, how the shares were voted, and whether the vote was for or against the recommendation of the issuer's board of directors.

Proxy Access

SEC rules that are currently in effect prohibit shareholders from gaining access to a company's proxy statement to propose their own director nominees or to propose changes to a company's governing documents relating to the nomination or election of directors. In late 2009, the SEC proposed changes to the federal proxy rules to facilitate shareholder access to the proxy statements (and proxy cards) of public companies for these purposes.

Section 971 of the Dodd-Frank Act, included in part over concerns that the SEC lacked the regulatory authority to enact the proxy access rules, expressly authorizes the SEC to prescribe rules that would require proxy statements to include:

- nominees submitted by shareholders to serve on the board of directors of the issuer; or
- proposed changes to a company's governing documents relating to the nomination or election of directors.

The Dodd-Frank Act only authorized the passage of proxy access rules; it did not require the SEC to enact such rules or specify the details of the rules. In response to the passage of the Dodd-Frank Act, on August 25, 2010, the SEC adopted final changes to the federal proxy rules to facilitate shareholder access to proxy materials. The effectiveness of the proxy access rules has been stayed by the SEC pending resolution of a petition being heard in the Court of Appeals for the District of Columbia. For more information about the proxy access rules promulgated by the SEC, please see the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Process – Recent Development – Final Proxy Access Rule."

Compensation Committee Independence and Authority to Retain Advisors

Compensation Committee Independence

Section 952 of the Dodd-Frank Act requires that stock exchanges adopt listing standards requiring that each member of a public company's compensation committee be an independent member of the board of directors. The Act further directs the SEC to define independence by considering several relevant factors (which mirror the eligibility criteria for audit committee members under Section 301 of SOX), including:

- the source of the committee member's compensation, including any consulting, advisory or other compensatory fee paid by the company to the director; and
- whether the committee member is affiliated with the issuer, a subsidiary of the issuer or an affiliate of the issuer's subsidiary.

These independence requirements will not apply to (i) foreign private issuers that annually disclose to their shareholders why they do not have an independent compensation committee, (ii) limited partnerships, (iii) companies in bankruptcy proceedings, (iv) open-ended management investment companies registered under the Investment Company Act of 1940, as amended or (v) "controlled companies," which are listed companies of which more than 50% of the voting power for the election of directors is held by an individual, group or other company.

Under currently existing New York Stock Exchange rules, with certain exceptions, a New York Stock Exchange listed company must have a compensation committee composed entirely of independent directors whose responsibilities include reviewing and approving matters related to the compensation of the company's CEO and making recommendations to the full board of directors with respect to the compensation of other executives. Likewise, companies listed on NASDAQ must also have independent director oversight of executive officer compensation, whether through the independent members of the board of directors or a compensation committee composed entirely of independent directors. For these and other reasons, most public companies' compensation committees already consist of only independent directors. Nevertheless, SEC rulemaking in furtherance of the Dodd-Frank Act may impose enhanced independence requirements for compensation committee members.

Authority to Retain Advisors

Section 952 of the Dodd-Frank Act requires public companies to give compensation committees the authority to hire their own compensation consultants, independent legal counsel and other advisors, and to be responsible for the compensation and oversight of such advisors. Public companies must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to the compensation consultants, legal counsel and other advisors. The compensation committee is not required, however, to implement or act consistently with the advice or recommendations of such advisors. Moreover, such advice or recommendations should not affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of its duties.

Practice Tip: Public companies should review their existing compensation committee charters to make sure that the charters conform with the provisions of Section 952 and any rules the SEC adopts to implement such provisions. Many compensation committee charters, however, may already grant the committee the ability to hire and compensate its own advisors. For example, existing New York Stock Exchange rules (but not the listing rules of NASDAQ) require New York Stock Exchange listed companies to provide their compensation committees with the power to appoint compensation consultants.

There has traditionally not been any significant emphasis on compensation committees retaining independent legal counsel and it is not clear how the Dodd-Frank Act might impact the retention of legal advisors by compensation committees. A similar provision in SOX required public companies to permit their audit committees to retain independent legal counsel. Nevertheless, audit committees have tended to retain independent legal counsel only in circumstances involving special investigations relating to financial restatement matters.

Compensation Consultants and Advisors

In addition to the requirements relating to the independence of the compensation committee and its authority to retain advisors, Section 952 of the Dodd-Frank Act requires compensation committees to take into consideration certain factors to be specified under rules to be adopted by the SEC in selecting compensation consultants, legal counsel and other advisors. In particular, the Dodd-Frank Act requires the SEC to

identify those factors that affect the independence of compensation consultants, legal counsel and other advisors, while preserving the ability of compensation committees to retain the services of such advisors. These factors must include:

- the provision of other services to the company by the person that employs the compensation consultant, legal counsel or other advisor;
- the amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel or other advisor, as a percentage of the total revenue of the person that employs the advisor;
- the policies and procedures of the person that employs the compensation consultant, legal counsel or other advisor designed to prevent conflicts of interest;
- any business or personal relationship of the compensation consultant, legal counsel or other advisor with a member of the compensation committee; and
- any stock of the public company owned by the compensation consultant, legal counsel or other advisor.

While the compensation consultants, legal counsel and other advisors are not required to be independent, compensation committees may only appoint and select advisors after considering the SEC's independence factors.

The Dodd-Frank Act further instructs the SEC to ensure that the factors described above are "competitively neutral" among the categories of consultants, legal counsel and other advisors. At this time, absent further direction from the SEC, the meaning and effect of "competitively neutral" is unclear. Based on the Congressional record, it appears, however, that Congress was focused at a minimum on ensuring equal treatment for large and small consultants.

Compensation Consultant Independence Disclosure Requirement

In any proxy or consent solicitation material for an annual shareholders' meeting occurring on or after July 21, 2011, in accordance with the SEC regulations to be issued in furtherance of the Dodd-Frank Act, a public company must disclose:

- whether the compensation committee retained or obtained the advice of a compensation consultant; and

- whether the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed.

This enhanced disclosure requirement only applies to compensation consultants (and not to other advisors).

Under rules recently enacted by the SEC, public companies are required to disclose in their proxy statements certain information about the fees paid to compensation consultants and their affiliates if the consultant or its affiliates provided other non-executive and non-director compensation consulting services to the company that generated fees in excess of $120,000 during the company's last fiscal year. The recently enacted rules did not require independent directors or board approval of such non-executive compensation consultant services. We expect, however, that as a result of the Act, compensation committees will develop policies and procedures to address potential conflicts of interest resulting from other services provided by the consultant or other relationships between the consultant and the company.

The Dodd-Frank Act requires the SEC to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer (other than a controlled company) that is not in compliance with the compensation consultant and proxy statement disclosure provisions discussed above. The SEC rules promulgated under this section must also provide for appropriate procedures for a public company to have a reasonable opportunity to cure any defect that would be the basis for a prohibition before its implementation.

Executive Compensation Disclosures

Item 402 of Regulation S-K requires public companies other than foreign issuers to disclose certain information about the compensation they pay to certain named executive officers and non-employee directors. Section 953 of the Dodd-Frank Act directs the SEC to amend Item 402 to require additional disclosures comparing (i) the compensation paid to executive officers with the company's financial performance (Pay versus Performance) and (ii) the compensation paid to the CEO with the average compensation paid to all other employees (Pay Equity). Proposed rules regarding Executive Compensation Disclosure are not expected until the spring of 2011.

Pay versus Performance

Section 953 of the Dodd-Frank Act directs the SEC to promulgate rules requiring public companies to provide a clear description of their executive compensation programs. Specifically, public companies will be required to disclose in their proxy statements for annual shareholders' meetings information that shows the relationship between the executive compensation paid to executive officers and the financial performance of the company. Such figures should take into account changes in the stock value and dividends of the company and any distributions. The SEC rules, which are not expected until the spring of 2011, will likely address the precise scope of this requirement, including the definitions of "executive compensation," "executive officers," and "financial performance." Section 953, however, does indicate that the disclosure may be provided in the form of a performance graph.

Pay Equity

Section 953 of the Dodd-Frank Act also directs the SEC to amend Item 402 of Regulation S-K to require public companies to disclose the following information in any SEC filing that requires the disclosure of named executive officer compensation:

- the median of the total annual compensation of all employees other than the CEO;
- the total annual compensation of the CEO; and
- the ratio of these two amounts.

This disclosure is to be provided in accordance with rules to be adopted by the SEC. However, Section 953 specifies that the total compensation of all employees should be calculated according to the methods used under Item 402 to calculate named executive officer pay.

Practice Tip: Considering the resources needed to calculate the total annual compensation for named executive officers, the calculation of the median of the total annual compensation of all employees other than the CEO will likely be a significant burden for many companies. For example, total annual compensation for named executive officers reflects increases in pension values and the costs of perquisites, which may not be information that is readily available for all employees. Until the SEC proposes rules implementing this provision of the Dodd-Frank Act, it is not clear how the SEC will address these practical problems. To address concerns about the potential burdens on companies, the SEC may choose to provide that this disclosure shall be treated as furnished and not filed under the securities laws. Also, the SEC proposed rules could allow for ratios that use estimates in the calculation.

Incentive Compensation Clawback Policy

Section 954 of the Dodd-Frank Act requires the SEC to adopt rules directing the national securities exchanges to prohibit the listing of any company that does not adopt and implement a "clawback" policy that meets certain minimum requirements. Upon adoption of the new rules, a listed company will be required to develop and implement a policy providing that, in the event that the company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, the company will recover the portion of any incentive compensation (including stock options) based on erroneous data and granted to any executive officer during the 3-year period preceding the date the financial statements are required to be restated that are in excess of what would have been paid to the executive officer under the restated financial statements. Such clawback policy is required to apply to both current and former executive officers, without regard to whether such officers engaged in any misconduct.

In addition to requiring the clawback of erroneously paid incentive compensation as described above, a listed company will be required to disclose its policy on incentive-based compensation that is based on financial information required to be reported under the securities laws.

Section 954's clawback requirement is significantly broader than the clawback requirement contained in Section 304 of SOX, which is discussed in greater detail in the chapter of this book entitled "The Sarbanes Oxley Act." Under SOX, if a company is required to restate its financial statements due to material noncompliance, as a result

of misconduct, with any financial reporting requirement under the securities laws, the company's CEO and CFO must reimburse the company for any bonus or other incentive or equity-based compensation received from the company during the 12-month period following the publication or SEC filing (whichever is first) of the financial document being restated, and any profits realized from the sale of the company's securities during that period. SOX's clawback requirement is narrower than that of the Dodd-Frank Act in the following respects:

- SOX's requirement applies only to a company's CEO and CFO, whereas the rules to be issued pursuant to the Dodd-Frank Act will apply to all current and former executive officers;
- SOX's requirement only applies if there has been misconduct, whereas the rules to be issued pursuant to the Dodd-Frank Act will apply without regard to whether the restatement results from misconduct; and
- SOX requires a clawback of compensation received during 12-month period following the publication or SEC filing (whichever is first) of the financial document being restated, whereas the rules to be issued pursuant to the Dodd-Frank Act will require clawback of erroneous awards granted during the 3-year period preceding the date of restatement.

The SEC's tentative rulemaking schedule indicates that the SEC will propose rules under Section 954 between April and July 2011.

> **Practice Tip:** In addition to adopting and developing a clawback policy that meets the new requirements, a listed company must consider whether to amend its incentive compensation award agreements in order to provide the company with the right to claw back erroneously paid compensation. Because the scope of the required clawback policy will not be known until the SEC issues final rules, it is recommended that companies wait until the new rules are adopted before determining what actions to take.

Director and Employee Hedging Policy

Section 955 of the Dodd-Frank Act directs the SEC to adopt rules that will require an issuer to disclose information regarding its director and employee hedging policy in the proxy or consent solicitation materials for its annual shareholders' meetings. Specifically, an issuer will be required to disclose whether any employee or

director (or any designee of such person) is permitted to purchase financial instruments designed to hedge against a decrease in the market value of equity securities (i) granted to the employee or director as part of such person's compensation or (ii) directly or indirectly held by such employee or director. The types of hedging instruments that will be subject to the rules will include, at minimum, prepaid variable forward contracts, equity swaps, collars and exchange funds. The SEC's tentative rulemaking schedule indicates that the SEC will propose rules under Section 955 between April and July 2011.

> **Practice Tip:** Employee and director hedging is often addressed in a company's insider trading policy. While many companies may determine to prohibit hedging transactions (or may already prohibit such transactions), we expect that a considerable number of companies will wish to maintain flexibility to allow for legitimate hedging transactions that allow insiders to monetize their equity interests. It is recommended that companies which do consider adopting a policy to prohibit such activities, or updating any applicable policies already in place, wait to do so until the SEC has adopted rules clarifying the scope of the disclosure requirements.

Board Leadership Structure

Section 972 of the Dodd-Frank Act requires the SEC to issue rules by January 17, 2011 requiring public companies to disclose in their proxy statements for their annual shareholders' meetings the reasons why they have chosen either the same person or different individuals to serve in the positions of chairman of the board and CEO. SEC rules enacted in December 2009 included a requirement that public companies discuss the rationale for their board leadership structure, including with respect to the Chairman and CEO positions. Section 972 of the Dodd-Frank Act appears to simply codify the rule change and does not appear to impose any additional requirements on public companies.

Whistleblower Incentives and Protections

Section 922 of the Dodd-Frank Act creates new financial incentives for whistleblowers to report suspected securities laws violations directly to the SEC. Section 922 added a new Section 21F to the Exchange Act. Under Section 21F, any eligible whistleblower who provides the SEC with original information relating to a previously unknown violation of the securities laws derived from his or her own

knowledge and analysis, which leads to a successful enforcement action resulting in over $1 million in monetary sanctions, must be awarded between 10% and 30% of the sanctions collected. A whistleblower may receive an award under Section 21F if the following conditions are met:

- the whistleblower provided "original information" to the SEC (see "Original Information" below);
- the original information provided by the whistleblower led to a successful judicial or administrative enforcement action resulting in over $1 million in monetary sanctions; and
- the whistleblower is not otherwise disqualified from receiving an award for any of the reasons specified in Section 21F (see "Eligibility for Awards" below).

The Dodd-Frank Act requires the SEC to issue final regulations implementing Section 21F by April 18, 2011. On November 3, 2010, the SEC issued proposed implementing regulations. The public comment period for the proposed rules will end on December 17, 2010, after which the SEC is expected to issue final rules. However, it is important to note that the whistleblower provisions of Section 21F became effective immediately upon enactment of the Dodd-Frank Act, and, as a result, an otherwise eligible whistleblower will be eligible to receive an award so long as the information was provided after July 21, 2010. Furthermore, the new whistleblower provisions apply with respect to all securities laws violations, regardless of whether they occurred prior to or after July 21, 2010.

Original Information. For purposes of Section 21F, "original information" means information that:

- is derived from the independent knowledge or analysis of a whistleblower;
- is not known to the SEC from any other source, unless the whistleblower is the original source of the information; and
- is not exclusively derived from an allegation made in a judicial or administrative hearing, in a government report, hearing, audit or investigation, or from the news media, unless the whistleblower is the source of the information.

For purposes of the above definition, the SEC's proposed rules would define "independent knowledge" to mean factual information in the whistleblower's possession that is not derived from publicly available sources. Similarly, the proposed rules would define "independent analysis" as the whistleblower's own analysis, whether done alone or in combination with others.

The proposed rules would also identify a number of specific circumstances under which information will not be considered to be derived from the whistleblower's independent knowledge or analysis. Under one such exclusion, a person with legal, compliance, audit, supervisory or governance responsibilities for any entity would generally not be considered to have provided independent knowledge or analysis where the information was communicated to such person with the reasonable expectation that he or she would take steps to cause the entity to respond to such violation. Similarly, the proposed rule provides that a person would generally not be considered to have provided independent knowledge or analysis where he or she obtained the information otherwise from or through an entity's legal, compliance, audit or other similar functions or process for identifying, reporting and addressing potential non-compliance with law. However, each of the two exclusions identified above would cease to be applicable if the entity does not disclose the information to the SEC within a reasonable time or if the entity proceeds in bad faith. The SEC's stated rationale for these proposed exclusions was to avoid implementing Section 21F in such a way that would create incentives for persons who obtain information through legal, compliance and audit functions to circumvent or undermine the proper operation of the entity's internal processes for responding to securities laws violations.

Many public companies have established telephone hotlines and other internal reporting procedures through which employees may anonymously report any concerns of potential wrongdoing. Some observers have suggested that the way "original information" is defined by the statute may provide an incentive to an employee who suspects a potential securities law violation to bypass these internal reporting procedures and report his or her suspicions directly to the SEC or anonymously through a lawyer. An employee who reported information about a suspected violation internally could worry that he or she will be deprived of his or her chance to receive an award if the company were to subsequently self-report the violation to the SEC and the information was no longer deemed "original." As a result, these observers are concerned that the effectiveness of internal corporate compliance programs could be jeopardized.

To partially address this concern, the SEC's proposed implementing rule grants the benefit of a 90-day "look-back" period to any employee who reports information regarding suspected violations internally to appropriate compliance personnel. For purposes of determining his or her eligibility to receive an award, such an employee whistleblower who subsequently reports the same information to the SEC will be deemed to have done so as of the date that he or she disclosed such information internally.

Practice Tip: A company may consider taking the following steps in order to strengthen its compliance program in light of the provisions of Section 21F:

- Offer incentives to employees to report suspected violations internally.
- Review and update the company's code of business conduct, insider trading policy and other ethics policies.
- Conduct training programs that inform employees of where they should report any suspected violations of the law or the company's ethics policies.
- Adopt a policy prohibiting retaliation against whistleblowers and publicize this policy internally.
- Ensure that all procedures for internal reporting are in place, including a means by which employees may anonymously report suspected violations.
- Promptly investigate any violations reported by internal whistleblowers.

Eligibility for Awards. The following persons will be ineligible to receive awards under Section 21F:

- certain current and former members of regulatory agencies, the Department of Justice, self-regulatory organizations (SROs), the Public Company Accounting Oversight Board (PCAOB) and law enforcement organizations;
- any whistleblower who is convicted of a criminal violation related to the enforcement action for which the whistleblower otherwise could receive an award;
- any whistleblower who gains the information through the performance of a required audit and for whom making a whistleblower submission would be contrary to the requirements of Section 10A of the Exchange Act; and

- any whistleblower who fails to submit information to the SEC as it may require.

In addition, the SEC's proposed implementing rules would disqualify any whistleblower who (i) acquired the submitted information from one of the above sources, (ii) is a close relative of an SEC employee or (iii) knowingly and willfully made any false statement or representation to the SEC.

Notably, nothing in Section 21F excludes a non-U.S. person from receiving an award. Accordingly, an employee of a U.S. company's foreign subsidiary may receive an award from the SEC if he or she is otherwise eligible. This may be of particular concern to any U.S. company whose overseas operations expose it to enforcement risk under the Foreign Corrupt Practices Act (FCPA), because monetary sanctions arising from FCPA violations can be very substantial.

Size of Awards. The SEC will have discretion under Section 21F to award a whistleblower anywhere from 10% to 30% of the amount that is collected of the monetary sanctions imposed in the SEC enforcement action and in any related action brought by the Attorney General of the United States, an appropriate regulatory agency, an SRO, or a State attorney general in connection with any criminal investigation. The SEC will consider (i) the significance of the information provided by the whistleblower to the enforcement action, (ii) the degree of assistance provided by the whistleblower and his or her legal representative in the enforcement action, (iii) the programmatic interest of the SEC in deterring violations of the securities laws and (iv) any other relevant factors established under the SEC's implementing regulations.

New Anti-Retaliation Protections for Whistleblowers. Section 21F also includes new legal protections for employee whistleblowers who lawfully provide information regarding securities law violations to the SEC (or who provide certain other assistance to the SEC based upon or related to such information) and are consequently discharged, demoted, threatened, harassed or otherwise discriminated against in the terms or conditions of their employment. These protections include a new private right of action for (i) reinstatement of employment, (ii) two times back pay owed to the individual, plus interest and (iii) compensation for litigation costs, expert witness fees and reasonable attorney's fees. This new private right of action may be brought in a federal district court within six years of the violation or three years of discovery of the violation, but in no case more than ten years after the violation. Under the SEC's

proposed implementing rules, a whistleblower would be entitled to these protections if he or she has provided information with respect to a potential securities laws violation, even if the SEC or the courts ultimately determine that no actual securities laws violation occurred.

Subject to certain exceptions, the SEC is prohibited from disclosing any information which could reasonably be expected to reveal the identity of any whistleblower.

Amendments to Existing SOX Whistleblower Provisions. In addition to creating new Section 21F of the Exchange Act, the Dodd-Frank Act also makes certain amendments to the whistleblower provisions of SOX, including the following:

- Section 922(c) of the Dodd-Frank Act extends the statute of limitations for SOX whistleblower claims from 90 to 180 days after the employee became aware of the retaliatory conduct;
- Section 922(e) of the Dodd-Frank Act amends the SOX whistleblower provision such that the rights and remedies provided for therein may not be waived by any agreement, policy form or condition of employment, including by a pre-dispute arbitration agreement; and
- Section 929A of the Dodd-Frank Act extends SOX whistleblower protection to employees of all consolidated subsidiaries and affiliates of a public company.

Notably, the whistleblower provisions of SOX are not displaced or limited by the provisions of new Section 21F of the Exchange Act, and continue to be effective independent of Section 21F.

FOREIGN AUDIT WORK PAPERS

Section 929J of the Dodd-Frank Act amends Section 106 of SOX to include oversight of both foreign public accounting firms and the registered public accounting firms who use them.

Foreign Public Accounting Firms. Foreign public accounting firms who perform material services upon which a registered public accounting firm relies in the conduct of an audit or interim review, issues an audit report, performs audit work or conducts interim reviews:

- are subject to the jurisdiction of U.S. courts; and

- must produce foreign audit work papers and all other documents of the firm related to any such work, upon request, to the SEC or PCAOB.

Registered Public Accounting Firms. Additionally, any registered public accounting firm that relies on the work of a foreign public accounting firm must:

- also produce the foreign audit work papers and all other documents of the firm related to any such work; and
- obtain an agreement of the foreign public accounting firm for such production as a condition to its reliance on the work of such foreign firm.

Additionally, any foreign public accounting firm that performs work for a registered public accounting firm must consent to the rules to be promulgated by the SEC pursuant to Section 929J of the Dodd-Frank Act. Section 981 of the Dodd-Frank Act allows the PCAOB to share all information it receives, including such foreign audit work papers with the applicable foreign auditor oversight authority without losing the information's status as confidential or privileged.

These provisions are effective immediately.

BROKER VOTING

As described in more detail in the section of this handbook titled "Proxy Statement and Annual Report Disclosures and Process – Broker Voting," most brokers and other intermediaries are subject to Rule 452 of the New York Stock Exchange, which permits them to vote shares for which they have not received voting instructions from the beneficial holders only on what are referred to as "routine" matters. If the beneficial holders do not provide voting instructions to the intermediaries, the intermediaries will not be permitted to vote those shares on most matters that come before a shareholders' meeting, including on the election of directors, the approval or amendment of equity compensation plans and most other matters involving fundamental corporate transactions.

Section 957 of the Dodd-Frank Act imposes a new requirement that national securities exchanges prohibit their member organizations (that is, the brokers and other intermediaries) from granting or authorizing a proxy to vote the shares held by street holders on any executive compensation matters without the instructions of such holders. Under prior rules, votes on executive compensation not involving an equity incentive plan, including votes on management say-on-pay proposals, were treated as

routine matters in which the intermediaries could vote without instructions from the street holder. In response to the new requirement of the Dodd-Frank Act, the New York Stock Exchange filed a proposed rule change to Rule 452 and corresponding NYSE Listed Company Manual Section 402.08 on August 26, 2010, to prohibit broker discretionary voting on all executive compensation matters, including the say-on-pay, frequency of say-on-pay and golden parachute votes. The SEC approved the rule change on an accelerated basis on September 9, 2010. Likewise, The NASDAQ Stock Market LLC filed a proposed rule change on September 14, 2010, which amended NASDAQ Rule 2251 to prohibit its member organizations from voting shares without instructions from the beneficial owners in matters regarding the election of directors or executive compensation or any other "significant matter," as determined by the SEC. The SEC approved the rule change on an accelerated basis on September 24, 2010.

SOX Reports for Smaller Reporting Companies and Non-Accelerated Filers

Section 989G of the Frank-Dodd Act amended Section 404 of SOX by adding a new subsection exempting smaller reporting companies and non-accelerated filers from the requirement that their independent auditors prepare an attestation report on the company's internal controls over financial reporting and include that report in their quarterly and annual reports on Forms 10-Q and 10-K.

New Conflict Minerals, Mine Safety and Extractive Industries Disclosures

Title XV of the Dodd-Frank Act contains three "Miscellaneous Provisions" that impose new disclosure obligations on public companies that operate in certain extractive industries or use specified conflict minerals in their products or production methods.

Use of Conflict Minerals

Section 1502 of the Dodd-Frank Act requires the SEC to enact rules by April 15, 2011 requiring certain public companies to disclose whether their products or production methods use conflict minerals that originated in the Democratic Republic of Congo or its adjoining countries.

Conflict minerals are defined as columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, and any other minerals or derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

On December 15, 2010, the SEC issued proposed rules to implement Section 1502. Under the proposed rules, if conflict minerals are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by a public company, the public company would be required to disclose whether its conflict minerals originated in the Democratic Republic of the Congo or an adjoining country. If the conflict minerals originated in the Democratic Republic of the Congo or an adjoining country (or if the company is not able to conclude that its conflict minerals did not originate in such countries), the company would be required to furnish a "Conflict Minerals Report" as an exhibit to its annual report that includes, among other matters, a description of the measures taken by the company to exercise due diligence on the source and chain of custody of its conflict minerals. These due diligence measures would include, but would not be limited to, an independent private sector audit of the company's report conducted in accordance with standards established by the Comptroller General of the United States. The Conflict Minerals Report would be required to include a description of the products manufactured or contracted to be manufactured that are not "DRC conflict free." "DRC conflict free" is defined in Section 1502 to mean products that do not contain minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Any company required to furnish a report would be required to certify that it obtained an independent private sector audit of its report and make its reports available to the public on its website.

Mine Safety

Pursuant to Section 1503 of the Dodd-Frank Act, public companies that operate coal or other mines must disclose in all periodic reports filed after the enactment of the Act detailed information related to health and safety violations under the Federal Mine Safety and Health Act of 1977, as well as any pending legal actions before the Federal Mine Safety and Health Review Commission, with respect to the periods covered by such reports. The SEC issued proposed rules implementing Section 1503 on December 15, 2010.

Payments by Resource Extraction Issuers

Under Section 1504 of the Dodd-Frank Act, the SEC is directed to enact rules by April 15, 2011 requiring public companies that engage in the commercial development of oil, natural gas or minerals ("resource extraction issuers") to disclose any payments they or their subsidiaries have made to the U.S. or foreign governments for the purpose of commercial development of those resources. The SEC issued proposed rules implementing Section 1504 on December 15, 2010.

Filing Deadlines for Schedule 13D and Form 3

Section 929R of the Dodd-Frank Act amended Section 13(d) of the Exchange Act to authorize the SEC to establish by rule a shorter time period within which a Schedule 13D must be filed. Similarly, the Act amended Section 16(a) to authorize a shorter time period within which a new Section 16 insider would be required to file a Form 3. As this handbook goes to publication, the SEC has not proposed any rule change that would shorten either of the current 10-day reporting windows applicable to these filings.

PERIODIC AND CURRENT REPORTING UNDER THE EXCHANGE ACT

Under Section 13(a) of the Securities Exchange Act of 1934, as amended (which we refer to as the Exchange Act), and its implementing regulations, every company with a class of securities registered under Section 12 of the Exchange Act is required to file certain periodic and current reports with the SEC. The obligation to register a class of securities under Section 12 of the Exchange Act may arise pursuant to either: (i) Section 12(b), which requires the registration of securities listed for trading on a national securities exchange; or (ii) Section 12(g), which generally requires a company to register a class of its equity securities if the company has more than $10 million in total assets and the class is held of record by 500 or more persons. In addition, Section 15(d) of the Exchange Act requires companies that have had an offering of securities registered under the Securities Act of 1933, as amended (which we refer to as the Securities Act), to comply with the same reporting requirements imposed by Section 13(a) on companies that have a class of securities registered under Section 12 of the Exchange Act. Throughout this handbook, we refer to companies subject to the reporting requirements of Section 13(a) or Section 15(d) as "public companies" or "issuers."

Reporting Forms

Assuming it does not qualify as a "foreign private issuer," the principal documents filed by a public company to comply with its reporting obligations under Section 13(a) or 15(d) of the Exchange Act include its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Below is a brief summary of each of these documents, which are discussed in more detail later in this section:

Annual Reports on Form 10-K

A company's Annual Report on Form 10-K includes the company's yearly audited financial statements and is the company's primary investor disclosure document regarding key aspects of its business, financial statements and business prospects and risks, including the following items:

- a description of its business;
- risk factors and legal proceedings;
- a discussion and analysis of the company's operating results and its liquidity and capital resources; and

- an evaluation of the company's disclosure controls and procedures and an assessment of the effectiveness of its internal controls over financial reporting.

The Form 10-K also includes various matters related to compensation and corporate governance, which may be, and usually are, included in the company's annual proxy statement and incorporated by reference into its Form 10-K.

Quarterly Reports on Form 10-Q

A company's Quarterly Report on Form 10-Q provides its unaudited quarterly financial statements and generally updates certain disclosures made in its previously filed Form 10-K. Among other things, a company is generally required to report on Form 10-Q the following information in respect of its most recently completed fiscal quarter:

- a discussion and analysis of the company's operating results and its liquidity and capital resources;
- an evaluation of the company's disclosure controls and procedures;
- any material changes to its risk factors and legal proceedings disclosures; and
- any unregistered sales of equity securities or repurchases of the company's equity securities.

In addition, both the Form 10-K and Form 10-Q must be accompanied by certifications from the company's principal executive and principal financial officers as to the accuracy of the information provided in the reports and the design and effectiveness of the company's disclosure controls and procedures and internal controls over financial reporting.

Current Reports on Form 8-K

A company is required to file or furnish with the SEC a Current Report on Form 8-K to disclose the occurrence of certain material events. Triggering events that generally require the filing or furnishing of a Form 8-K include:

- entering into, or terminating, a material contract;
- material acquisitions or dispositions;

- the disclosure of quarterly or annual financial results;
- material financing arrangements;
- the acceleration of material financing obligations;
- material exit or disposal activities;
- delisting or non-compliance with a listing rule;
- unregistered sales of the company's equity securities;
- a change in accountants;
- a determination that the company's previously issued financial statements should no longer be relied upon;
- changes in the board of directors;
- the appointment, retirement, resignation or termination of certain executive officers, or the entry into or amendment of a material compensatory arrangement with such officers;
- charter and bylaw amendments; and
- amendments to or waivers of the company's code of ethics.

In addition, public companies are required to file a Form 8-K to report the voting results of shareholders' meetings.

Public companies organized outside the United States that meet the definition of a "foreign private issuer" are not required to file or furnish reports on Forms 10-K, 10-Q or 8-K, and instead are subject to reporting on Forms 20-F and 6-K. We discuss the reporting and disclosure requirements applicable to foreign private issuers in the section of this handbook entitled "Foreign Private Issuer Reporting and Compliance."

Categories of Public Companies

There are four main categories of public companies for Exchange Act reporting purposes:

Large Accelerated Filers

A company becomes a large accelerated filer after it first meets the following conditions as of the end of a fiscal year: (i) it had a public float (*i.e.*, an aggregate

worldwide market value of the voting and non-voting common equity held by its non-affiliates) of $700 million or more, as of the last business day of its most recently completed second fiscal quarter; (ii) it has been subject to the reporting requirements of the Exchange Act for at least 12 months; (iii) it has filed at least one Annual Report on Form 10-K; and (iv) it is not eligible to file as a smaller reporting company for purposes of its Annual and Quarterly Reports.

Accelerated Filers

An accelerated filer is a company that would otherwise qualify as a large accelerated filer, except that it had a public float of at least $75 million, but less than $700 million, as of the last business day of the second fiscal quarter of its most recently completed fiscal year.

Smaller Reporting Companies

A smaller reporting company is generally any company that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company, provided that:

- it had a public float of less than $75 million as of the last business day of the second fiscal quarter of its most recently completed fiscal year;
- in the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, it had a public float (computed based upon the estimated public offering price of its shares) of less than $75 million as of a date within 30 days of the date of the filing of the registration statement; or
- in the case of a company whose public float was zero as calculated for purposes of the above two bullets (*e.g.*, because it had no public equity outstanding or no market price for its equity existed), it had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available.

Smaller reporting companies are subject to reduced reporting requirements in some instances, including with respect to their financial statements and internal controls over financial reporting.

Non-Accelerated Filers

A "non-accelerated filer" is generally any company that does not qualify as a large accelerated filer or an accelerated filer. In most (but not all) cases, a non-accelerated filer will also be a smaller reporting company and a smaller reporting company will also be a non-accelerated filer.

Asset-Backed Issuers

Asset-backed issuers are subject to modified reporting requirements pursuant to which they may omit certain items normally required to be disclosed on Forms 10-K, 10-Q and 8-K but are required to furnish certain other information prescribed in Regulation AB. Because it is a highly specialized area that is unlikely to be relevant to the majority of readers, this handbook does not cover the reporting obligations of asset-backed issuers.

Filing Deadlines; Failure to Timely File a Required Report

The filing deadlines for Forms 10-K, 10-Q and 8-K are as follows:[3]

Filing Form	Large Accelerated Filers	Accelerated Filers	Non-Accelerated Filers/ Smaller Reporting Companies
Form 10-K	Within 60 days after the end of the company's fiscal year	Within 75 days after the end of the company's fiscal year	Within 90 days after the end of the company's fiscal year
Form 10-Q	Within 40 days after the end of the company's fiscal quarter	Within 40 days after the end of the company's fiscal quarter	Within 45 days after the end of the company's fiscal quarter
Form 8-K	Form 8-Ks are generally due within four *business* days following the triggering event. Certain items, however, including disclosures made pursuant to Regulation FD, may require the company to file a Form 8-K on a shorter timetable. It is common practice for a company to file a Form 8-K promptly after its earnings release and prior to its earnings call in order to avail itself of a safe harbor from the otherwise applicable requirement to file an additional Form 8-K to disclose the release of material financial information made during its earnings call. This safe harbor, and earnings releases generally, are discussed in greater detail later in this section. Another exception to the four business day rule are financial statements of any business acquired in a material acquisition disclosed on Form 8-K, which is required to be filed either with the initial report on Form 8-K disclosing the material acquisition *or* by amendment not later than 71 calendar days after the date such initial report must be filed.		

[3] The deadlines provided herein are the general deadlines for the respective forms, which may not apply in all circumstances. Forms can be filed with the SEC on Monday through Friday, except for Federal holidays (*i.e.*, days when the SEC is closed). Forms due on a date when a filing cannot be made are due on the next business day. Most Exchange Act filings must be transmitted no later than 5:30 p.m. Eastern time on the due date. However, registration statements that are filed pursuant to Rule 462(b) under the Securities Act to increase the number of shares in an offering and insider filings on Forms 3, 4 and 5 may receive the same day's filing date if transmitted up to 10:00 p.m. Eastern time.

A company that fails to timely file a periodic report on Forms 10-K or 10-Q or a current report on Form 8-K violates Sections 13(a) or 15(d) of the Exchange Act and may be subject to enforcement action by the SEC. Such a failure could also subject the company to liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Rules 13a-11(c) and 15d-11 provide a safe harbor from such liability for failures to file reports required to be made pursuant to certain Form 8-K items – specifically, Items 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e) and 6.03. The safe harbor extends only until the next date on which the company is required to file a periodic report on Form 10-K or 10-Q. Significantly, the safe harbor does not provide protection from 10b-5 liability for material misstatements or omissions contained in a Form 8-K.

In addition to potential liabilities under the Exchange Act, a company that fails to timely file an Exchange Act report may be rendered ineligible to file a "short-form" registration statement on Form S-3. In order to use Form S-3, a company generally must have filed in a timely manner all reports required to be filed during the 12-month period preceding the filing of the Form S-3. There is a limited exception to this general rule for reports required to be filed pursuant to certain items on Form 8-K – specifically, Items 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a) and 5.02(e). Additionally, a company's failure to furnish to the SEC the Form 8-K required by Item 2.02 in a timely manner will not affect such company's eligibility to use Form S-3, because such reports are "furnished" to the SEC rather than "filed." The failure to timely file a report pursuant to any other items of Form 8-K or to timely file any periodic reports, however, will render the company ineligible to use a Form S-3 for 12 months. Moreover, a company is in all cases required to be current in all of its filings at the time it actually files the Form S-3.

Form 10-K

All public companies other than foreign private issuers must file an Annual Report on Form 10-K following the end of each fiscal year. The Annual Report generally includes the following itemized disclosures:

Part I

Item 1 – Business. A description of the business of the company and any developments in its business since the beginning of the most recently completed fiscal year.

Item 1A – Risk Factors. The risk factors investors should consider when investing in the company (which are discussed in more detail below).

Item 1B – Unresolved Comments. For accelerated filers and large accelerated filers, a description of any material unresolved comments from the SEC staff regarding the company's periodic and current reports, which were received 180 days or more before the end of the fiscal year.

Item 2 – Properties. A description of the company's real property (rented or owned).

Item 3 – Legal Proceedings. A description of any material legal proceedings other than ordinary routine litigation incidental to the business, to which the company or any of its subsidiaries is a party or to which any of its property is subject, and any such proceedings that were terminated in the fourth quarter of its fiscal year (along with a description of the outcome).

Item 4 – (Removed and Reserved). Effective February 28, 2010, the disclosure of voting results under Item 4 has been eliminated and the results must be reported instead in a Current Report on Form 8-K. Issuers should include the item in the body of their Form 10-K written as "Item 4. (Removed and Reserved)." with the disclosure left blank.

Part II

Item 5 – Securities and Trading Markets. This item principally includes the following disclosures:

- an Equity Compensation Plan Information table, which may be incorporated by reference to the company's proxy statement; this table is described in more detail in the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Process;"
- the trading market for the company's common stock, along with the historical high and low sales prices by quarter for the two most recent fiscal years and any subsequent interim periods;
- the number of registered holders of each class of common stock;
- the frequency and amount of cash dividends and the company's intentions regarding future payments of dividends;

- unregistered sales of securities not previously disclosed in a Form 10-Q or 8-K; and
- information on a monthly basis relating to any repurchases by the company of its common stock during the fourth quarter.

Item 6 – Selected Financial Data. A comparative presentation of selected financial data for the last five fiscal years.

Item 7 – MD&A. The management's discussion and analysis of the company's operating results and its liquidity and capital resources (which is discussed in more detail below).

Item 7A – Market Risk. Quantitative and qualitative disclosures relating to market sensitive instruments held by the company and other primary market risk exposures. Smaller reporting companies do not need to provide the information required by this item.

Item 8 – Financial Statements. The audited consolidated financial statements of the company, along with certain supplementary quarterly financial data. The schedules to the financial statements may be filed under Item 15 of the Form 10-K.

Item 9 – Changes in and Disagreements with Accountants. If there has been a change in the principal accountants of the company, disclosure of: (i) any disagreements with the accountants that the accountants would have been required to disclose; or (ii) any "reportable event" that had occurred, which was material and accounted for or disclosed in a manner different from what the former accountants would have apparently concluded was required. Disclosure is required with respect to disagreements or reportable events that occurred during the year in which the change in accountants took place or during the subsequent year.

Item 9A – Controls and Procedures. This item principally includes the following disclosures:

- the conclusion of the company's principal executive and financial officers regarding the effectiveness of the company's disclosure controls and procedures (which are discussed in more detail below in the "Disclosure Controls and Procedures" part of this section and in the section of this handbook entitled "The Sarbanes-Oxley Act");

- management's assessment of the effectiveness of the company's internal control over financial reporting, including disclosure of any material weakness in its internal controls;
- an attestation report of the independent auditors on the company's control over financial reporting; and
- any changes in the company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, such internal controls.

Companies need not comply with this item until after they have filed an Annual Report on Form 10-K for a prior fiscal year. As codified in Section 989G of the Dodd-Frank Act, smaller reporting companies and non-accelerated filers are exempt from the requirement to include the attestation report of the independent auditors on the company's internal control over financial reporting. See the section of this handbook entitled "The Dodd-Frank Wall Street Reform and Consumer Protection Act – SOX Reports for Smaller Reporting Companies and Non-Accelerated Filers."

Item 9B – Other Information. Any information required to be reported in a Form 8-K during the fourth quarter that was not reported.

Part III

The following Part III items can be (and commonly are) incorporated by reference to the company's annual proxy statement, provided that such proxy statement is filed within 120 days of the company's fiscal year end. If the proxy statement is not filed within such 120-day period, the company must file an amendment to its Form 10-K prior to the end of such period that includes the Part III information.

For a more detailed discussion of the Part III disclosures required by Items 10-14 of Form 10-K, see the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Process."

Item 10 – Directors, Executive Officers and Corporate Governance

Item 11 – Executive Compensation

Item 12 – Security Ownership

Item 13 – Related Person Transactions and Director Independence

Item 14 – Accountant Fees and Services

Part IV

Item 15 – Exhibits and Financial Statement Schedules. Companies should list under this item their financial statements and the schedules required to be filed by Item 8, along with all exhibits required to be filed by Item 601 of Regulation S-K. The exhibits to the Form 10-K will generally include: (i) all material contracts; (ii) the company's organizational documents; (iii) all instruments defining the rights of security holders; (iv) a list of the company's significant subsidiaries; (v) any applicable consents of experts and counsel (namely, the consent of the independent auditors where the financial statements are incorporated by reference in one or more registration statements); (vi) certifications under SOX, which are described in more detail below; and (vii) if required, interactive data files with the company's financial statements in XBRL (see "XBRL Requirements" below). Most exhibits can be incorporated by reference to a previously filed document. Management contracts and compensatory plans and arrangements must be specifically identified.

> **Practice Tip:** Whenever the issuer files an amendment to its charter or bylaws on a periodic report, it must file a complete copy of the charter or bylaws as amended; amendments should not be filed separately.

Summary of Selected Items

Risk Factors. Item 503(c) of Regulation S-K requires public companies to disclose under the caption "Risk Factors" a discussion of the most significant factors that make investing in the securities of the company risky or speculative. The factors should be those risks that are specific to the company and should not include risks that apply to every public company. As a general rule, any fact or circumstance that could pose a risk to the company's financial condition, results of operations or potential growth, or which could otherwise materially affect the performance of the company's securities, may be a risk factor. In addition to identifying the risk factors, the company must discuss how each factor could affect the company or its securities. The discussion of risk factors must be written in plain English.[4] Smaller reporting companies are not required to provide the information required under this item. Many smaller reporting companies, however, will include risk factors in their Annual Reports to take advantage of a safe harbor defense for forward-looking statements.

[4] In general, a document written in plain English will avoid the use of definitions or technical terms, be concise and well organized and use clear and active statements. See Rule 421(d) under the Securities Act.

Section 21E of the Exchange Act provides a safe harbor defense for companies in securities litigation for forward-looking statements that are made by the company in its Exchange Act reports. This defense is similar to the defense in Section 27A of the Securities Act and the "bespeaks caution" defense developed in securities case law. Forward-looking statements, which are commonly found in a company's MD&A (defined below), are statements not of historical fact but of the expectations of the company with respect to its future performance or other predictions or expectations regarding future events. To qualify for the safe harbor, companies must identify the forward-looking statements in the report with sufficient particularity and accompany the statements by cautionary language that identifies the significant factors that could cause actual results to materially differ from those contained in the forward-looking statements. The risk factors identified in the Form 10-K and other filings can provide the meaningful cautionary language required by the safe harbor.

Management's Discussion and Analysis of Financial Condition and Results of Operations. Item 303 of Regulation S-K requires a discussion and analysis of the company's operating results and its liquidity and capital resources. As articulated by the SEC, the purpose of this disclosure is to present the company's financial condition and results of operations "through the eyes of management" and to provide the context for analysis of the financial information presented in the periodic report. A critical requirement of the Management's Discussion and Analysis of Financial Condition and Results of Operations (better known as the MD&A) is to disclose any known trends, commitments, events or uncertainties that have had or are reasonably likely to have a material effect (positive or negative) on the company's operating results or liquidity. The MD&A should identify and discuss the principal drivers that have impacted and will continue to impact the company's operating results and financial condition, as well as key performance measures, including non-financial performance indicators, which are used by management and which would be material to investors, particularly where management refers to these measures in its earnings releases. In general, the MD&A should emphasize material information and de-emphasize or omit immaterial or duplicative information. Among other material items, the MD&A should include an analysis of the following matters relating to the company:

- changes in cash flows;
- debt instruments and certain related covenants, including covenants: (i) the company has breached or is reasonably likely to breach; or (ii) that materially restrict the company's ability to incur additional debt or equity financing;

- critical accounting policies and estimates that require subjective judgments to account for uncertain matters or matters subject to change;
- any material tax contingencies or trends or uncertainties that could affect the company's tax obligations or effective tax rate;
- commitments for capital expenditures;
- material contingencies arising from pending litigation and regulatory matters;
- commitments for environmental expenditures; and
- any off-balance sheet arrangements.

Practice Tip: The Office of the Chief Accountant of the Division of Corporation has been reminding public companies of their obligations under ASC Subtopic 450-20 (formerly, SFAS 5) to establish accruals for litigation and other contingencies when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. When a loss is not both probable and estimable, an accrual is not recorded, but disclosure of the contingency is required to be made when there is at least a reasonable possibility that a loss or an additional loss has been incurred. The disclosure should indicate the nature of the contingency and give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Rule 10-01(a)(5) of Regulation S-X requires the disclosure of material contingencies in interim financial statements. The Staff also expects companies to update their loss contingency disclosures as new information becomes available. Reporting of litigation and other contingencies may be made on an aggregate basis. In addition to financial statement reporting, companies also need to address disclosure of litigation and other contingencies in their risk factors, legal proceedings and MD&A disclosures.

The MD&A should include a liquidity and capital resources section that provides a clear picture of the company's ability to generate cash and to meet existing and known or likely future cash requirements. The discussion should focus on material changes and trends in operating, investing and financing cash flows and the reasons underlying those changes. The MD&A must also include quantitative tabular disclosure regarding the company's contractual obligations. For more information about disclosures relating to off-balance sheet

transactions and contractual obligations in the MD&A, see the "Enhanced Disclosure Requirements" discussion in the section of this handbook entitled "The Sarbanes-Oxley Act."

Practice Tip: On September 17, 2010, the SEC issued interpretive guidance on the presentation of liquidity and capital resources in the MD&A. The interpretive guidance reminds companies that the MD&A is required to identify and separately describe internal and external sources of liquidity and briefly describe any material unused sources of liquidity. Important trends and uncertainties relating to liquidity might include difficulties in accessing the debt markets, reliance on commercial paper on other short-term financing arrangements, maturity mismatches between borrowing sources and the assets funded by those sources, changes in terms requested by counterparties, changes in the valuation of collateral, and counterparty risk. In addition, if borrowings during the reporting period are materially different than the period-end amounts recorded in the financial statements, disclosure about the intra-period variations is required to properly disclose the company's liquidity position. Disclosures of contingencies affecting off-balance sheet financings also is required in the MD&A. In a companion release, the SEC proposed amendments to enhance the disclosures that companies present about short-term borrowings. The proposed rules would require a company to provide, in a separately captioned subsection of the MD&A, a comprehensive explanation of its short-term borrowings, including both quantitative and qualitative information.

Sarbanes-Oxley Certifications. The Sarbanes-Oxley Act of 2002 created two certification requirements for the principal executive and principal financial officers of public companies. Section 302 of SOX requires a certification that is filed with each quarterly and annual report and which states that the reports are accurate and complete and that the company has in place adequate disclosure controls and procedures and internal control over financial reporting. Section 906 of SOX requires a certification that is furnished[5] with any report containing financial statements and which states that the report fully complies with Sections 13(a) or 15(d) of the Exchange Act and fairly presents, in all material respects, the financial condition and results of operations of the company. Although paragraph 3 of the Section 302 certification may be omitted in certain circumstances, and plural references to "certifying officers" in paragraphs 4 and 5 can be made singular, the certifications must otherwise strictly follow the language provided in SEC rules. The SEC has said that it will not accept an altered

[5] Unlike information that is "filed", information that is "furnished" is not: (i) subject to the liability provisions of Section 18 of the Exchange Act; or (ii) automatically incorporated by reference into the company's registration statements.

certification even if the alteration would appear to be inconsequential. If a filed certification is not correct and complete, the accompanying report may be considered by the SEC to be materially incomplete and deemed not filed (thus potentially affecting Form S-3 eligibility, among other things). Additional discussion of the Section 302 and Section 906 certifications can be found in the section of this handbook entitled “The Sarbanes-Oxley Act.”

Signatures

The Form 10-K must be signed on behalf of the company by a duly authorized officer as well as by its principal executive officer(s), its principal financial officer(s), its controller or principal accounting officer, and by at least a majority of the members of the board of directors. When the form is filed by a limited partnership, it must be signed by at least a majority of the members of the board of directors of any corporate general partner that signs the report.

XBRL Requirements

On January 30, 2009, the SEC published a rule requiring public companies, in any of their filings that include financial statements, to include interactive data files with the financial statements readable in XBRL (eXtensible Business Reporting Language) format. A three-year phase-in period applies to the rule in accordance with the following schedule:

Filer	Filing Requirements
Domestic and foreign large accelerated filers that use U.S. GAAP and have a worldwide public common equity float above $5 billion as of the end of the second quarter of the most recently completed fiscal year	Beginning with the next quarterly report on Form 10-Q or, for foreign filers, the next annual report on Form 20-F or 40-F, for a fiscal period that ended on or after June 15, 2009
All other domestic and foreign large accelerated filers that use U.S. GAAP	Beginning with the next quarterly report on Form 10-Q or, for foreign filers, the next annual report on Form 20-F or 40-F, for a fiscal period that ended on or after June 15, 2010
All remaining filers	Beginning with the next quarterly report on Form 10-Q or, for foreign filers, the next annual report on Form 20-F or 40-F, for a fiscal period that ended on or after June 15, 2011

Initially, the notes and schedules to the financial statements may be included as a single block of text. After one year of filing, however, the detailed quantitative disclosures in the notes and schedules must also be tagged in XBRL. Companies are not required to, but may, tag each narrative disclosure in the footnotes and schedules. The XBRL exhibits must also be available on the company's corporate website.

Companies are required to state on the cover page of each periodic report whether all XBRL filings have been filed and posted as required during the preceding 12 months. Companies which are not yet required to file their financial statements in XBRL format should include this question in accordance with the form and leave the "yes" and "no" boxes blank.

Form 10-Q

Public companies other than foreign private issuers are required to file a Quarterly Report on Form 10-Q with respect to each of their first three fiscal quarters. The Quarterly Report generally presents financial information for and as of the end of the fiscal quarter and generally updates the disclosures made in the Annual Report on Form 10-K. The Form 10-Q includes the following itemized disclosures:

Part I – Financial Information (All Part I items must be included in every Quarterly Report)

Item 1 – Financial Statements. The unaudited quarterly financial statements of the company.

Item 2 – MD&A. The MD&A should discuss and analyze the operating results for quarterly and year-to-end periods, as well as the company's liquidity and capital resources. The disclosures included in the Annual Report on Form 10-K regarding material trends, commitments, contingencies and other developments should be updated, where applicable.

Item 3 – Market Risk. The market risk disclosures from the Annual Report should be updated.

Item 4 – Controls and Procedures. The information required to be disclosed in the Quarterly Report is similar to that required in the Annual Report on Form 10-K, except that management's assessment of the effectiveness of the internal controls over financial reporting and the auditor's attestation report do *not* need to be included in the Form 10-Q.

Part II – Other Information (Non-applicable Part II items may be omitted)

Item 1 – Legal Proceedings. Any new material legal proceeding or material development relating to a previously disclosed legal proceeding should be disclosed.

Item 1A – Risk Factors. Any material changes in the risk factors disclosed in the Annual Report on Form 10-K should be disclosed. Smaller reporting companies are not required to respond to this item.

Item 2 – Unregistered Sales of Equity Securities and Repurchases. Any unregistered sale of securities during the quarter, other than unregistered sales previously disclosed on a Form 8-K. Companies also should disclose any shares repurchased during the quarter.

Item 3 – Defaults Upon Senior Securities. Any significant defaults with respect to payments on its debt obligations or any material arrearages in the payment of dividends.

Item 4 – (Removed and Reserved). Effective February 28, 2010, the disclosure of voting results under Item 4 has been eliminated and the results must be reported instead in a Current Report on Form 8-K. Issuers should simply exclude any reference to Item 4 in their Quarterly Reports on Form 10-Q.

Item 5 – Other Information. Under this item, companies must disclose: (i) any information which should have been but was not reported on a Form 8-K; and (ii) any material changes to the process for shareholders to recommend nominees to the board of directors. Companies also are required to report under this item any change in the deadline for shareholder proposals where the annual meeting date is changed by more than 30 days from the date of the prior year's annual meeting.

Item 6 – Exhibits. The company should file any exhibit not previously filed with its Annual Report on Form 10-K if the obligation to file the exhibit arose during the applicable fiscal quarter. In addition, companies must include certifications by their principal executive and principal financial officers identical to those filed with the Annual Report on Form 10-K (discussed above in the "Form 10-K" part of this section).

Signatures

The Form 10-Q must be signed on behalf of the company by a duly authorized officer and by the principal financial or chief accounting officer of the company.

Form 8-K

In addition to the periodic reports on Forms 10-K and 10-Q, companies subject to the Exchange Act's reporting requirements are required to file a Current Report on Form 8-K to disclose the occurrence of an event specified in the form.

With some exceptions, reports on Form 8-K are generally required to be filed with or furnished to the SEC within four business days after the occurrence of the

event to be disclosed. If the event occurs on a Saturday, Sunday or a day on which the SEC is closed, then this four business day period begins to run on the first business day thereafter. One important exception to the general four business day rule concerns filings made under Item 7.01 or Item 8.01 of Form 8-K solely to satisfy a company's obligations under Regulation FD; any such filings must be made in accordance with the requirements of Regulation FD, which may require disclosure of the event on either a simultaneous or a prompt basis, depending on the circumstances. A second exception applies to acquired company financial statements and pro-forma financial information required to be filed under Item 9.01 with respect to acquisitions reported pursuant to Item 2.01; such statements and information may be filed either with the initial report on Form 8-K disclosing the acquisition *or* by amendment not later than 71 calendar days after the date that the initial report on Form 8-K is required to be filed.

The following items are reportable on a Form 8-K (selected items are discussed in more detail below):

Section 1 – Business and Operations

Item 1.01 – Entry into or material amendment of a material definitive agreement not made in the ordinary course.

Item 1.02 – Termination of a material definitive agreement other than upon its scheduled expiration, where such termination is material to the company.

Item 1.03 – Bankruptcy or receivership.

Section 2 – Financial Information

Item 2.01 – Acquisition or disposition of a significant amount of assets (or a business) not in the ordinary course.

Item 2.02 – Results of operations and financial condition.

Item 2.03 – Creation of a direct, material financial obligation or a material obligation under an off-balance sheet arrangement.

Item 2.04 – Triggering events that accelerate or increase a direct material financial obligation or a material obligation under an off-balance sheet arrangement.

Item 2.05 – Restructuring costs associated with exit or disposal activities.

Item 2.06 – Material impairments to the company's assets other than impairments taken in connection with the preparation, review or audit of financial statements to be included in the company's next periodic report.

Section 3 – Securities and Trading Markets

Item 3.01 – Notice of the delisting of a class of securities from a securities exchange, failure to satisfy a continued listing rule or standard, or transfer of the principal listing of a class of the company's common equity.

Item 3.02 – Unregistered sales of equity securities constituting in the aggregate more than 1% of the total outstanding securities of a class (or 5% for smaller reporting companies), which have not previously been disclosed in an Exchange Act filing.

Item 3.03 – Material modifications to the rights of security holders (for example, material amendments to a company's organizational documents or issuances or modifications of a class of securities that materially affects the rights of a different class).

Section 4 – Matters Related to Accountants and Financial Statements

Item 4.01 – A change in the company's independent auditors.

Item 4.02 – Non-reliance on previously issued financial statements or on a related audit report or a completed interim review.

Section 5 – Corporate Governance and Management

Item 5.01 – Change in control of the company, including any arrangements that may result in a change of control in the future.

Item 5.02 – Departure of directors or certain officers, the appointment of directors other than at an annual meeting of shareholders or a special shareholders' meeting convened for such purpose, the appointment of certain officers and the entering into or modification of compensatory arrangements with certain officers.

Practice Tip: An issuer need not file a Form 8-K to disclose information if the issuer has previously reported substantially the same information required by the Form 8-K on a registration statement under Section 12 of the Exchange Act or under the Securities Act, a report under Section 13 or 15(d) of the Exchange Act or a definitive proxy statement or information statement under Section 14 of the Exchange Act.

Item 5.03 – Amendments to a company's organizational documents not proposed in a proxy statement or a change in the company's fiscal year other than by a vote of security holders.

Item 5.04 – Notice of blackout periods under certain types of employee benefit plans.

Item 5.05 – Specified amendments to the company's code of ethics applicable to the company's principal executive, financial and accounting officers, controller or persons performing similar functions, or the approval of or failure to act in the face of a material departure from a provision of such code of ethics.

Practice Tip: Disclosure is not required if the company discloses the amendments or waivers to the code of ethics on its Internet website within four business days and has disclosed in its most recent annual report its intent to provide such information in that manner. If the company elects this alternative, it must maintain such information on its website for at least 12 months. Because of a NASDAQ listing requirement, however, NASDAQ listed companies must still file a Form 8-K for waivers to their code of ethics.

Item 5.06 – Change in shell company status.

Item 5.07 – Submission of maters to a vote of security holders.

Section 6 – Asset-Backed Securities

Items 6.01 through 6.05 – Disclosures relating to asset-backed securities.

Section 7 – Regulation FD

Item 7.01 – Disclosures of material non-public information pursuant to Regulation FD that the company elects to furnish on Form 8-K.

Section 8 – Other Events

Item 8.01 – Other optional disclosures of any events not otherwise called for by the Form 8-K that the registrant deems of importance to security holders, including disclosure pursuant to Regulation FD that the registrant desires to file.

Section 9 – Financial Statements and Exhibits

Item 9.01 – Financial statements relating to business acquisitions described in response to Item 2.01 and exhibits required to be filed pursuant to Item 601 of Regulation S-K.

Summary of Selected Items

Entry Into a Material Definitive Agreement (Item 1.01). Item 1.01 requires a company to make certain disclosures in the event that it: (i) enters into a material definitive agreement not made in the ordinary course of its business; or (ii) enters into a material amendment to such an agreement.[6] For these purposes, a "material definitive agreement" is any agreement, whether conditional or unconditional, that provides for obligations that are material to and enforceable against the company or for rights that are material to the company and enforceable by the company. In general, a *material* agreement would mean any agreement "to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase" the issuer's securities.[7] Upon entry into such material definitive agreement or amendment, the company is required to disclose the following information:

> **Practice Tip:** The SEC has taken the position that a material definitive agreement must be summarized in the body of the Form 8-K, even if it is filed as an exhibit to the Form 8-K.

> **Practice Tip:** Compensatory arrangements for directors and officers do not need to be disclosed under Item 1.01. Compensatory arrangements of certain executive officers, however, must be disclosed under Item 5.02(e), as discussed in further detail below.

- the date on which the agreement was entered into or amended;
- the identity of the parties to the agreement or amendment;
- a brief description of any other material relationship between the company or its affiliates and any of the other parties to the agreement; and
- a brief description of the material terms of the agreement or amendment.

Certain contracts, other than those immaterial in amount or significance, are deemed to be material definitive agreements notwithstanding the fact that they are made in the ordinary course of a company's business. These contracts include: (i) any

[6] A company may be required to disclose a material amendment even if it did not previously disclose the underlying agreement (for example, if the amendment results in the agreement becoming a material definitive agreement).

[7] SEC Rule 405 under the Securities Act.

contract upon which the company's business is "substantially dependent;" (ii) any contract calling for the acquisition or sale of any property, plant or equipment for a consideration exceeding 15% of the fixed assets of the company on a consolidated basis; (iii) any material lease under which a part of the property described in the company's registration statement is held; and (iv) certain agreements (other than compensatory agreements) to which directors, officers, promoters, voting trustees, security holders named in the company's registration statement or report, or underwriters are parties.

Termination of a Material Definitive Agreement (Item 1.02). Item 1.02 of Form 8-K requires a company to disclose the termination of any material definitive agreement other than by expiration of the agreement on its stated termination date or as a result of all parties completing their obligations under the agreement. In the event of any such termination, the company must disclose:

- the date of the termination;
- the identity of the parties to the agreement;
- a brief description of any other material relationship between the company or its affiliates and any of the other parties;
- a brief description of the terms and conditions of the agreement that are material to the company;
- a brief description of the material circumstances surrounding the termination; and
- any material early termination penalties incurred by the company.

The company need not make any disclosure as a result of negotiating or discussing the termination of a material definitive agreement; rather, the obligation to file arises only when such an agreement has actually been terminated. If the registrant believes in good faith that a material definitive agreement has not been terminated, it need not make any disclosures under Item 1.02 unless it has received a notice of termination pursuant to the terms of the agreement. However, the SEC staff has taken the position that if a company receives advance notice of termination of a material definitive agreement from a counterparty (*e.g.*, pursuant to a provision in the agreement requiring such advance notice), the company must file a Form 8-K under Item 1.02 even if it intends to negotiate with the counterparty and believes in good

faith that the agreement will ultimately not be terminated. Similarly, receipt of a notice of non-renewal of a material definitive agreement, which provides for renewal subject to notice of non-renewal, will also trigger a filing obligation.

Acquisition or Disposition of a Significant Amount of Assets Not in the Ordinary Course (Item 2.01). Item 2.01 requires a company to disclose any acquisition or disposition by it or any of its majority-owned subsidiaries of a significant amount of assets. The information that must be disclosed regarding any such transaction includes, among other things:

- the date of completion of the transaction;
- a brief description of the assets involved;
- the identity of the person(s) from whom the assets were acquired or to whom they were sold and the nature of any other material relationship between such person(s) and the company or any of its affiliates;
- the nature and amount of consideration given or received for the assets; and
- in certain circumstances in which there is a material relationship between the company and the source of funds for the transaction, the identity of such source of funds.

An acquisition or disposition is deemed to involve a "significant amount of assets" if either of the following two conditions are met: (i) the company's and its subsidiaries' equity in the net book value of such assets or the amount paid or received for the assets upon such acquisition or disposition exceeds 10% of the total assets of the company, on a consolidated basis; or (ii) if it involves a business that is "significant" within the meaning of Regulation S-X. An acquisition or disposition need not be reported if it is between a company and one of its subsidiaries, or between two subsidiaries of a company. Likewise, it is not necessary to report either the redemption or acquisition of securities from the public or the sale or other disposition of securities to the public.

Practice Tip: Typically, a company will file a Form 8-K under Item 1.01 upon entering into a material definitive agreement to acquire or dispose of a significant amount of assets, and then later file a Form 8-K under Item 2.01 to report the closing of such acquisition or disposition. However, because Item 2.01 (unlike Item 1.01) is limited to transactions involving a significant amount of assets, it is possible that in some circumstances the company may not need to report the closing of an acquisition or disposition made pursuant to an agreement previously reported under Item 1.01.

Results of Operations and Financial Condition (Item 2.02). Item 2.02 requires a company to furnish certain information regarding any release or public announcement that discloses material non-public information regarding the company's results of operations or financial condition for a completed quarterly or annual fiscal period (*e.g.*, any earnings releases). Item 2.02 contains a limited exemption from this requirement where complementary earnings information is presented orally, telephonically, by webcast, by broadcast, by conference call, or by similar means. In order to take advantage of this exemption, the company must:

- provide the information as part of a presentation that is complementary to, and initially occurs within 48 hours after, a related written announcement or release that has been furnished on Form 8-K prior to the presentation;
- make the presentation broadly accessible to the public by dial-in conference call, webcast, broadcast or similar means;
- provide the financial and other statistical information contained in the presentation on its website (this may take the form of an audio file of the initial webcast, if applicable); and
- have announced the presentation by means of a widely disseminated press release that included instructions as to how to access the presentation and the location on the company's website where the financial and statistical information would be available.

For a further discussion of best practices in relation to earnings releases, including practice tips on how to conduct an earnings call in compliance with applicable regulations, please see the section of this handbook entitled "Regulation of Analyst Communications and Other Voluntary Disclosures."

The information (and corresponding exhibits) furnished in a report pursuant to Item 2.02 will not be deemed to be "filed" for purposes of the Exchange Act unless the company specifically states that such information is to be considered "filed" or incorporates it by reference into a filing under the Securities Act or Exchange Act. Unlike information that is "filed," information that is "furnished" is not: (i) subject to the liability provisions of Section 18 of the Exchange Act; or (ii) automatically incorporated by reference into the company's registration statements.

Costs Associated with Exit or Disposal Activities (Item 2.05). Item 2.05 requires a company to make certain disclosures in the event that the board of directors or the

officers of the company commit the company to an exit or disposal plan, or otherwise dispose of a long-lived asset or terminate employees under a plan of termination (of the type described in paragraph 8 of FASB Statement of Financial Accounting Standards No. 146 (now codified as Accounting Standards Codification Topic 420)), under which *material* charges will be incurred pursuant to generally accepted accounting principles (GAAP) applicable to the company. In such event, the company must disclose, among other things, a description of the course of action, the facts and circumstances leading to the expected action, the expected completion date, and estimates of the costs to be incurred in connection with the action and the amount of the charge that will result in future cash expenditures. If the issuer is unable to provide an estimate at the time of filing, the issuer must file an amended report within four business days after it determines such estimate.

Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review (Item 4.02). Under Item 4.02, if a company's board of directors, a committee of the board, or authorized officers conclude that any previously issued financial statements should no longer be relied upon because of an error in such financial statements, the company must generally disclose:

- the date that the conclusion regarding non-reliance was made;
- an identification of the financial statements that should no longer be relied upon, and the reason(s) why this is the case; and
- a statement of whether the audit committee (or, in the absence of an audit committee, the board of directors or authorized officers) discussed the matters disclosed with the company's independent accountant.

In the event that the company is advised by, or receives notice from, its independent accountant that disclosure should be made or action should be taken to prevent future reliance on a previously issued audit report or completed interim review related to previously issued financial statements, the company must disclose:

- the date on which the company was so advised or notified;
- an identification of the financial statements that should no longer be relied upon;
- a brief description of the information provided by the accountant; and

- a statement of whether the audit committee (or, in the absence of an audit committee, the board of directors or authorized officers) discussed the matters disclosed with the company's independent accountant.

In the latter circumstance, the company must, no later than the date of the Form 8-K filing, provide its independent accountant with a copy of these disclosures, request that the accountant promptly furnish a letter addressed to the SEC stating whether or not it agrees with the statements made by the company, and thereafter amend the applicable Form 8-K by filing the accountant's letter as an exhibit no later than two business days after the receipt of the letter.

Departure of Directors or Certain Officers; Election of Directors, Appointment of Certain Officers; Compensatory Arrangements of Certain Officers (Item 5.02). Item 5.02 requires a company to disclose various matters relating to the election and departure of directors and the appointment and compensation of officers.

> **Practice Tip:** Disclosure under Item 5.02(b) is triggered by notice of the director's intention to retire, resign or refuse to stand for re-election. Disclosure is not required solely by reason of discussions or considerations of resignation, retirement or refusal to stand for re-election. Whether communications represent notice or discussions is a facts and circumstances determination.

Directors. If a director retires, resigns, or refuses to stand for re-election, the company is generally required to disclose the fact that such event occurred and the date of the event. However, if the director's resignation or refusal to stand for re-election is due to a disagreement with the company or the director is removed for cause, the company is required to: (i) describe the circumstances surrounding the disagreement that it believes caused the director's resignation, refusal to stand for re-election, or removal; (ii) file a copy of any written correspondence from the director concerning such circumstances; (iii) simultaneously provide the director with a copy of the foregoing disclosures and the opportunity to agree or disagree with the statements contained therein; and (iv) file any letter received from the director in response within two business days of receipt.

Upon the election of a new director other than by a vote of security holders at a shareholders' meeting, the company must disclose certain information, including,

among other things, the name of the new director, the date of his or her election and a description of any arrangement or understanding between the new director and any other person pursuant to which the director was elected.

Officers. In addition to disclosures relating to director retirements, resignations or refusals to stand for election, issuers must disclose under this Item the retirement, resignation or termination of any of the following executive officers: (i) each of the named executive officers discussed in the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Process;" (ii) the president; (iii) the principal accounting officer; (iv) the principal operating officer; or (v) any person performing similar functions.

A company also must disclose certain information upon appointing a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer or person performing similar functions. The information that a company is required to disclose includes, among other things:

- the name and position of the newly appointed officer;
- the date of his or her appointment;
- certain information that would otherwise be required in the company's proxy statement, including the officer's relevant business experience and material interests in certain related person transactions involving the company; and
- a brief description of any material contract or arrangement entered into or materially amended and any award under such contract or arrangement, in each case in connection with the appointment.

If the company intends to make a public announcement of the appointment of the officer other than by means of filing a Form 8-K, the company may delay the filing of the Form 8-K disclosing the appointment until the day on which the public announcement is made.

Practice Tip: Grants or awards made pursuant to a plan or arrangement that are materially consistent with the previously disclosed terms of such plan or arrangement do not need to be disclosed under this Item. Therefore, it is often not necessary to separately disclose equity grants or incentive awards made to executives pursuant to previously disclosed incentive plans. In that regard, a company does not need to disclose on Form 8-K specific performance targets or goals that are adopted pursuant to a previously disclosed incentive bonus plan if the specific performance targets or goals are materially consistent with the previously disclosed terms of the plan.

In the event the company enters into, adopts, commences or materially modifies a material compensatory plan, contract or arrangement to which a "named executive officer"[8] of the company is a party, it is generally required to disclose a brief description of the plan, contract or arrangement and the amounts payable to the officer thereunder. Likewise, a company must disclose any material modification to any material grant or award issued under any such plan, contract or arrangement.

Lastly, if a payment, grant, award or other occurrence causes a previously incalculable salary or bonus figure that was omitted from a proxy statement to become calculable, in whole or in part, such figure should be disclosed under this Item.

Submission of Matters to a Vote of Security Holders (Item 5.07). Item 5.07 requires disclosure of the results of any matter submitted to a shareholder vote within four business days of the date of the shareholders' meeting at which the vote took place. With respect to any such matter, a public company is required to disclose the date and type of the shareholders' meeting at which the matter was voted upon (if applicable), the name of each director elected at such meeting (if applicable), a brief description of each other matter voted upon at the meeting, and the number of votes cast for, against or withheld (as well as the number of abstentions and broker non-votes) with respect to each such matter, including a separate tabulation with respect to each nominee for office.

[8] We discuss the meaning of the term "named executive officer" in the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Process." For purposes of Item 5.02, "named executive officers" refers to those named executive officers for whom disclosure was required in the company's most recent filing under the Securities Act or Exchange Act that required disclosure pursuant to Item 402(c) of Regulation S-K.

The requirement to report under Item 5.07 applies with respect to any matter submitted to a vote of security holders, through the solicitation of proxies or otherwise. Therefore, the requirement will apply even to matters voted upon at a meeting that does not involve the election of directors.

> **Practice Tip:** Issuers are required to report the preliminary voting results of the shareholders' meeting with four business days of the meeting and final voting results within four business days after such final results are known. However, an issuer does not need to report preliminary results if the final results are reported within four business days of the meeting. The four business day period for reporting under Item 5.07 begins to run with the first day following the date on which the meeting ended.

Regulation FD Disclosure (Item 7.01). Item 7.01 provides for disclosure of material non-public information under Regulation FD. Regulation FD, which is discussed in greater detail in the section of this handbook entitled "Regulation of Analyst Communications and Other Voluntary Disclosures," generally provides that when a public company or person acting on its behalf discloses material non-public information to certain persons, the company must also disclose such information publicly. Under Regulation FD, the required public disclosure may be made either by filing or furnishing a Form 8-K, or, alternatively, by another method that is reasonably designed to result in broad disclosure to the public. Disclosures made under Item 7.01 are generally deemed "furnished" and not "filed" for purposes of other filings that incorporate by reference the company's filings under the Exchange Act. In order to provide for incorporation by reference, companies may disclose their Regulation FD disclosures under Item 8.01.

Financial Statements and Exhibits (Item 9.01). Item 9.01 provides for the filing of certain required exhibits. Exhibits relating to material definitive agreements are generally not required to be filed with the Form 8-K. Instead, such exhibits, to the extent required to be filed under Item 601 of Regulation S-K, need only be filed with the next quarterly or annual report for the relevant period. However, many companies file non-required exhibits with their reports on Form 8-K in order to qualify the Form 8-K disclosure by reference to more complete disclosures in the exhibit.

In addition to providing for the filing of required exhibits, Item 9.01 requires the disclosure of acquired company audited historical financial statements in accordance

with Item 3-05 of Regulation S-X and pro forma financial information in accordance with Article 11 of Regulation S-X (in connection with acquisitions or dispositions required to be disclosed under Item 2.01). In cases of acquisitions reported under Item 2.01, such financial statements and information may be filed either with the initial report on Form 8-K disclosing the acquisition *or* by amendment not later than 71 calendar days after the date that the initial report on Form 8-K must be filed.

Confidential Treatment Requests

Certain disclosures required by SEC regulations may contain information that the company believes would result in competitive harm to the company if disclosed. For example, the requirement to disclose the material terms of and to file a material contract might include pricing terms, technical specifications and other trade information. Public companies are permitted to make a written objection to the public disclosure of any information contained in a filing required under the Exchange Act, including reports on Forms 10-K, 10-Q and 8-K, in accordance with the procedures set forth in Rule 24b-2 under the Exchange Act. Under this rule, the company is permitted to omit from the filed material the portion that it desires to keep undisclosed (the "confidential portion"). In lieu of the confidential portion, the company is required to indicate at the appropriate place that confidential information has been omitted and filed separately with the SEC. In addition, the company must file a copy of the confidential portion together with an application to the SEC making an objection to the disclosure of the confidential portion. Upon receipt of such materials, the SEC will make a determination as to whether to sustain the company's objection.

Rule 24b-2 sets forth the criteria for obtaining confidential treatment of information under the Exchange Act. The rule incorporates the criteria for non-disclosure of confidential information consistent with the exemptions from disclosure under the Freedom of Information Act (FOIA) and the SEC's FOIA rules. The most typical exemption involves "trade secrets and commercial or financial information obtained from a person that is privileged or confidential."[9]

Requests for confidential treatment must include a factual analysis of the basis for the exemption requested and a legal analysis for why the request falls under the applicable exemption, including, where necessary, citation to case law. Companies should avoid conclusory statements and must identify and address each portion of the

[9] 5 U.S.C. 552(b)(4); 17 CFR 200.80(b)(4).

disclosure for which it is requesting confidential treatment. In addition, companies must specify a duration for the confidential treatment and provide an analysis supporting the requested duration. Lastly, companies must consent to the release of the confidential information to "other government agencies, offices or bodies and to the Congress."[10] For a more detailed discussion of the requirements for a confidential treatment request, including the process involved, see the Division of Corporation Finance, Staff Legal Bulletin No. 1, dated February 28, 1997 (with Addendum dated July 11, 2001).

On September 28, 2010, the SEC's Office of Inspector General issued a final report on its assessment of the Division of Corporation Finance's confidential treatment processes and procedures. The report contains eight recommendations that were developed to strengthen the processes and procedures used by the SEC in evaluating, approving and monitoring confidential treatment requests. The SEC agreed with four of the recommendations, partially agreed with three others and did not concur with one of the recommendations. The report may result in greater scrutiny being applied to confidential treatment requests, particularly where companies use declarative statements and boilerplate language to justify their requests.

Disclosure Controls and Procedures

In addition to the SOX certifications that the principal executive officer and principal financial officer must make at least every quarter in connection with the company's periodic reports, companies must maintain disclosure controls and procedures to ensure that: (i) information required to be disclosed by the company in its Exchange Act reports is recorded, processed, summarized and reported accurately and on a timely basis; and (ii) information is accumulated and communicated to management, including the executive officers, as appropriate to allow timely decisions regarding such required disclosures. Moreover, as described above with respect to Item 9A of the Form 10-K and Part I, Item 4 of the Form 10-Q, companies must on a quarterly basis evaluate the effectiveness of their disclosure controls and procedures and disclose their conclusions of that evaluation in their periodic SEC reports.

[10] Rule 24b- 2(b)(2)(iii).

To help maintain the disclosure controls and procedures, companies are advised to establish a disclosure committee consisting of key individuals in the company, such as the chief financial officer, controller, general counsel, securities counsel, investor relations officer and internal auditor. Although the establishment of a disclosure committee was recommended by the SEC as part of its rulemaking under Sections 906 and 302 of SOX, it is not required under SEC rules. Companies may adopt a written charter setting forth the duties and responsibilities of the disclosure committee. Companies also may request that the members of the committee and other members of management execute sub-certifications that the principal executive and financial officers may rely on in making their certifications under Sections 906 and 302. For additional discussion of disclosure controls and procedures, see the section of this handbook entitled “The Sarbanes-Oxley Act.”

PROXY STATEMENT AND ANNUAL REPORT DISCLOSURES AND PROCESS

A company's annual proxy statement provides shareholders with information regarding matters to be voted on at the company's annual shareholders' meeting, solicits proxies of shareholders to make voting at the meeting more convenient, and provides information about the company's corporate governance and compensation policies and related matters, including the information required by Part III of Form 10-K. The purpose of the proxy disclosures is to enable shareholders to make informed voting and investment decisions.

Each public company that is not a foreign private issuer is required to prepare and file its proxy statement on Schedule 14A in compliance with the rules of Regulation 14A and the relevant sections of Regulation S-K. In addition, the company's stock exchange may impose additional requirements on the information to be included in the proxy statement.

Overview of Annual Proxy Statement Disclosure Requirements

A proxy statement for a company's annual meeting of shareholders will generally include the following items:

The Notice. A notice about the meeting and the items to be voted on.

General Information. Information about the meeting, including where and when it will be held and how shareholders can vote.

Directors and Officers. Identification of the company's directors and officers, including biographical information relating to their board service on public companies and other relevant experience. Under recent rule amendments, companies are now required to disclose, for each director and any nominee for director, the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company. In addition, companies are now required to disclose any prior directorships of public companies or registered investment companies held by directors or nominees within the past five years.

Director Elections. Identification of the company's proposed nominees for directors to be voted on at the meeting.

Corporate Governance. Corporate governance matters, including disclosures regarding the independence of the board, the duties of board committees, board attendance, the existence of a code of ethics, descriptions of the policies regarding

shareholder nominations of directors and shareholder communications to the board and certain legal proceedings involving directors and officers.

Board leadership structure and role in risk oversight. Under recent amendments to Item 407 of Regulation S-K, a company must describe the leadership structure of its board and why the company has determined that its leadership structure is appropriate given its specific characteristics or circumstances. If one person serves as both principal executive officer and chairman, the company is required to disclose whether it has a lead independent director, and, if so, what role such independent director plays in the leadership of the board. In addition, a company must disclose the extent of the board's role in the risk oversight of the company and the effect that this has on the board's leadership structure.

Board Diversity. Companies are required to disclose whether, and if so, how the nominating committee or board considers diversity in identifying nominees for director. If the nominating committee or board has a policy with regard to the consideration of diversity, disclosure is required of how this policy is implemented, as well as how the effectiveness of the policy is assessed. The SEC recognizes that different companies have differing definitions of diversity, and that for some companies diversity includes differences of viewpoint, professional experience, education, skills and other qualities and attributes, while other companies focus on diversity concepts such as race, gender and national origin.

Potential conflicts of interest involving compensation consultants. Under recent SEC rule amendments, a public company is now required to disclose the fees paid to a compensation consultant and its affiliates if the board or management has engaged the compensation consultant to provide advice with respect to the compensation of directors and executives, and such consultant or its affiliates provided other non-executive compensation consulting services to the company that generated fees in excess of $120,000 during the company's last fiscal year. Disclosure will generally not be required if the board and management have retained different compensation consultants, provided that the board's consultant does not provide additional non-executive compensation consulting services to the company. In addition, the Dodd-Frank Act imposes additional disclosure requirements regarding the independence of, and potential conflicts of interest involving, compensation consultants. The new requirements apply to any proxy or consent solicitation material for an annual shareholder meeting occurring on or after July 21, 2011. For additional information,

see the section of this handbook entitled "The Dodd-Frank Wall Street Reform and Consumer Protection Act – Independence of Compensation Consultants and other Advisors."

Independent Auditors. Companies must disclose all audit fees billed for each of the last two fiscal years and describe the services provided by their auditors under the categories of audit fees, audit-related fees, tax fees and all other fees. Companies must also disclose the audit committee's pre-approval policies and procedures with respect to non-audit fees. In addition, while SOX generally requires the audit committee of the board of directors to appoint the independent auditors, most companies will ask their shareholders to ratify this appointment.

Practice Tip: The fees to be disclosed pursuant to this requirement are those billed by the auditors for services during each of the last two fiscal years, *not* the actual payments made during such fiscal years.

Audit Committee Report. The audit committee of the company's board of directors is required to make certain disclosures relating to the audited financial statements of the company, including that it has discussed the audited financial statements with management and recommended their inclusion in the company's Annual Report on Form 10-K.

Other Company Proposals. The most common proposals by companies, other than for the ratification of auditors and the election of directors, involve the adoption or amendment of equity incentive plans and other incentive compensation plans. If there are any proposals other than those relating to the election of directors, ratification of the company's auditors, qualified shareholder proposals or incentive compensation plan proposals, the company must file a preliminary version of the proxy statement at least 10 days before filing the final, definitive version of its proxy statement. During this 10-day period, the SEC staff may comment on the preliminary version, potentially requiring changes to the disclosures in the proxy statement.

Shareholder Proposals. Shareholders may seek to include their proposals in the company's proxy statement by following the requirements of SEC Rule 14a-8, which are discussed in more detail below.

Equity Compensation Plan Information. Unless they have disclosed the information in their Annual Reports on Form 10-K, companies must disclose certain information relating to their equity compensation plans, including how many shares

are subject to outstanding awards and how many shares are available for issuance pursuant to new awards. This table is also required if the company is proposing to adopt or amend an equity compensation plan.

Compensation Discussion and Analysis (CD&A). The company is required to discuss the reasons why it pays the compensation it pays to certain of its executive officers called named executive officers, and to describe the process it takes in determining the compensation it pays. This requirement is discussed in more detail below.

Compensation Committee Report. The compensation committee must report that it has discussed the CD&A with management and recommended its inclusion in the company's proxy statement.

Compensation Policies and Practices that Present a Material Risk to the Company. Under recently added Item 402(s) of Regulation S-K, to the extent that a company's compensation policies and practices for its employees are reasonably likely to have a material adverse effect on the company, the company must disclose its compensation policies and practices as they relate to risk management practices and risk-taking incentives. This disclosure requirement does not apply to smaller reporting companies.

Practice Tip: Companies should engage in an appropriate compensation risk assessment in order to support their conclusion (which will typically be the case) that their compensation policies and practices are not reasonably likely to have a material adverse effect. In proxy statements for the first proxy season that addressed this new disclosure requirement, many companies disclosed the process for their compensation risk assessment. In cases where companies do not include disclosure, the SEC typically asks for an explanation of the company's process for determining that no disclosure is required. In addition, RiskMetrics' position is that companies should include disclosures regarding compensation and risk assessment. The SEC Staff has recommended that the Item 402(s) disclosure be presented together with, but not as part of, the company's compensation disclosures. Given that the say-on-pay vote is with respect to executive compensation, as disclosed, the Item 402(s) disclosure should not be included as part of the CD&A.

Executive Compensation and Non-Employee Director Compensation. Companies must provide specific tabular and narrative disclosure relating to their compensation of the named executive officers and of their directors. These requirements are discussed in more detail below.

Beneficial Ownership Table. Companies must disclose how many shares of their voting securities are beneficially owned by their directors, named executive officers, known beneficial owners of more than 5% of any class of such voting securities, and all executive officers and directors as a group. Beneficial ownership is determined in accordance with Rule 13d-3 under the Exchange Act, and rests on whether a holder has or shares the power to vote the securities or investment power over the securities, including the power to dispose of them. Persons are deemed to beneficially own any securities that they have the right to acquire within 60 days (for example, pursuant to options, warrants, convertible securities or other agreements).

Related Person Transactions. Companies must disclose certain material transactions involving more than $120,000, in which the company is a participant and in which certain related persons have a material interest. This requirement is discussed in more detail below.

Section 16(a) Compliance. Companies must disclose if they are aware of any director, executive officer or greater than 10% beneficial owner who failed to timely file an insider report on Form 3, 4 or 5 since the beginning of the most recently completed fiscal year.

Form of Proxy Card. The proxy card provides shareholders with the ability to vote without being physically present at the meeting. The card must provide shareholders with the ability to withhold votes for directors, to vote for or against proposals or to abstain from voting on any matter.

Summary of Selected Items

Executive and Director Compensation

Pursuant to Item 402 of Regulation S-K, public companies other than foreign private issuers, must disclose certain basic information about the compensation they pay to non-employee directors and certain executives called the named executive officers. The disclosure requirements include compensation tables and narrative disclosure of all elements of compensation, whether in cash, equity incentive plan awards, perquisites or other forms of compensation. Smaller reporting companies have reduced disclosure requirements under this Item.

The main elements of the executive compensation disclosures that apply to the named executive officers, in addition to the Compensation Discussion and Analysis section, are as follows:

- a summary compensation table showing all compensation paid or earned in respect of the fiscal year (which is discussed in greater detail below);
- a table showing all grants of plan-based awards during the fiscal year, including equity awards and non-equity incentive bonuses;
- a table showing the outstanding equity awards as of the end of the last fiscal year;
- a table showing all option exercises and stock awards that vested during the fiscal year;
- a table and narrative describing earned pension benefits;
- a table and narrative describing any nonqualified deferred compensation arrangements, accounts and contributions; and
- a table and narrative describing any arrangements or agreements to pay compensation to the named executive officers upon their termination or upon a change in control of the company.

The required disclosures for non-employee directors include a table similar to the summary compensation table showing all compensation earned or paid in the fiscal year (*e.g.*, director fees and equity awards), identification of all outstanding option awards at fiscal year end, and a narrative description of all factors necessary to understand the disclosures in the table, including a description of each arrangement under which compensation is paid.

Determination of Named Executive Officers. The following executive officers are the named executive officers for whom compensation disclosure is required under SEC rules:

- any principal executive officer serving during the most recently completed fiscal year (usually the CEO);
- any principal financial officer serving during the most recently completed fiscal year (usually the CFO);
- the three highest paid executive officers (other than the principal executive and principal financial officers) serving at the end of the most recently completed fiscal year; and

- up to two additional individuals who served as executive officers during the most recently completed fiscal year, if they would have been among the three highest paid officers except for the fact that they were no longer serving as executive officers at the end of the most recently completed fiscal year.

Practice Tip: If a principal executive officer or principal financial officer served during only part of the fiscal year, such officer *is* a named executive officer for such fiscal year. Therefore, it is possible that both current and former principal executive and financial officers can be named executive officers in a given fiscal year.

The determination of the named executive officers other than the principal executive and financial officers should be based on the total compensation that would be disclosed for such executive officers in the summary compensation table, less the amounts disclosed in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column. The summary compensation table is discussed in greater detail below.

Practice Tip: Special attention should be paid to severance benefits paid to or earned by executive officers who are not serving at the end of the fiscal year. Because the summary compensation table requires disclosure of all paid and earned compensation, the payment of severance benefits upon termination of an executive officer can cause such officer to be among the highest paid executive officers even if his or her compensation would otherwise not have resulted in the officer being a named executive officer.

Compensation Discussion and Analysis. The Compensation Discussion and Analysis section (better known as the CD&A) is a relatively new requirement that became effective for proxy statements filed on or after December 15, 2006, which included executive compensation disclosures with respect to a fiscal year ending on or after such date. The CD&A replaced a previously required report by the compensation committee and requires a discussion of how the compensation committee of the board of directors determined the compensation paid to each named executive officer for the most recent fiscal year, including the committee's philosophy and objectives in making compensation decisions. As set forth in Item 402(b) of Regulation S-K, the CD&A should discuss the following areas:

- the objectives of the company's compensation program;

- what the compensation program is designed to reward;
- each element of compensation;
- why the company chooses to pay each element;
- how the company determines the amount (and, where applicable, the formula) for each element to pay; and
- how each compensation element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements.

The CD&A is a narrative that is meant to put the compensation disclosures made elsewhere in the proxy statement into context. Therefore, the CD&A should analyze and not merely repeat what compensation is paid. For example, the CD&A should discuss: (i) how and why the amounts and types of compensation were paid; (ii) how compensation is linked to performance and how performance targets were set; (iii) the roles of the compensation committee, management and outside consultants in recommending and determining the types and amounts of compensation to pay; and (iv) if peer companies were used for benchmarking, the names of such companies and how they were selected.

Many companies pay cash bonuses under non-equity incentive plans that specify particular performance targets that must be met in order for the executives to receive various levels of payout under the plans. Companies that use this approach must disclose in the CD&A the specific targets that were used for the most recently completed fiscal year, unless doing so would cause competitive harm. The SEC has, however, objected to attempts by some companies to omit performance targets on the basis of competitive harm. Companies that do omit specific performance targets must provide a description of how difficult the undisclosed targets are to achieve. Such companies should also be prepared to provide the SEC with an analysis of the potential competitive harm; such analysis should be substantially equivalent to the type of analysis which would be required to obtain confidential treatment of any other required Exchange Act disclosure (as discussed in more detail above in the "Confidential Treatment Requests" part of this section of this handbook).

> **Practice Tip:** Performance targets need not be disclosed for future fiscal years unless such disclosure is necessary to an understanding of the compensation paid in the most recently completed fiscal year.

Summary Compensation Table. The summary compensation table, the form of which is copied below, should disclose all compensation paid to or earned by the named executive officers in respect of the most recently completed fiscal year. Specifically, companies must disclose for each of the last three fiscal years with respect to the named executive officers:

- their annual salaries;
- their discretionary cash bonuses (that is, bonus amounts that were not paid pursuant to a previously-adopted plan);
- the grant date fair value of stock awards and option awards made during the most recently completed fiscal year;
- their non-equity incentive plan compensation (including performance-based bonuses);

Practice Tip: The compensation for executives who were not previously named executive officers does not need to include any years prior to the year in which they became a named executive officer.

- changes in the value of their pension benefits and above-market earnings on deferred compensation; and
- the value of perquisites, termination payments, and all other compensation paid or that became payable to them in the fiscal year.

FORM OF SUMMARY COMPENSATION TABLE

Name and principal position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Principal Executive Officer									
Principal Financial Officer									
A....									
B....									
C....									

Shareholder Proposals

Subject to certain exceptions, a company must include in its proxy statement a shareholder's proposal if the shareholder satisfies the following requirements:

- the shareholder has continuously held for at least 1 year by the date it submits the proposal no less than $2,000 in market value, or 1%, of the securities entitled to be voted at the meeting;
- the shareholder must continue to hold such securities through the date of the meeting;
- the shareholder must submit the proposal by the deadline provided in Rule 14a-8, which for annual meetings will normally be 120 days prior to the anniversary of the mailing of the prior year's annual proxy statement. For other meetings of shareholders, the deadline is a reasonable time before the company begins to print and send its proxy materials; and
- the shareholder or its duly qualified representative must attend the meeting to present the proposal.

A shareholder may only submit one proposal for each meeting, which proposal (including any accompanying supporting statement) may not exceed 500 words. A shareholder must follow state law with respect to the procedures for attending the meeting and presenting its proposal.

Companies may exclude a shareholder proposal from their proxy statements if the shareholder fails to satisfy the procedural requirements set forth above or if one or more of the following bases for excluding the proposal applies:

- if the proposal is not a proper subject for shareholder action under the laws of a company's jurisdiction of organization;

Practice Tip: Many proposals are not proper subjects for shareholder action under applicable corporate laws if they would require the company's board of directors to take action in an area where the law vests the power to take such action in the board and not the shareholders. Shareholders often avoid this problem by writing their proposals as a recommendation to or request of the board, rather than a requirement. In addition, proposals requiring an amendment to the company's charter may be improper under applicable corporate laws if board action is required for such amendment, while proposals to amend the company's bylaws generally are not improper.

- if the proposal would cause the company to violate any applicable state, federal or foreign law;
- if the proposal or supporting statement violates the proxy rules, including the antifraud provisions;
- if the proposal deals with a matter relating to the company's ordinary business operations;

Practice Tip: Proposals are excludable under this basis where the proposal relates to tasks fundamental to management's ability to run the company, involves intricate details or seeks to implement complex policies. Proposals are generally *not* excludable on this basis where the proposals relate to social policy issues, raise significant policy considerations, or involve CEO succession planning or executive compensation matters.

Where a proposal relates to environmental, financial or health risks, companies have historically been able to exclude the proposal on this basis if it focused on the company's internal evaluation of the risks that it would face as a result of its operations, rather than if the proposal focused on a company minimizing or eliminating its operations that affect the environment or public health. The SEC, however, issued guidance on October 27, 2009 stating that going forward it will focus on whether the actual subject matter to which the risk pertains or which gives rise to the risk involves a matter of ordinary business to the company or if it "transcends the day-to-day business matters of the company and raises policy issues so significant that it would be appropriate for a shareholder vote." See Staff Legal Bulletin 14E. This new focus should make it more difficult for companies to exclude proposals relating to climate change and other environmental matters.

- if the proposal relates to a personal claim or interest or is designed to result in a benefit which is not shared by the other shareholders;
- if the proposal relates to operations which account for less than 5% of the company's total assets, sales and earnings and is not otherwise significantly related to the company's business;
- if the company would lack the power to implement the proposal;
- if the proposal relates to director elections, including the procedures for nominating or electing directors (but see the amendment to Rule 14a-8(i)(8), which is discussed below in the "Recent Development – Final Proxy Access Rule" part of this section);

- if the proposal directly conflicts with a management proposal or substantially duplicates another proposal by another shareholder;
- if the company has substantially implemented the proposal;
- if the proposal is a resubmission of a proposal that was submitted within the past 5 years, which did not receive certain threshold levels of support; or
- if the proposal relates to specific amounts of stock or cash dividends.

If the company intends to exclude a proposal, it must file its reasons with the SEC at least 80 days before it files its definitive proxy statement. To exclude a proposal on the basis that it is not a proper subject for shareholder action or would violate applicable laws, companies are generally required to submit a legal opinion. In all cases, the burden is on the company to prove that it has a justifiable basis for excluding the shareholder proposal.

Related Person Transactions

Under Item 404 of Regulation S-K, companies are required to disclose information about certain transactions involving "related persons" and the company or any of its subsidiaries, and to describe their policies relating to the review, approval and ratification of such related person transactions. A "related person" generally includes any of the following persons:

- any director or nominee for director;
- any executive officer;
- any beneficial owner of more than 5% of a class of the company's voting securities; or
- any immediate family member of any such director, nominee, executive officer or beneficial owner.

Disclosure is required for any transactions, arrangements or relationships that meet the following criteria:

- the transaction occurred or has continued since the beginning of the company's most recently completed fiscal year (including during the period of time after the completion of such fiscal year), or is a currently proposed transaction;
- in which a related person had or will have a director or indirect *material* interest;

- in which the amount involved exceeds $120,000; and
- in which the company or any of its subsidiaries was or is to be a participant.

Related person transactions include transactions in which a related person has only an indirect material interest. For example, if a director is an executive officer of a third party that does business with the company, the transactions with the third party may need to be disclosed. However, the SEC has provided a safe harbor for transactions in which the interest of the related person is limited to the person being a director and/or less than 10% equity owner of the third party engaging in transactions with the company.

If a transaction must be disclosed, the company must generally disclose the following information about such transaction:

- the identity of the related person and such person's interest in the transaction;
- the approximate dollar value of the transaction and of the related person's interest in the transaction; and
- any other information that would be of material interest to shareholders.

Certain transactions require disclosure of additional information. For example, for transactions involving loans, the company must disclose the largest amount outstanding during the relevant period and all interest and principal payable during such period.

Recent Development – Final Proxy Access Rule

Current SEC rules allow a company to deny shareholders access to the company's proxy statement to propose their own director nominees or to make other proposals relating to the nomination or election of directors. In late 2009, the SEC proposed a new rule, which was adopted in final form on August 25, 2010, to give shareholders access to the proxy statements (and proxy cards) of public companies for these purposes. The new proxy rules were delayed in part due to concerns regarding the SEC's statutory authority to adopt such rules. Section 971 of the Dodd-Frank Act expressly provided the SEC with such authority. See the section of this handbook titled "The Dodd-Frank Wall Street Reform and Consumer Protection Act – Proxy Access."

The SEC's final rule, as adopted, adds a new Rule 14a-11 under the Exchange Act and amends certain related rules, including Rule 14a-8. Rule 14a-11 gives

shareholders the right, under certain circumstances, to include a nominee or nominees for director in a public company's proxy materials. Rule 14a-8, as amended, will facilitate access to the company's proxy materials for the purpose of proposing changes to the procedures for nominating directors. The rules adopted on August 25, 2010 are similar to the proposed rules from 2009, with certain important changes that are discussed below.

The new proxy rules were to become effective with respect to most issuers 60 days from the date of publication in the Federal Register, (or November 15, 2010). The application of the rule to smaller reporting companies was delayed for three years. On September 29, 2010, however, the U.S. Chamber of Commerce and Business Roundtable petitioned the U.S. Court of Appeals for the District of Columbia Circuit to vacate Rule 14a-11 and its requirements as unlawful under the Investment Company Act, the Exchange Act and the Administrative Procedures Act, and at the same time requested that the SEC stay the effectiveness of the rule pending resolution of the Court of Appeals petition. In response, on October 4, 2010, SEC stayed the effective date of the new proxy rules, including Rule 14a-11 and the amendments to Rule 14a-8, pending the resolution of the Court of Appeals petition.

Scope of Shareholder Access to Proxy Materials

Rule 14a-11 requires certain public companies to include shareholder nominations for directors in their annual proxy statements. With certain exceptions, the rule applies to most Exchange Act reporting companies, including investment companies, controlled companies, voluntary filers, smaller reporting companies and non-U.S. domiciled issuers that are not foreign private issuers. Foreign private issuers remain exempt from all U.S. proxy rules, including Rule 14a-11.

Shareholder Requirements to Use Rule 14a-11

Only certain shareholders are allowed to submit shareholder nominations for the board of directors. To submit nominations, a shareholder or shareholder group must:

- collectively own at least 3% of the voting shares of the company;
- have held the requisite percentage continuously for at least three years at the time of providing notice to the company of its intent to use Rule 14a-11; and
- provide notice of its intent to use Rule 14a-11 by filing a Schedule 14N with the Securities and Exchange Commission at least 120 days and no earlier than 150 days prior to the anniversary of the mailing of the prior year's proxy statement.

> **Practice Tip:** The SEC amended Rule 13d-1 to clarify that a shareholder or shareholder group that beneficially owns more than 5% of a class of voting securities of a company, and which is otherwise eligible to report its ownership on Schedule 13G, will not lose its Schedule 13G eligibility solely as a result of nominating one or more director candidates pursuant to Rule 14a-11. This exemption, however, applies solely to activities in connection with a nomination under Rule 14a-11. Other activities, including activities taking place upon the election of a nominee proposed through Rule 14a-11, are not eligible for this exemption.

Information to be included in Schedule 14N. Schedule 14N requires the nominating shareholder or shareholder group to disclose or certify certain information related to its share ownership and intentions, including:

- disclosing the percentage of shares entitled to be voted by the shareholder or shareholder group;
- disclosing the period of time such shares have been held by the shareholder or each member of the shareholder group;
- biographical and other information about the shareholder or shareholder group and the shareholder nominee or nominees, similar to the disclosure required in a contested election;
- certifying the intent of the shareholder or shareholder group to hold shares through the date of the shareholders' meeting at which the directors are to be elected; and
- certifying that the shareholder or shareholder group is not holding stock for the purpose of changing control of the company or to gain more than the maximum number of nominees that the company could be required to include under Rule 14a-11.

The shareholder or shareholder group would be entitled to a statement in support of each shareholder nominee, not to exceed 500 words per nominee. A company that receives a notice on Schedule 14N from an eligible shareholder or shareholder group would be required to include in its proxy statement disclosure concerning the nominating shareholder or shareholder group and the shareholder nominee or nominees, and include on its proxy card the names of the shareholder nominees.

Nominating Shareholders Must File Schedule 14N. As stated above, a nominating shareholder or shareholder group must provide notice of its intent to use Rule 14a-11

by filing a Schedule 14N with the SEC at least 120 days and no earlier than 150 days prior to the anniversary of the mailing of the prior year's proxy statement. New Rule 14a-5(e)(3) requires that a company provide in a proxy statement the deadline for submitting nominees for inclusion in the proxy materials of the next annual meeting of shareholders. However, if a company moves its meeting date more than 30 days from the meeting date of the previous year, the company must file a Form 8-K within four days of determining the meeting date and disclose the date by which a shareholder or shareholder group must provide its Schedule 14N notice. The Schedule 14N should be delivered to the company concurrently with filing the schedule with the SEC.

Practice Tip: Rule 14a-11 does not permit companies to opt out of the rule. To the extent that shareholders have the right to nominate directors at meetings of shareholders, Rule 14a-11 enables shareholders access to the company's proxy statement to include the shareholders' nominees. However, the rules does not preclude a company's constituent documents from establishing eligibility requirements for shareholder nominees that do not discriminate against proxy access nominees. Any such eligibility requirements would need to be permissible under the governing state law.

Limitations on the Use of Rule 14a-11

Rule 14a-11 is not intended to allow shareholders or shareholder groups access to the company's proxy statement in order to take control over a company. Therefore, in addition to requiring the nominating shareholder or shareholder group to certify on Schedule 14N that it is not holding the company's stock with the purpose of bringing about a change of control of the company, Rule 14a-11 specifically limits the maximum number of director positions that can be filled through shareholder nominees.

The total number of nominees from all shareholders that may be elected in reliance on Rule 14a-11 is limited to nominees that would represent 25% of the company's board of directors or one shareholder nominee, whichever is greater. Generally, shareholder nominees elected to the board through methods outside of Rule 14a-11 would not count towards the maximum limitation.

Excluding Shareholder Nominations from Proxy Materials. Public companies may exclude shareholder nominations if the shareholder fails to satisfy the procedural requirements set forth above. The nominee must also satisfy the objective independence standards of any national securities exchange or national securities

association that are applicable to a company's directors. Nominees are not subject to any other independence or qualification standards that may apply to the directors of a particular company, though a shareholder or shareholder group must disclose in the proxy materials whether it believes the nominee satisfies such company standards. If a company is unsure whether a shareholder nominee may be excluded, the company may solicit the opinion of the SEC and request a no-action letter.

Amendments to Rule 14a-8

Among the traditional reasons that a public company could reject a shareholder proposal was if the proposal would relate to a nomination or election of the board of directors or a procedure for such nomination or election, including proposed changes to a company's governing documents that addressed the election process (for example, a change in the advance notice provisions in a company's bylaws). In conjunction with new Rule 14a-11, Rule 14a-8(i)(8) has been amended to delete the exception that allowed a company to reject shareholder proposals concerning procedures for shareholders' director nominees. As amended, Rule 14a-8(i)(8) allows shareholder proposals that augment or supplement Rule 14a-11 nominations, such as by lowering the holding period or otherwise relating to the procedure for nominating or electing directors. The amended Rule 14a-8(i)(8) would still allow a company to reject proposals that, among other things, would question the competence or decisions of directors or director nominees, would remove a director from office before his or her term expired, or would affect the outcome of an upcoming election of directors. In addition, Rule 14a-8 is not available for proposals seeking to submit a specific individual for election as director in the proxy materials. Such proposals may be submitted only under and in compliance with Rule 14a-11 or through other permitted avenues.

Annual Meetings – The Solicitation and Voting Process

The local laws of a company's jurisdiction of organization will determine the requirements for a company's annual meeting of shareholders. In general, however, the annual meeting process for most public companies is similar and includes the following elements:

- Companies must set a record date to determine who can vote at the meeting and, therefore, who should receive the proxy materials.
- Companies must run a broker search at least 20 business days before the record date in order to identify which banks, brokers and other nominees hold shares for their shareholders who hold unregistered shares in "street name."

- Companies register with the Depository Trust Company (DTC), whose nominee holds all of such street shares, and who will then pass its rights down to the individual banks, brokers and nominees, who in turn will pass their rights on down to the individual street holders.
- Companies traditionally held their shareholders' meeting about 30 days after mailing the proxy statements and other proxy materials (such as the proxy card and glossy annual report) to their shareholders. Under the SEC's E-Proxy rules, however, companies may mail only a notice to their shareholders about the annual meeting, which describes how their shareholders may access the complete set of proxy materials on the Internet or request a paper copy of such materials. If a company chooses this option, it must complete the mailing of these Notices of Internet Availability at least 40 days prior to the date of the meeting.
- Companies should generally have available at their annual meetings: (i) affidavits of mailing of the proxy materials; (ii) the DTC position report showing the banks, brokers and other nominees holding shares in the company; (iii) the registered shareholder list; (iv) a meeting agenda; (v) rules of conduct for shareholders present at the meeting; and (vi) ballots for anyone who wishes to vote in person. The secretary and chairman of the meeting will often follow a written script prepared in advance of the meeting. In most cases, companies should appoint an inspector of elections to tabulate the votes; the inspector should sign a formal written oath and provide a written report of the votes. After the meeting, the company should prepare minutes for the meeting, which should be filed in the corporate records.

Annual Reports to Shareholders

The annual report to shareholders is an investor document, usually in a glossy binding. The report must comply with the disclosure requirements set forth in Rule 14a-3(b) and also include certain disclosures by the stock exchange on which the company's securities are listed. Under Rule 14a-3(a), no solicitation of proxies may be made unless the shareholders have been furnished with the annual report. Most public companies include the annual report in the mailing with their proxy statement or include the annual report with the proxy materials in accordance with the e-proxy requirements. Many companies satisfy their annual report disclosure requirements by wrapping a glossy cover over their printed Form 10-K, together with a "Letter to Shareholders" from the Chief Executive Officer.

Broker Voting

The vast majority of shareholders hold their shares indirectly through banks, brokers and other intermediaries. This type of ownership is commonly called holding shares in "street name." For shares held in street name, the proxy materials are sent to the intermediaries who forward them on to the beneficial holders with a request for voting instructions.

Most brokers and other intermediaries are subject to Rule 452 of the New York Stock Exchange (NYSE) as members of the exchange, which rule permits them to vote shares for which they have not received voting instructions only on what are referred to as "routine" matters. Member organizations of The NASDAQ Stock Market LLC (NASDAQ) are subject to NASDAQ Rule 2251, which generally prohibits voting on uninstructed shares but permits brokers and intermediaries to follow the rules of another stock exchange. As a result, NYSE Rule 452 has historically governed voting on uninstructed shares by brokers and other intermediaries regardless of whether the issuer was a NASDAQ or NYSE listed company. Under Rule 452, if the beneficial holders do not provide voting instructions to the intermediaries, the intermediaries will not be permitted to vote those shares on non-routine matters. Historically, "routine" matters included the election of directors (if uncontested), ratification of the auditors, and most other matters not involving fundamental corporate transactions or the approval of equity incentive plans or amendments to such plans. Effective July 1, 2009, however, uncontested director elections are no longer treated as routine matters and intermediaries are not permitted to vote in any director elections without instructions from the street holder.

In addition, Section 957 of the Dodd-Frank Act requires the rules of the national securities exchanges to prohibit their member organizations (that is, brokers and other intermediaries) from voting or granting a proxy to vote the shares held by their clients on matters regarding director elections or executive compensation or on any other "significant matter," as determined by the SEC, without the instructions of such holders. Under prior rules, votes on executive compensation not involving an equity incentive plan, including votes on say-on-pay, were treated as routine matters in which the intermediaries could vote without instructions. In response to the new requirement of the Dodd-Frank Act, the NYSE filed a proposed rule change to Rule 452 and corresponding NYSE Listed Company Manual Section 402.08 on August 26, 2010, to prohibit broker discretionary voting on all executive compensation matters, including the say-on-pay, frequency of say-on-pay and golden parachute votes. The SEC

approved the rule change on an accelerated basis on September 9, 2010. Likewise, NASDAQ filed a proposed rule change on September 14, 2010, which amended NASDAQ Rule 2251 to prohibit its member organizations from voting shares without instructions from the beneficial owners in matters regarding the election of directors or executive compensation or any other "significant matter," as determined by the SEC. The SEC approved the rule change on an accelerated basis on September 24, 2010.

REGULATION OF ANALYST COMMUNICATIONS AND OTHER VOLUNTARY DISCLOSURES

While public companies are subject to numerous laws, rules, regulations and listing requirements that mandate the disclosure of information in registration statements, periodic reports and various other filings, public companies often share news, projections and other information with the market on a voluntary basis as part of their investor and public relations strategies. Prior to 2000, voluntary public company disclosure was not heavily regulated by the SEC. However, with the adoption of Regulation FD in October 2000 and Regulation G and related rules in March 2003, the SEC established rules that affect the scope, timing and content of voluntary disclosure by U.S. public companies.

Regulation FD (FD stands for fair disclosure) was implemented to address perceived abuses involving the selective disclosure of material nonpublic information to analysts, institutional stockholders and others with the opportunity to profit from such information. Numerous public companies were disclosing earnings results and other nonpublic information to analysts and institutional investors before broadly disseminating that information to the general public. The SEC believed this informational disparity undermined the investing public’s confidence in the fairness and integrity of securities markets, since those who were privy to such information had the opportunity to profit at the expense of the uninformed. With the adoption of Regulation FD, the SEC now requires any issuer that discloses material nonpublic information to securities market professionals, stockholders and others who might reasonably be expected to trade on that information to publicly disclose such information on a simultaneous or prompt basis, depending on the circumstances.

With the adoption of Regulation G and related rules, the SEC sought to establish uniformity in the type of financial information that is presented to investors in an issuer’s public filings and in earnings reports and other voluntary disclosures. Regulation G was implemented pursuant to Section 401(b) of SOX (for further discussion, see the section of this handbook entitled “The Sarbanes-Oxley Act”), which directed the SEC to address public companies’ use of “pro forma” financial information and other financial measures that were not prepared and presented in accordance with generally accepted accounting principals, or GAAP. Subject to certain exceptions that are discussed below, Regulation G requires any public company disclosure that includes a non-GAAP financial measure to:

- include the most directly comparable GAAP measure; and
- provide a reconciliation between the non-GAAP measure and the most directly comparable GAAP measure.

When Regulation G was adopted, the SEC simultaneously made changes to Item 10 of Regulation S-K and the Form 8-K filing requirements to address non-GAAP financial measures included in SEC filings as well as earnings and other financial information that is disclosed outside of required SEC filings.

The Pre-Regulation FD Framework

Prior to the Supreme Court's decisions in *Chiarella v. United States* (445 U.S. 222 (1980)) and *Dirks v. SEC* (463 U.S. 646 (1983)), the SEC relied on principles of fraud, particularly the law of insider trading, to deter trading conducted while in possession of material nonpublic information. Early case law developed a "parity of information" standard, which required that all traders have equal access to corporate information. These early decisions also provided the foundation for the "disclose or abstain" rule: a corporate insider must disclose all material nonpublic information known to him before trading, or if such disclosure is not possible, must abstain from trading.

In *Chiarella*, the Supreme Court refused to expand the scope of the disclose or abstain rule beyond corporate insiders to include third parties who are in possession of material nonpublic information. The Court rejected the "parity of information" standard where trading could be deemed fraudulent whenever one trader possessed material information not generally available to the public. The Court instead held that the law imposed no duty to disclose information or abstain from trading absent a fiduciary or other relationship of trust and confidence between the trading parties.

In *Dirks*, the Supreme Court considered whether a "tippee" who received material nonpublic information from a corporate insider was liable for trading on the basis of that information. The Court held that a recipient of inside information is only prohibited from trading when the recipient knows (or should have known) that the information received from an insider had been made available improperly and in breach of the insider's fiduciary duty to shareholders. The Court suggested that such a breach could be found when the insider stood to receive a pecuniary or reputational benefit as a result of the disclosure. The decision in *Dirks* reflected the Court's belief that analysts play an important role in uncovering and disseminating information to investors and was thought to offer significant protection to insiders who make selective disclosures to analysts, as well as to the analysts and their clients who receive such information.

After *Dirks*, the SEC's approach to eliminating the informational disparities created by selective disclosure shifted from treating such disclosure as a type of fraudulent conduct to requiring full and fair disclosure of material information by issuers. With the adoption of Regulation FD, the SEC sought to create a more level playing field for smaller investors by ensuring that all investors are provided with timely access to any material information that an issuer chooses to disclose.

Regulation FD

In August 2000, the SEC adopted Regulation FD, which prohibits the selective disclosure of material nonpublic information to securities market participants when it is reasonably foreseeable that those participants will trade on the basis of that information. Regulation FD requires an issuer to publicly disseminate information that it has selectively disclosed to market professionals and security holders, with the timing of such dissemination dependent on whether the selective disclosure was "intentional" or "non-intentional." Every U.S. issuer that is subject to the Exchange Act's reporting requirements must comply with Regulation FD. "Foreign private issuers" are not required to comply with Regulation FD, although they remain subject to liability for conduct that violates the antifraud provisions of the federal securities laws, including Rule 10b-5 under the Exchange Act. Foreign private issuers are discussed further in the section of this handbook entitled "Foreign Private Issuer Reporting and Compliance."

Practice Tip: Many foreign private issuers have chosen to voluntarily comply with Regulation FD to reduce the risk that their selective disclosure to analysts and other market participants will result in insider trading liability under Rule 10b-5.

What Disclosure is Covered by Regulation FD?

Regulation FD only covers disclosure made by "senior officials" of the issuer, which is defined to include any director or executive officer, investor relations or public relations officer, or any other officer, employee or agent of the issuer who regularly communicates with market professionals, stockholders and other persons covered by the regulation. Generally, an issuer would not be liable for the selective disclosure of material nonpublic information by an employee who is not a senior official, so long as that employee was not directed to make the disclosure by a senior official.

Regulation FD does not cover every disclosure by a senior official, but only disclosure to the following persons:

- brokers-dealers, investment advisers and certain institutional investment managers, and in each case, their associated persons;
- investment companies, hedge funds and their affiliated persons; and
- any of the issuer's stockholders, if it is reasonably foreseeable that they will trade on the basis of the information disclosed.

Communications Excluded from Regulation FD

Regulation FD excludes from its coverage any disclosure of material nonpublic information by a senior official that is made:

- to a person who owes the issuer a duty of trust or confidence, such as an attorney, investment banker, or accountant;
- to any person who expressly agrees to maintain the information in confidence; and
- in connection with most offerings of securities registered under the Securities Act.

Practice Tip: Pursuant to Section 939B of the Dodd-Frank Act, the SEC removed the exemption in Regulation FD for disclosures made to credit ratings agencies. As a result, companies that disclose material nonpublic information to credit ratings agencies will need to review their agreements with such entities in order to assure that there is an appropriate confidentiality undertaking.

Practice Tip: Many issuers rely on the use of confidentiality agreements as a means of selectively disclosing material nonpublic information without violating Regulation FD, particularly in the context of private placements. Regulation FD does not require that such an agreement be in writing; rather, an express oral agreement will suffice. Although not required, it is recommended that any confidentiality agreement include an acknowledgement that a recipient of material nonpublic information is prohibited from trading on the basis of that information.

Timing of Public Disclosure

The timing of any public disclosure an issuer is required to make pursuant to Regulation FD depends on whether the selective disclosure was intentional or non-intentional.

- Intentional Disclosure. Disclosure will be considered intentional if the person making it knows, or is reckless in not knowing, that the selectively disclosed information is both material and nonpublic. If selective disclosure is deemed to be intentional, the issuer must make *simultaneous* public disclosure of such information. To ensure compliance with this requirement, issuers will often publicly disseminate any material nonpublic information before disclosing it to a more limited audience. Note that a disclosure need not be planned to be deemed intentional. For instance, if a company's CEO is in a nonpublic meeting with analysts and provides information the CEO knew (or should have known) was material and nonpublic in response to a spontaneous question on a subject which was not on the agenda, the CEO's disclosure would be "intentional" and in violation of Regulation FD, even though the disclosure was not planned.

- Non-Intentional Disclosure. If a senior official discovers that there has been a non-intentional disclosure of information that such official knows, or is reckless in not knowing, is both material and nonpublic, that information must be publicly disseminated promptly, which means as soon as reasonably practicable after such discovery, but in no event after the later of: (i) 24 hours; or (ii) the commencement of the next day's trading on the NYSE.

Satisfying the Public Disclosure Requirement

Issuers have considerable flexibility in determining how to satisfy the public disclosure requirements of Regulation FD. The public disclosure requirement can be satisfied by filing the information in a Form 8-K or by any other non-exclusionary method of disclosure that is reasonably designed to provide broad public access to the information. Issuers who choose not to file a Form 8-K can rely on traditional methods of public dissemination – such as issuing a press release to a wire or news service – or on more current technologies, such as a conference call that is accessible to the public by phone or webcast.

Practice Tip: If an issuer intends to make public disclosure by means of a conference call or webcast, the SEC requires that the public be given notice a reasonable period of time in advance. The SEC has also suggested that the webcast or call be made available for some reasonable period of time afterwards, and as a result, many issuers will post a replay or transcript in the investor relations section of their websites. See "Practice Tip: Conducting a Reg FD/Reg G Compliant Earnings Call" below.

Is a Website Posting Public Disclosure? At the time Regulation FD was adopted, the SEC recognized the potential for using website disclosure as an acceptable means of satisfying the "public disclosure" requirement of Regulation FD, but stopped short of concluding that such disclosure would, by itself, suffice. In August 2008, the SEC issued an Interpretative Release – *Commission Guidance on the Use of Company Websites* (SEC Release No. 34-58288) – in which it concluded that certain issuers could satisfy the public disclosure requirement under Regulation FD by posting information to their websites, provided those issuers were able to conclude – using factors outlined in the release – that their website is a recognized channel of distribution and that any information posted and accessible on the website has been "disseminated" for purpose of the regulation. While the release did not provide "bright-line" guidance as to when the public disclosure requirements of Regulation FD could be satisfied by an issuer's website posting, it did provide a non-exclusive list of considerations that an issuer could use to make such a determination.

What is Material Information?

Regulation FD only prohibits the selective disclosure of *material* information. Regulation FD does not define materiality, but instead relies on the definition that has been developed through case law. Based on the general principles established by the courts, information would be considered material if:

- there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision;
- it would be viewed by a reasonable investor as significantly altering the total mix of information available; or
- it is reasonably certain to have a substantial effect on the market price of the issuer's securities.

Given the fact-dependent nature of the analysis, there is no bright-line rule as to what should be considered material for purposes of Regulation FD. In the adopting release for Regulation FD, however, the SEC provided a non-exclusive list of the types of information and events that issuers should carefully review to assess materiality:

- earnings information;
- mergers, acquisitions, tender offers, joint ventures, or changes in assets;
- new products or discoveries, or developments regarding customers or suppliers (*e.g.*, the acquisition or loss of a contract);
- changes in control or in management;
- change in auditors or auditor notification that the issuer may no longer rely on an auditor's audit report;
- events regarding the issuer's securities — *e.g.*, defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and
- bankruptcies or receiverships.

Practice Tip: The SEC has made clear that any communication between an issuer and analysts regarding earnings involves a high degree of risk under Regulation FD. As a result, any information that an issuer plans to disclose to an analyst should be carefully scrutinized to confirm that it is not material or has already been publicly disseminated. If those determinations cannot be made with certainty, the issuer should consider the information material and comply with the public disclosure requirements of Regulation FD.

The Consequences of Violating Regulation FD

Only the SEC can bring an action for a violation of Regulation FD. Upon determining that material nonpublic information has been selectively disclosed in violation of Regulation FD, the SEC can bring an administrative action seeking a cease-and-desist order, or a civil action seeking an injunction and/or monetary penalties against both the issuer and its executives. A violation of Regulation FD does not give rise to a private right of action or by itself represent a violation of the general

antifraud provisions of Rule 10b-5 under the Exchange Act, although it is important to be aware that selective disclosure could in certain circumstances result in a violation of Rule 10b-5.

Since the adoption of Regulation FD, the SEC has brought a handful of enforcement actions against issuers and executives who were alleged to have been responsible for selective disclosure in violation of Regulation FD. One investigation and three enforcement actions were commenced by the SEC in 2002, and one enforcement action has been brought each year since, with two actions brought in 2010. Each enforcement action involved an issuer that had experienced a measurable spike in the trading volume and price of its stock that had not been preceded by publicly announced news. For the most part, the Regulation FD enforcement actions brought to date have resulted in the submission of an offer of settlement by the issuers and/or executives who were the subject of the action. While none of these settlements included an admission or denial of the SEC's findings, the fact patterns described in each action provide guidance as to the focus of the SEC's enforcement efforts. The types of conduct described in these actions included:

- nonpublic communications with analysts to quantify or expand upon the issuer's prior public disclosures;
- disclosure of an issuer's outlook during a nonpublic investor conference that contradicted the outlook presented during a public earnings call;
- the mistaken belief by an issuer's spokesperson that information posted to the issuer's website had been publicly disseminated and that the subsequent selective disclosure of that information was permitted;
- an issuer's selective reaffirmation of earnings guidance, which was contrary to its stated policy of publicly announcing all earnings updates; and
- selective disclosure during a nonpublic investor meeting that was communicated through a combination of statements, tone, emphasis and demeanor.

Public and Nonpublic Statements

In October 2010, the SEC settled its most recent enforcement action against Office Depot, Inc., CEO Stephen Odland and former CFO Patricia McKay over alleged indirect guidance the two officers gave to analysts in a series of one-on-one

calls. According to the SEC complaint, the company did not directly tell the analysts that it would not meet their expectations but "signaled" that message through its references to recent public statements of comparable companies about the impact of the slowing economy on their earnings. As a result of the calls, fifteen of the eighteen analysts lowered their estimates, bringing the consensus second quarter 2007 estimate down from $0.48 to $0.45 and the shares of Office Depot dropped 7.7% in the following week. To settle the complaint, Odland and McKay each agreed to pay a $50,000 penalty and also agreed without admitting or denying wrongdoing to cease and desist from future violations. The action highlighted the SEC's decision to focus on high ranking company officials who have instructed subordinates to engage in conduct that violated Regulation FD and also specifically singled out Office Depot for not having written Regulation FD policies or procedures in place at the time.

The settlement with Office Depot followed an earlier SEC action in March 2010 against Presstek, Inc. and its former CEO Edward J. Marino. The SEC alleged that Marino disclosed negative material nonpublic information regarding Presstek's financial performance to the managing partner of an investment management company. As a result of the disclosure, the managing partner decided to sell all of the shares of Presstek held by the investment funds he advised. The SEC agreed to a settlement with Presstek for a $400,000 civil penalty. The Presstek action, together with the Office Depot case, suggests that the SEC is continuing to focus on Regulation FD compliance.

As a comparison to the above actions, in a previous case in August 2005, the United States District Court for the Southern District of New York dismissed complaints filed by the SEC against Siebel Systems, Inc. and two of its executives alleging violations of Regulation FD and the SEC's cease-and-desist order issued in connection with a 2002 enforcement action. In its complaints, the SEC cited various public statements made by Seibel's CFO that described Seibel's generally poor performance, which he attributed to the overall performance of the economy. Later, at two private events attended by institutional investors, the CFO stated that things were better and deals were in the pipeline. The SEC claimed the CFO violated Regulation FD by making "significantly more positive and upbeat" comments at these private meetings, and by failing to link Seibel's business results to the performance of the economy, as he had done in his public statements. The SEC argued that the CFO's public and nonpublic comments were materially different, which represented a violation of Regulation FD when his comments from the private meetings were not publicly disseminated.

In reaching its decision to dismiss the SEC's complaints, the District Court disagreed with the heightened level of scrutiny used by the SEC to analyze the CFO's statements at the private events, finding that such scrutiny placed an unreasonable burden on corporate officials to become linguistic experts. The court believed that the SEC's excessive scrutiny of vague general comments could have a chilling effect on public disclosure, as companies would fear that even the slightest variance in their public and private statements would represent a violation of Regulation FD. The court believed that the SEC's aggressive enforcement posture provided companies with no clear guidance as to how to conform their conduct to comply with Regulation FD and was not supported by the language of the rule.

While the District Court's decision in Seibel can be viewed as a clear rebuke of the SEC's overly aggressive enforcement efforts, it also illustrated the significant risks inherent in nonpublic discussions with securities market participants and reinforced the benefit of providing senior officials with a script for any such occasion, which may help eliminate inadvertent deviations between public and nonpublic statements.

The Importance of Compliance Programs

In September 2009, the SEC settled a Regulation FD enforcement action, which was brought against Christopher Black, the former CFO of American Commercial Lines, or ACL. The action was significant in that it represented the first time the SEC did not include the issuer in an enforcement action for a violation of Regulation FD. The SEC alleged that Mr. Black, who also acted as ACL's investment relations officer, had violated Regulation FD by sending an e-mail to analysts that contained nonpublic earnings information. Although the CEO had instructed Mr. Black to ask ACL's outside counsel to review the email, Mr. Black failed to do so. In its complaint, the SEC identified the key factors that it considered when deciding to exclude ACL as a party to the action, including that ACL:

- had fostered a culture of compliance, including the implementation of Regulation FD controls and procedures and training sessions with counsel;
- ensured the prompt public dissemination of the selectively disclosed information in a Form 8-K filing;
- promptly reported the violation to the SEC and fully cooperated in the SEC's investigation; and
- reviewed its procedures after the violation occurred and revised them as necessary to prevent a similar violation in the future.

While the enforcement action against Mr. Black shows that even a robust compliance program cannot always prevent a violation of Regulation FD, it demonstrates that an effective compliance program may persuade the SEC to not pursue an enforcement action against the company even where one of its officers has violated Regulation FD.

Practice Tips: Following are some of the lessons that can be learned from the SEC's enforcement actions to date:

- Senior officials must exercise extreme caution during any nonpublic meeting with market professionals and investors and should understand that even reaffirmations, non-specific responses or clarifications to prior guidance may constitute a violation of Regulation FD.
- At each meeting between an issuer and market participants, one person should be given responsibility for ensuring that senior officials remain within scripted boundaries and redirecting the discussion when off-agenda topics are raised.
- Senior officials should understand that their tone or demeanor should not convey information that they would be prohibited from relaying verbally. In short, be careful not just of *what* you say, but *how* you say it!
- The SEC often looks to changes in stock price and trading volume when assessing the materiality of a disclosure. If the market reacts to disclosure that had been considered immaterial, the company should reevaluate its conclusion and consider making prompt public disclosure.
- A robust compliance program, together with prompt public disclosure and proactive corrective measures following a violation, may help insulate a company from liability for a senior official's non-compliant acts.

Regulation G and Related Rules

The SEC adopted rules that became effective in March 2003 that regulate the public disclosure by public companies and their representatives of financial measures that are not calculated and presented in accordance with GAAP. These rules were promulgated pursuant to Section 401(b) of SOX to eliminate investor confusion that

may result from the use by public companies of non-GAAP financial measures. The rules consisted of:

- a new Regulation G, which governs public disclosure of non-GAAP financial measures, principally in a company's earnings release;

- amendments to Item 10 of Regulation S-K, which governs the inclusion of non-GAAP financial measures in registration statements, periodic reports and certain other filings made with the SEC; and

- amendments to the Form 8-K reporting requirements, which require issuers to furnish in a Form 8-K any material nonpublic information regarding the issuer's results of operations or financial condition that the issuer has disclosed or released.

Regulation G was adopted in order to ensure the uniformity and comparability of financial information provided by public companies. Generally, whenever a public company discloses or releases material information that includes a non-GAAP financial measure (other than certain disclosures relating to a proposed business combination), the company is required to comply with Regulation G. Regulation G includes:

- a general anti-fraud provision which prohibits the use of a non-GAAP financial measure in a manner which, taken together with any accompanying disclosure, is untrue or misleading; and

- a requirement that, upon a public company's disclosure of a non-GAAP financial measure, the company must also disclose the most directly comparable GAAP financial measure and a quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure.

Practice Tip: As part of its review of periodic reports on Forms 10-K and 10-Q, the SEC Staff will review company earnings releases and investor presentations to determine whether companies are omitting material information from their SEC filings, and may issue comments where material information is disclosed in such presentations and not included in a company's SEC filings, including the company's MD&A.

What are Non-GAAP Financial Measures?

A non-GAAP financial measure is a numerical measure of a company's historical or future financial performance, financial position or cash flow that excludes (or includes) amounts that are included (or excluded) in the comparable GAAP measure. Non-GAAP financial measures do not include operating and other statistical data (such as same store sales) or ratios calculated using GAAP financial measures.

What Types of Disclosures Does Regulation G Cover?

Regulation G covers any public communication of material information that contains a non-GAAP financial measure, whether written, oral, communicated in a webcast or other broadcast or furnished voluntarily in a press release or as part of a required filing with the SEC. If non-GAAP information is communicated orally – *e.g.,* as part of a presentation given during an earnings call or webcast – Regulation G does not require oral disclosure of the directly comparable GAAP measure and the required reconciliation, provided that:

- such information is provided on the issuer's website at the same time that the presentation is being given; and
- the website address where such information can be found is included in the presentation.

Practice Tip: If a non-GAAP financial measure is included in slides or other materials that are distributed in hard copy or made available electronically to participants in a conference call or webcast, the comparable GAAP measure and reconciliation required by Regulation G must also be included in that material.

Non-GAAP Measures in SEC Filings

In addition to the requirements of Regulation G, Item 10 of Regulation S-K imposes additional restrictions and disclosure requirements whenever non-GAAP financial measures are included in filings with the SEC. The additional disclosures are:

- the most directly comparable GAAP measure must be presented in the filing *with equal or greater prominence*;
- the filing must include a statement disclosing the reasons why management believes that presentation of the non-GAAP financial measure provides useful information to investors concerning the company's financial condition or results of operations; and
- the filing must include, to the extent material, a statement disclosing the additional purposes, if any, for which the company's management uses the non-GAAP financial measure.

Item 10 prohibits:

- excluding charges or liabilities that required, or will require, cash settlement from non-GAAP liquidity measures, other than the measures Earnings Before Interest and Taxes (EBIT) and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA);
- adjusting a non-GAAP financial performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when (1) the nature of the charge or gain is such that it is reasonably likely to recur within two years, or (2) there was a similar charge or gain within the prior two years;
- presenting non-GAAP financial measures on the face of the company's GAAP financial statements or in the accompanying notes;
- presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X; and
- using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

Practice Tip: In January 2010, the Staff updated its C&DI's on Non-GAAP financial measures to facilitate the inclusion of non-GAAP financial measures in SEC filings. In Question 102.03, the Staff relaxed the requirements for presenting non-GAAP measures that exclude recurring items. Previously, the Staff generally required that a company demonstrate the usefulness of disclosing a non-GAAP measure that excluded recurring charges. In the updated C&DI, the Staff modified its position to permit the disclosure of such non-GAAP measures provided that the company otherwise complies with Regulation G and Item 10(e). In Question 102.04, the Staff clarified that Item 10(e)(i)(D) of Regulation S-K only requires that a company disclose how management uses a non-GAAP measure to the extent that it is material, and that the company does not need to use the non-GAAP measure in its business in order to be allowed to disclose it. In Questions 102.09 and 103.01, the Staff stated that companies may disclose adjusted EBIT and adjusted EBITDA measures in a company's MD&A where necessary to disclose a material term of a credit facility. Otherwise, the exception in Item 10(e) allowing disclosure of EBIT and EBITDA as non-GAAP liquidity measures does not apply to adjusted EBIT and adjusted EBITDA measures. However, the prohibition in Item 10(e) would not prohibit the disclosure of adjusted EBIT or adjusted EBITDA as a performance measure.

The Consequences of Violating Regulation G

Similar to Regulation FD, only the SEC can bring an action for a violation of Regulation G. The SEC can bring an administrative action seeking a cease-and-desist order, or a civil action seeking an injunction and/or monetary penalties. Regulation G expressly provides that a person's failure to comply with its requirements does not by itself affect such person's liability under Rule 10b-5, although the SEC has expressed its view that some disclosures of non-GAAP financial measures could give rise to a violation of Rule 10b-5 if all the elements for such a violation are present.

Amendments to Form 8-K

When Regulation G was adopted in 2003, the SEC also amended the Form 8-K filing requirements to include a new Item 2.02 (previously, Item 12), "Disclosure of Results of Operations and Financial Condition." Item 2.02 requires any public company that publicly discloses or releases material nonpublic information regarding a company's results of operations or financial condition for an annual or quarterly fiscal period to furnish such information in a Form 8-K that is filed with the SEC within four business days of such disclosure or release. While a new Item 2.02 Form 8-K would ordinarily need to be filed each time such earnings and financial information is disclosed, the SEC provided a limited exception for material nonpublic earnings and financial information that is disclosed orally, telephonically, by webcast, by broadcast, or by similar means in a presentation that is complementary to, and occurs within 48 hours after, a related written release or announcement that is the subject of an Item 2.02 Form 8-K. See "Practice Tip: Conducting a Reg FD/Reg G Compliant Earnings Call" below.

Any earnings information that is included in a Form 8-K pursuant to Item 2.02 is deemed to be "furnished" and not "filed" with the SEC, which means such information is not subject to Section 18 of the Exchange Act or incorporated by reference into the issuer's registration statements. As a result, not all of the restrictions and disclosure requirements imposed by Item 10 of Regulation S-K would apply where non-GAAP financial measures are used in an earnings release furnished under Item 2.02 of Form 8-K. Instead, the Item 2.02 Form 8-K must only include, in addition to the disclosure required by Regulation G:

- the reasons why management believes that the non-GAAP financial measures are useful to investors; and
- the additional purposes, if any, for which management uses the non-GAAP financial measures.

Practice Tip: Conducting a Reg FD/Reg G Compliant Earnings Call

The following outlines the procedures that should be followed by a public company that intends to conduct an analyst/investor conference call to discuss an earnings release for a recently completed quarterly or annual fiscal period.

1. Notice. Provide notice a reasonable period of time in advance of the call. For regular quarterly earnings calls, the SEC has stated that notice of several days would be reasonable. The notice, which can be delivered in a press release or Form 8-K or by using any other widely-disseminated method of delivery, must include:

- the date, time, subject matter and means for listening to the call (*e.g.,* the dial-in number or location of a webcast);
- if any financial, statistical or Regulation G information is required to be posted to the company's website in connection with the call (see Item 4 below), the address for that website and the location where the information can be found (*e.g.,* in the investor relations section of the website); and
- whether, and for how long, the public can access a replay or transcript of the call on the company's website (see Item 6 below).

2. Notify Stock Exchanges. Both NYSE-listed and NASDAQ-listed companies must provide their exchange with advance notice before issuing an earnings release. At least ten minutes prior to issuing an earnings release:

- a NYSE-listed company must notify its NYSE representative by telephone and provide the NYSE with the text of the earnings release by e-mail; and
- a NASDAQ-listed company must notify MarketWatch through its electronic disclosure submission system.

3. File the Earnings Release with a Form 8-K. The earnings release should be included under Item 2.02 of a Form 8-K that is furnished to the SEC in advance of the earnings call. The timing is important: if the Form 8-K is furnished to the SEC *no more than 48 hours* prior to the earnings call, there will be no need to furnish another Item 2.02 Form 8-K with any earnings information that is discussed during the call (assuming proper advance notice of the call has been given, as described above).

4. Post Financial, Statistical and Regulation G Information to Website. Any financial and statistical information that will be used during the earnings call should be posted to the company's website prior to the call. If any non-GAAP financial measures will be used during the call, the disclosure required under Regulation G should also be posted to the website. The SEC encourages, but does not require, that such information remain available on a company's website for a minimum of 12 months.

5. Conduct Earnings Call. The company should conduct its earnings call within 48 hours after the Item 2.02 Form 8-K has been furnished to the SEC. Public access to the call should be provided through a dial-in number, a webcast or similar method of broadcast. Members of the public that are provided with a dial-in number can be given "listen-only" access and do not need to be provided with the ability to ask questions. Prior to commencing the call, it is recommended that a company spokesperson or senior official:

- disclose the location on the company's website of any financial or statistical information that will be used during the call, as well as any information required by Regulation G; and
- recite and/or identify the location of the company's disclaimer for forward-looking statements, to ensure that any forward-looking information discussed during the call is afforded the protection of the safe harbor under the Private Securities Litigation Reform Act of 1995.

6. Post Replay or Transcript of Call to Website. Promptly after the earnings call, post an audio replay or transcript of the call to the company's website. By doing so (and assuming the public was provided with proper advance notice of where and when the replay or transcript would be available), any material nonpublic information that is discussed during the call will be deemed to have been publicly disseminated for purposes of Regulation FD.

THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act of 2002 was adopted in response to a series of highly publicized corporate accounting scandals. SOX ushered in sweeping reforms designed to strengthen the integrity of the financial markets by improving the accuracy and reliability of public disclosures required under the securities laws. These reforms included measures to:

- strengthen the role and independence of audit committees;
- increase management accountability for the quality and accuracy of public companies' financial reporting and other material public disclosures;
- reduce the potential for management conflicts of interest;
- improve the regulatory oversight and independence of public accounting firms;
- increase protections for whistleblowers;
- enhance public companies' financial disclosures and real-time reporting; and
- require attorneys, including attorneys practicing in-house, to report corporate wrongdoing.

Additional reforms introduced by SOX include scheduled SEC reviews of periodic public company disclosures, rules and regulations to address conflicts of interest arising from securities recommendations by research analysts, expanded criminal penalties for violations of federal securities laws and an extended statute of limitations for private rights of actions relating to securities fraud claims.

Many of the SOX reforms apply generally to all public companies. Others apply only to listed companies*,* which for SOX purposes are those public companies that have listed their securities on a U.S. stock exchange, such as the NYSE or NASDAQ.

It is important to note that SOX applies generally to U.S. and non-U.S. companies alike. However, a number of the SEC rules and stock exchange listing standards implementing SOX provide exemptions or other limited compliance relief to non-U.S. companies that qualify as foreign private issuers. The application of SOX to foreign private issuers is discussed further in the section of this handbook entitled "Foreign Private Issuer Reporting and Compliance."

The SOX reforms are reflected in its specific provisions as well as through amendments to the Securities Act, the Exchange Act and other federal laws, SEC

rules, stock exchange listing rules and rules adopted by the Public Company Accounting Oversight Board (PCAOB), an independent self-regulatory agency created by SOX to oversee public accounting firms. We discuss below the aspects of SOX that most directly affect public companies.

Audit Committee Standards and Independence

Listed Company Audit Committee Requirements

Section 301 of SOX required the SEC to issue rules directing U.S. stock exchanges to prohibit the listing of a company's shares unless its audit committee meets certain standards designed to ensure auditor independence and to preserve the integrity of the audit process from improper influence by company management. As a result, the SEC adopted Rule 10A-3 under the Exchange Act, which mandated that the exchanges adopt listing standards that at a minimum incorporate the requirements of Section 301, which are discussed below. In fact, the rules adopted by the stock exchanges vary somewhat from these threshold requirements. There are also variations among the rules adopted by individual stock exchanges. We discuss the variations in the applicable rules of the NYSE and NASDAQ in the section of this handbook entitled "Stock Exchange Listing Requirements."

Section 301 of SOX and Rule 10A-3 require stock exchanges to adopt the following listing standards applicable to listed companies:

Responsibility for Auditor Oversight. The audit committee must be directly responsible for the appointment, compensation and oversight of the work of the company's registered public accounting firm engaged to perform audit services, and the auditors must report directly to the audit committee. Any disagreements between management and the auditors regarding financial reporting are to be resolved by the audit committee. This role of the audit committee does not supersede any requirements under law or a company's governing documents for the company's board or shareholders to recommend, or approve or ratify its auditors. Rather, it establishes that the audit committee's selection is required in addition to any such requirement. As discussed below under "Auditor Independence and Oversight – Permitted Non-Audit Services; Pre-Approval of Services," the audit committee must pre-approve all audit and, subject to certain *de minimis* exceptions, non-audit services provided by the company's auditors.

Independence. Each audit committee member must be "independent," which means, at a minimum, that he or she must not, other than as compensation for service on the board of directors or any of its committees, accept any consulting, advisory or other compensatory fees from the company, or be an "affiliated person" of the company or any of its subsidiaries. The definition of "affiliated person" for these purposes is consistent with the definition employed elsewhere in the federal securities laws, and means a person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the subject person. "Control" is also defined consistently with other definitions of that term in the federal securities laws to mean the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.

Practice Tip: The prohibition on an audit committee member receiving any compensation other than in the member's capacity as a member of the board of directors or any board committee extends to payments received as an officer or employee, as well as certain other compensatory payments, whether direct or indirect. These would include payments to spouses and certain close family members, as well as payments to an entity in which the audit committee member is an executive officer, director, general partner, managing member or similar position and which provides consulting, advisory or similar services to the company or any subsidiary.

Whether a particular person is an "affiliated person" depends on a consideration of all relevant facts and circumstances. Because of the difficulty inherent in making such a determination, the SEC expressly adopted a safe harbor exception from the definition of "affiliated person" for the purpose of testing the independence of audit committee members. Under the exception, a person is deemed not to control an issuer if the person is neither an executive officer nor a greater than 10% shareholder of the issuer. In contrast, executive officers, employee directors, general partners and managing members of affiliates are deemed to be affiliates of the company.

The SEC has authority to exempt particular relationships from the independence requirements for audit committee members, and has exercised that authority to provide accommodations for newly public companies and audit committee members who sit on the board of both a parent company and its controlled subsidiary. Recognizing the difficulty that private companies often have in recruiting outside directors prior to

going public, SEC rules require only one independent audit committee member at the time a company goes public, a majority of independent members within 90 days thereafter and a fully independent audit committee within a year. In the case of companies that operate through subsidiaries with overlapping boards of directors, the SEC reasoned that an audit committee member of a parent company who is otherwise independent should not lose that designation merely by serving on the board of a controlled subsidiary. Accordingly, SEC rules exempt from the "affiliated person" prohibition those audit committee members who sit on the boards of both a parent company and its controlled subsidiary, provided that the member otherwise meets the independence requirements for both the parent and subsidiary.

Foreign private issuers are accorded additional exemptions from the independence requirements for audit committee members. For example, where a foreign private issuer's home country laws require its board to contain a non-management employee representative, that person may sit on the audit committee, as may a non-management affiliated person with observer-only status. In addition, a non-management representative of a foreign government may sit on the foreign private issuer's audit committee provided the representative receives no compensation other than for service on the board and its committees. For foreign private issuers whose board of directors is divided into supervisory and management tiers, the SEC considers the supervisory tier to be the board of directors for purposes of the independence requirements. Foreign private issuers that have separate boards of auditors or statutory auditors under their home country law are not subject to the SOX required audit committee listing standards and independence requirements if certain conditions aimed at approximating these standards and requirements are met, including, to the extent permitted by law, application of the whistleblower, funding and authority to engage independent advisers requirements described below.

SEC rules require listed companies to disclose in their annual report, and in any proxy or information statement filed with the SEC for meetings at which directors are elected, whether their audit committee members are independent under the applicable SEC and stock exchange rules. If the listed company does not have an audit committee, its entire board of directors will be considered to be the audit committee, and it must disclose that the entire board is acting as the company's audit committee. Non-listed companies with audit committees must also disclose whether their audit committee members are independent, but may choose the applicable definition of independence from any SEC-approved stock exchange. In addition, a company relying

on any exemption from the SEC's audit committee independence requirements must disclose that fact and state whether the company's reliance on the exemption will have a material adverse effect on its audit committee's ability to act independently and satisfy the other requirements of Rule 10A-3.

Whistleblower Procedures. The audit committee must establish procedures to receive and handle complaints regarding accounting, internal accounting controls, or auditing matters, and which enable employees to submit, confidentially and anonymously, concerns regarding questionable accounting or auditing matters. Employees who provide evidence of fraud or other corporate wrongdoing are referred to generally as "whistleblowers."

Funding and Authority to Engage Advisers. The audit committee must have the authority to engage independent counsel and other advisers, and the company must provide appropriate funding, as determined by the audit committee, to compensate the company's auditors and any advisers the audit committee engages and to cover the audit committee's ordinary administrative expenses.

Audit Committee Financial Expert

Public companies are required to disclose in their annual report whether their audit committee has at least one member who qualifies as an "audit committee financial expert" as defined by SEC rules, and if not, why not. If the company's audit committee has more than one audit committee financial expert, the company may but is not required to disclose the names of the additional experts.

To qualify as an audit committee financial expert, a person must possess the following attributes:

- an understanding of GAAP and financial statements;
- the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;
- experience preparing, auditing, analyzing, or evaluating financial statements that are generally comparable in breath and complexity of issues to those of the company, or experience actively supervising one or more persons engaged in those activities;
- an understanding of internal control over financial reporting; and

- an understanding of audit committee functions.

In addition, the person must have developed those attributes through:

- education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or through experience in a similar position;
- experience actively supervising a person in any of the positions described above;
- experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or
- other relevant experience.

MANAGEMENT ACCOUNTABILITY FOR THE QUALITY AND ACCURACY OF FINANCIAL REPORTING AND OTHER PUBLIC DISCLOSURES

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Management is responsible for designing, maintaining and evaluating a company's disclosure controls and procedures as well as its internal control over financial reporting, and must include certain SOX-mandated reports and certifications relating to these matters in the company's periodic reports. The following discussion outlines management's responsibilities in this regard and the applicable SOX disclosures and certifications.

Design, Maintenance and Evaluation of Disclosure Controls and Procedures and Internal Control over Financial Reporting. Under Rules 13a-15 and 15d-15 under the Exchange Act, public companies are required to design and maintain disclosure controls and procedures and internal control over financial reporting. Disclosure controls and procedures are the controls and other procedures of a company designed to ensure that information the company is required to disclose in its Exchange Act reports is accurately accumulated and communicated to management in time to allow timely decisions regarding required disclosure. In contrast, internal control over financial reporting is a process designed by or under the supervision of a company's CEO and CFO, and effected by its board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in

accordance with GAAP, including assurance regarding the prevention or timely detection of inaccurate or unauthorized transactions.

In addition, management is required to evaluate, with the participation of the CEO and CFO, the effectiveness of the company's disclosure controls and procedures and internal control over financial reporting. Evaluation of disclosure controls must take place on a quarterly basis, and evaluation of internal controls must take place at the end of each fiscal year; however, management must disclose quarterly any change in the company's internal control over financial reporting that occurred during the quarter that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting. For foreign private issuers, such evaluations must be made as of the end of each fiscal year.

Practice Tip: Although there is substantial overlap between a company's disclosure controls and procedures and its internal control over financial reporting, each concept covers aspects that are not captured by the other. For example, a company's disclosure controls and procedures may not cover dual signature requirements imposed in order to safeguard assets, which would be included as an aspect of internal control over financial reporting.

Management's evaluation of the company's internal control over financial reporting must be based on a suitable, recognized control framework established by a group that has followed due-process procedures, including widespread distribution of the framework for public comment. To help companies strengthen their internal controls in a more cost-effective manner, the SEC has issued principles-based interpretive guidance[11] to provide flexibility and encourage companies to focus on those internal controls which will best identify and prevent risks which could result in a material financial misstatement. This guidance is organized around two broad principles. First is that management should evaluate whether its controls adequately address the risk that a material misstatement of the financial statements would not be prevented or detected in a timely manner. The second principle is that management's

[11] Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Securities Act Release No. 8810, Exchange Act Release No. 55,929, 72 Fed. Reg. 35,324 (June 20, 2007), *available at* http://www.sec.gov/rules/interp/2007/33-8810.pdf.

evaluation of evidence about the operation of its controls should be based on its assessment of risk, with more efficient approaches to gathering evidence being employed in low-risk areas and more extensive testing in high-risk areas. A company that evaluates its internal controls in accordance with the interpretive guidance will be deemed to have satisfied the SEC's requirements for internal control evaluations.

Companies may also choose to base their evaluation on another recognized control framework, such as the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework*. The chosen framework must be free from bias, permit reasonably consistent qualitative and quantitative measurements of a company's internal control, be sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of a company's internal controls are not omitted, and be relevant to an evaluation of internal control over financial reporting. Regardless of the framework used, a company must maintain evidence, including documentation, to provide reasonable support for management's assessment of internal control over financial reporting.

Disclosure in Respect of Disclosure Controls and Procedures and Internal Control over Financial Reporting. Section 404 of SOX directs the SEC to adopt rules requiring a public company's annual report to include an internal control report that states management's responsibility for establishing and maintaining adequate internal control structure and procedures for financial reporting and assesses, as of the end of the most recent fiscal year, the effectiveness of such structure and procedures. In addition, if the company is an accelerated filer or a large accelerated filer, the company's independent auditor is required to attest to and report on management's assessment, subject to PCAOB Auditing Standard No. 5 (AS 5).

The SEC's rules implementing Section 404 of SOX go further and require a public company's annual report to disclose:

- the conclusions of its CEO and CFO regarding the effectiveness of the company's disclosure controls and procedures;
- a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting;
- the framework management used to evaluate the effectiveness of the company's internal control over financial reporting; and

- management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of its most recent fiscal year, including whether or not internal control over financial reporting is effective.

In addition to the above, if the company is an accelerated filer or a large accelerated filer, its annual report must disclose that the company's public accounting firm has attested to and reported on management's evaluation of the company's internal control over financial reporting, and the company must include the public accounting firm's attestation report in the company's annual report.

Recent Development: Section 989G of the Dodd-Frank Act added new Section 404(c) to SOX, which exempts smaller reporting companies and non-accelerated filers from the requirement that the company include in its annual report an attestation report of its independent auditor on management's evaluation of the company's internal control over financial reporting.

Management's assessment of the effectiveness of its internal control over financial reporting must disclose any "material weakness" in the company's internal control over financial reporting identified by management. Management is not permitted to conclude that the company's internal control over financial reporting is effective if there are one or more material weaknesses in internal control over financial reporting. AS 5 identifies faults in internal controls in terms of a "deficiency," "significant deficiency," or "material weakness," with the latter being the most severe. A "deficiency" exists when the design or operation of a control does not allow management or employees to prevent or detect misstatements on a timely basis. A "significant deficiency" is a deficiency, or a combination of deficiencies, that is less severe than a material weakness yet important enough to merit attention. In contrast, a "material weakness" is defined in Rule 12b-2 under the Exchange Act as a "deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis."

In addition to the required annual disclosures, a public company must disclose in its quarterly reports the conclusions of its CEO and CFO regarding the effectiveness of the company's disclosure controls and procedures, and any change in the company's internal control over financial reporting that occurred during the quarter that has

materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

Section 302 Certification

Under Section 302 of SOX and related SEC rules, a public company's CEO and CFO must make certain certifications in respect of the company's disclosure controls and procedures and internal controls over financial reporting in connection with the company's annual and quarterly reports filed with the SEC. If a company has co-CEOs or co-CFOs, each of them must make the required certifications.

> **Practice Tip:** If a company's CEO or CFO changes, the person serving in the position at the time the report is filed with the SEC is required to sign the applicable certificate, even if he or she was not serving in the position during the period covered by the report.

The CEO and CFO must certify that, based on their knowledge, the report is not misleading and fairly presents the company's financial condition, results of operations and cash flows for the period covered by the report. The certifications must also cover the CEO's and CFO's responsibility for the design, maintenance and evaluation of the company's disclosure controls and procedures and internal control over financial reporting and certain related disclosures. The SEC has adopted a specific form of the Section 302 certificate, a copy of which appears at the end of this section. The SEC permits only the following limited variations to the form: (i) the omission of the third paragraph (which certifies that the financial statements in the subject report fairly present the company's financial condition, results of operations and cash flows) in circumstances where the accompanying report neither contains nor amends financial statements; and (ii) revision of the references to "other certifying officer(s)" to use a singular "officer" to reflect that there is only one additional certifying officer.

The required certificates must be filed as exhibits to the applicable filings. Foreign private issuers must include the exhibits with their annual reports on Form 20-F, but are not required to include them with their submissions on Form 6-K.

Section 906 Certification

Section 906 of SOX amended federal criminal law to require that each periodic report containing financial statements filed by a company with the SEC contain a certification from the company's CEO and CFO that the report fully complies with the

requirements of the Exchange Act and the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the company. The certification is considered "furnished" rather than "filed," and thus does not subject the certifying CEO or CFO to liability under Section 18 of the Exchange Act. Furthermore, unless specifically incorporated by reference, the Section 906 certification is not deemed incorporated by reference in any filing under the Securities Act or Exchange Act. Nonetheless, violations of Section 906 carry penalties of up to 10 years in prison and a $1 million fine for a knowing and reckless violation, and up to 20 years in prison and a $5 million fine for a willful violation.

Prohibition Against Improper Influence on Company Audits

Under Section 303 of SOX and related SEC Rule 13b2-2 it is unlawful for officers or directors of a public company and persons acting under their direction, to directly or indirectly take any action to fraudulently influence, coerce, manipulate or mislead an auditor engaged in the performance of an audit when the person knew or should have known that the action, if successful, could render the company's financial statements materially misleading. In contrast to Section 303, which prohibits a person from acting "for the purpose of" rendering a company's financial statements materially misleading, the standard of liability under SEC Rule 13b2-2 is negligence; no specific intent or resulting misleading financial statements need be shown. Conduct that the SEC suggests may violate Rule 13b2-2 includes, among others:

- threatening to cancel or canceling existing non-audit or audit engagements if the auditor objects to the company's accounting; and
- seeking to have a partner removed from the audit engagement because the partner objects to the company's accounting.

The SEC interprets the term "direction" to encompass a broader category of behavior than "supervision." Accordingly, persons who are not under the supervision of an officer or director but who act under their direction may be found liable for improperly influencing the audit process and the preparation of the company's financial statements. Such persons may include customers, vendors, creditors, accountants, securities professionals, attorneys and other advisers who, at the direction of an officer or director, provide false or misleading information which enables the company to mislead its auditor.

Forfeiture of Certain Bonuses and Profits Following Accounting Restatements

Under Section 304 of SOX, if a company is required to restate its financial statements due to material noncompliance, as a result of misconduct, with any financial reporting requirement under the securities laws, the company's CEO and CFO must reimburse the company for any bonus or other incentive or equity-based compensation received from the company during the 12-month period following the publication or SEC filing (whichever is first) of the financial document being restated, and any profits realized from the sale of the company's securities during that period. Section 304 is essentially a strict liability provision, requiring a CEO or CFO to reimburse the company for any such compensation regardless of whether or not the person knew of or engaged in the misconduct which led to the restatement. Section 304 provides no private right of action, as the SEC has the exclusive right to enforce its provisions.[12] It is important to note that Section 304 operates independently of the broader incentive compensation clawback provisions established by Section 954 of the Dodd-Frank Act, which are discussed in greater detail in the section of this handbook entitled "The Dodd-Frank Wall Street Reform and Consumer Protection Act – Incentive Compensation Clawback Policy."

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[12] *In re Digimore Corp. Derivative* Litig., F.3d 1223, 1238 (9th Cir. 2008); *Neer v. Pelino*, 389 F. Supp. 2d 648, 657 (E.D. Pa. 2005).

> **Practice Tip:** The SEC has taken an aggressive approach to enforcing the clawback provisions of Section 304. In July 2009, the SEC brought an enforcement action against the retired CEO of CSK Auto Corporation, Maynard L. Jenkins, to recover for CSK and its shareholders more than $4 million in bonuses and profits that Jenkins realized from the sale of CSK stock while the company was filing fraudulent financial statements. Notably, the SEC did not allege that Jenkins engaged in any fraudulent conduct, but that he "was captain of the ship and profited during the time that CSK was misleading investors about the company's financial health."[13] Jenkins moved to dismiss the SEC's complaint, arguing that the clawback provisions of Section 304 could not be applied to him absent his personal involvement in the misconduct that led to the restatement. On June 9, 2010, the court denied Jenkins' motion to dismiss, holding that Section 304 requires only misconduct on the part of the company, not specific misconduct by the company's CEO or CFO.[14]

Code of Ethics Disclosure. Under Section 406 of SOX and related SEC rules, public companies must disclose in their periodic reports whether they have adopted a code of ethics for their principal executive, financial or accounting officers or controller (or persons performing similar functions), and if not, why not. SOX defines "code of ethics" for this purpose as including standards reasonably necessary to promote honest and ethical conduct (including the ethical handling of actual or apparent conflicts of interest), full, accurate and timely disclosure in periodic reports and compliance with applicable governmental rules and regulations. Prompt disclosure must also be made of any changes to or waivers of a company's code of ethics. The code of ethics must be filed as an exhibit to the company's annual report, provided free of charge to any person who requests it, or posted on the company's website. If the company elects to post its code of ethics on its website, this must be noted in its annual report and the website address where the code may be accessed must be provided, and amendments and waivers may also be disclosed on the company's website. NASDAQ-listed companies must, however, disclose any waivers by filing a Form 8-K. Though neither SOX nor SEC rules require that public companies in fact adopt a code of ethics, as discussed in the section of this handbook entitled "Stock Exchange Listing

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[13] Press Release, SEC Seeks Return of $4 million in Bonuses and Stock Sale Profits From Former CEO of CSK Auto Corp. (July 22, 2009), *available at* http://www.sec.gov/news/press/2009/2009-167.htm

[14] *See* Order at 4 (Dkt. # 49), *SEC v. Maynard L. Jenkins*, Case No. CV-09-1510-PHX-GMS (D. Ariz. June 9, 2010).

Requirements," listed companies may be required to comply with stock exchange requirements which mandate a code of ethics, such as under the NYSE and NASDAQ listing rules.

Addressing Potential Conflicts of Interests

Prohibition on Loans to Directors or Officers

Section 402 of SOX generally prohibits a public company from making or arranging for any personal loans to its directors or executive officers. Excluded from this prohibition are:

- loans made before SOX's enactment, so long as the loan is not materially modified or renewed thereafter;
- specified home improvement and consumer credit loans made in the ordinary course of the company's business which are of a type generally offered to the public and on terms no more favorable than those offered to the public;
- margin loans by a broker-dealer to its employees which are permitted by applicable Federal Reserve System rules, are made in the ordinary course of business, are of a type generally offered to the public and on terms no more favorable than those offered to the public; and
- any loan made or maintained by an insured depositary institution if the loan is subject to the insider lending restrictions of the Federal Reserve Act.

Section 402's prohibitions apply from the moment a company becomes public, so a private company considering going public will generally need to discharge all personal loans to its directors or executive officers that fall outside the excluded categories described above before taking that step. Also, before a person is promoted to or becomes a director or executive officer, the person will need to repay any outstanding non-excluded loans.

A number of interpretive issues have arisen with respect to the scope of Section 402. In the absence of further SEC guidance, a number of practitioners have suggested that the following types of activities should be considered permissible under Section 402:

- advances of cash, in accordance with company policy, to cover reimbursable travel and similar expenses incurred in the performance of executive duties;
- personal use of a company credit card or company car if reimbursement is required;
- relocation expenses if reimbursement is required;
- "stay" and "retention" bonuses subject to repayment if the employee terminates employment before the designated date or otherwise fails to meet the conditions for the bonus;
- indemnification advances for litigation;
- tax indemnity payments to overseas-based executive officers;
- most 401(k) plan or broad-based employee benefit plan loans; and
- certain "cashless" option exercises.

Regulation BTR – Blackout Trading Restriction

Section 306 of SOX and SEC Regulation BTR prohibit a director or executive officer of a public company from purchasing, selling or otherwise acquiring or transferring any of the company's equity securities (other than exempted securities) during any pension fund "blackout period" with respect to the securities if the person acquires or previously acquired the securities in connection with his or her service or employment as a director or executive officer.

> **Practice Tip:** The blackout trading restrictions of Regulation BTR do not apply to equity securities acquired under a compensatory plan, contract, authorization or arrangement when the person is an employee, but not a director or executive officer, unless the securities were acquired as part of an inducement to become a director or executive officer.

A blackout period is any period of more than three consecutive business days during which the ability of not fewer than 50% of the participants or beneficiaries under

all “individual account plans” maintained by the company to purchase or sell an interest in the company’s securities, such as a 401(k) or other defined contribution plan, is temporarily suspended by the company or by a fiduciary of the plan. The company must provide timely notice to its directors and executive officers of any blackout period that triggers the trading restrictions of Regulation BTR and the reason for the blackout. In addition, U.S. domestic companies must promptly notify the SEC of a blackout period by filing a report on Form 8-K. Foreign private issuers are encouraged to notify the SEC of any blackout period by filing a similar report on Form 6-K, but are only required to file the notice as an exhibit to their annual report on Form 20-F.

Any profits realized by a director or executive officer in connection with a sale or purchase during a blackout period can be recovered by the company. A company may commence an action to recapture any profits realized by a director or executive officer from transactions which violated Regulation BTR. If a shareholder of the company requests it to commence such an action and the company fails to do so within 60 days of the request, the shareholder may initiate a derivative action to recover the profit on behalf of the company.

Accelerated Reporting by Section 16 Insiders

SOX Section 403 and related SEC rules accelerated the reporting deadline for public company officers, directors and greater than 10% shareholders subject to the beneficial ownership reporting and short-swing profit rules of Section 16 of the Exchange Act. Under these rules, which are discussed more fully in the section of this handbook entitled “Ownership and Trading Reports by Management and Large Shareholders,” these persons generally must report transactions in the company’s shares and related derivative securities to the SEC within two business days of the reportable transaction. Previously, reporting was generally required within 10 days of the end of the month in which the transaction occurred. SOX Section 403 and the related SEC rules also require that Section 16 reports be filed electronically via EDGAR.

Auditor Oversight and Independence

PCAOB Oversight

As noted above, SOX created the PCAOB to register, oversee, regulate, inspect and discipline accounting firms that audit the financial statements of public companies. The PCAOB is subject to SEC oversight, and the SEC appoints the five members of the PCAOB in consultation with the Chairman of the Federal Reserve Board of

Governors and the Secretary of the Treasury. The PCAOB is charged with establishing auditing, quality control, ethics and independence standards for public company auditors. Under Section 102 of SOX, any accounting firm that audits the financial statements of a public company must be registered with the PCAOB.

Recent Development: Section 929J of the Dodd-Frank Act amended Section 106 of SOX to increase the authority of the SEC and the PCAOB to compel foreign public accounting firms to produce their audit work papers and related documents by subjecting such firms to the jurisdiction of U.S. courts for purposes of enforcing a request for such documents. In addition, Section 929J requires U.S. registered public accounting firms, as a condition to relying on the work of a foreign public accounting firm in its audit, to obtain the agreement of the foreign public accounting firm to produce its audit work papers and related documents to the SEC or PCAOB upon request. A foreign public accounting firm is permitted to meet its document production obligations through alternate means, such as through foreign counterparts to the SEC or PCAOB. Section 929J deems any willful refusal to comply with an SEC or PCAOB request for documents to be a violation of SOX. Lastly, Section 981 of the Dodd-Frank Act amends Section 105(b)(5) of SOX to permit the PCAOB to share all documents and information it receives, including foreign audit work papers, with foreign government regulators or authorities empowered by governments to regulate auditors without losing the information's status as confidential or privileged.

Auditor Independence

A key aspect of the SOX reforms were its auditor independence provisions, which are set forth in Title II. These provisions target key aspects of auditor independence, including the provision of certain non-audit services, the influence of company management on registered public accounting firms and the audit process, conflicts of interest which arise when accounting firm employees become members of company management at former audit clients, and the development of effective communication between a company's audit committee and its registered public accounting firm.

The SEC implemented the SOX auditor independence requirements in large part by amending its previously existing definition of auditor independence in Rule 2-01 of Regulation S-X. Effectively, if the Rule 2-01 bans on and requirements in respect of

auditor activities and auditor-client relationships are not observed, the accounting firm will not be independent for purposes of the SEC's rules, and therefore will not be qualified to audit the company's financial statements to be filed with the SEC. The SEC also adopted Rule 2-07 of Regulation S-X to implement the SOX requirement that a public company's independent auditors provide certain reports to the company's audit committee prior to each filing of an audit report with the SEC. We review the SOX-mandated independence requirements in greater detail below.

Prohibition on Providing Certain Non-Audit Services. The SEC's auditor independence rules adopted or amended pursuant to Section 201 of SOX are based on the following general principles: (i) an auditor cannot audit its own work; (ii) an auditor cannot function in the role of management; and (iii) an auditor cannot serve as advocate for its client. In keeping with these principles, Section 201 of SOX and related SEC rules provide that an accounting firm that is performing any audit for a public company cannot also provide any of the following types of non-audit services to the company:

- bookkeeping or other services related to the accounting records or financial statements of the company;
- financial information systems design and implementation;
- appraisal or valuation services, including providing fairness opinions or contribution-in-kind reports;
- actuarial services;
- internal audit outsourcing services;
- management functions;
- human resources services;
- broker-dealer, investment adviser, or investment banking services;
- legal services; and
- expert services unrelated to the audit.

Notwithstanding the general prohibition on these services, SEC rules provide limited exceptions which allow an accounting firm to perform bookkeeping or other services related to the accounting records or financial statements of the company,

financial information systems design and implementation services, appraisal or valuation services, actuarial services and internal audit outsourcing services if it is reasonable to conclude that the results of these services will not be subject to audit procedures during the accounting firm's audit of the company's financial statements.

In general, audit services include not only audit, review, and attest services required under the securities laws, but also services related to the issuance of comfort letters, services related to statutory audits, and any services performed to enable the accounting firm to opine on the company's financial statements. By contrast, non-audit services are any professional or consulting services, including tax services, provided to a company by a registered public accounting firm other than in connection with an audit or a review of the company's financial statements. Although some have called for tax services to be included in the list of prohibited non-audit services, the SEC has maintained its long-standing position that an accounting firm can provide tax services to its audit clients without impairing the firm's independence. Nevertheless, the SEC has cautioned audit committees and accountants that in some situations providing tax services to an audit client may impair the accounting firm's independence. PCAOB rules adopted in July 2005 list a number of situations in which a registered public accounting firm providing tax services to audit clients will not be considered independent, including if the accounting firm provides services related to marketing, planning or opining in favor of a tax treatment on a transaction that is based on an aggressive interpretation of applicable tax laws and regulations.

Permitted Non-Audit Services; Pre-Approval of Services. A registered public accounting firm may provide non-audit services, including tax services, other than those expressly prohibited (as described above) only if the service is pre-approved by the company's audit committee. A public company's audit committee is also responsible for pre-approving all audit services provided by the company's auditors. The audit committee may establish pre-approval policies and procedures for the approval of audit and non-audit services. Any such policies and procedures must be detailed as to the particular service and the audit committee must be informed of each service. SOX establishes a *de minimis* exception to the audit committee pre-approval requirement for non-audit services. The exception provides that audit committee pre-approval is not required if: (i) the aggregate amount of all such non-audit services constitutes no more than 5% of the total amount of the accounting firm's revenues from the company during the fiscal year in which the non-audit services are provided; (ii) the services were not recognized by the company as non-audit services at the time of the engagement; and (iii)

the services are promptly brought to the attention of the company's audit committee and approved prior to completion of the audit by the committee or by one or more of its members to whom it has granted approval authority.

Disclosure of Non-Audit Services and Audit and Non-Audit Fees. A public company must disclose in its annual report filed with the SEC or its proxy statement: (i) its pre-approval policies with respect to the provision of non-audit services; (ii) any non-audit services provided by its auditor during the period covered by the report; and (iii) the amount of professional fees paid to the company's auditor for audit and non-audit services. The disclosure must show amounts for audit services, audit-related services, tax services and all other services, and the percentage of fees in each category for which the audit committee pre-approval requirement was waived under the *de minimis* exception. In addition, the company must describe, in qualitative terms, the types of non-audit services provided.

Accounting Firm Reports to Audit Committee. Prior to a company's filing of any audit report with the SEC, the accounting firm issuing the report must report directly to the audit committee on, among other things, all critical accounting policies and practices used, all alternative GAAP treatments for policies and practices related to material items discussed with management, and other material written communications between the accounting firm and management.

Rotation of Audit Partners; Prohibition of Certain Audit Partner Compensation. To address the risk that audit partners with strong links to their audit clients will be unable to exercise objective and impartial judgment in connection with an audit, Section 203 of SOX requires the lead and concurring audit partners with responsibility for a company's audit to rotate at least once every five years. In addition to the five-year rotation for lead and concurring partners, the SEC rules: (i) impose a five-year cooling-off period before they can re-engage in audits of the client; (ii) require a seven-year rotation, with a two-year cooling-off period, for audit partners (other than lead or concurring partners) who provide more than 10 hours of service in connection with an audit or who are lead partners in connection with the audit of a significant subsidiary; and (iii) prohibit an accounting firm from compensating an audit partner based on his or her procurement of engagements for the accounting firm to provide non-audit services to an audit client during the period of an audit engagement. The rotation requirements do not apply to audit partners who provide limited specialist or technical services. Certain small accounting firms are exempt from the rotation requirements and compensation restrictions.

Prohibition of Certain Relationships. Consistent with Section 206 of SOX, the SEC expanded its prohibitions on the types of employment relationships that may exist between an audit client and employees or former employees of its accounting firm and an accounting firm and employees or former employees of its audit clients. The SEC's rules include certain prohibitions on former principals and professional employees of an accounting firm serving in financial reporting oversight roles for the accounting firm's audit clients. The rules also continue to prohibit certain financial relationships between accounting firms and their clients.

Enhanced Disclosure Requirements

Off-Balance Sheet Transactions and Contractual Obligations

Under Section 401 of SOX and related SEC rules, a public company is required to disclose off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on the company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. The disclosure, which must be in a separately captioned subsection of the MD&A section of the company's SEC filings, must provide a comprehensive explanation of the company's off-balance sheet arrangements, including (to the extent necessary to an understanding of the arrangement):

- the nature and business purpose of the arrangements;
- the importance of the arrangements to the company for liquidity, capital resources, market risk or credit risk support, or other benefits;
- the amounts of revenues, expenses, and cash flows arising from the arrangements;
- the nature and amounts of any interests retained, securities issued, or amounts incurred in connection with the arrangements;
- the nature and amounts of any other obligations or liabilities (including contingent obligations or liabilities) arising from the arrangements that are or are reasonably likely to become material and the triggering events or circumstances that could cause them to arise;
- any known event, demand, commitment, trend or uncertainty that will result in or is reasonably likely to result in the termination or material reduction in

the availability or benefits to the company of the arrangements, and the course of action the company proposes to take in response; and

- any other information the company believes necessary to understand its off-balance sheet arrangements and their material effects on the company's business.

An "off-balance sheet arrangement" is defined to include any transaction, agreement or contractual arrangement to which an entity unconsolidated with the company is a party, under which the company has certain obligations or interests specified in Item 303(a)(4)(ii) of Regulation S-K, including contingent obligations or interests. Contingent liabilities arising out of litigation, arbitration or regulatory actions are not considered to be off-balance sheet arrangements. A company is not required to disclose an off-balance sheet arrangement until it has a definitive agreement for that arrangement that is unconditionally binding or subject only to customary closing conditions. If no such agreement exists, the disclosure obligation arises when the transaction is settled.

In addition, a company must provide as part of the MD&A section of its SEC filings an overview of its aggregate contractual obligations in tabular format, categorized as follows:

	Payments Due by Period				
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Long-tem debt obligations					
Capital lease obligations					
Operating lease obligations					
Purchase obligations					
Other long-term liabilities reflected on the company's balance sheet under GAAP					
Total					

The off-balance sheet transaction and contractual obligation information disclosed by a company, other than historical facts, is generally deemed to be a "forward-looking statement" under the statutory safe harbors for forward-looking statements provided in Section 27A of the Securities Act and Section 21E of the Exchange Act.

Conditions for Use of Non-GAAP Financial Measures

Section 401(b) of SOX directed the SEC to issue rules requiring non-GAAP financial measures included in financial statements, press releases, or other public disclosures to be presented in a manner that is not misleading, and which reconciles the non-GAAP financial measure with the company's financial condition and results of operation under GAAP. In response, the SEC amended its disclosure rules under Regulations S-K and S-B to impose requirements regarding the presentation of non-GAAP financial measures in SEC filings. In addition, the SEC issued Regulation G, which governs a public company's use of non-GAAP financial measures in any of its public disclosures. Under Regulation G, public companies that disclose or release non-GAAP financial measures must include in the disclosure or release a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP, as well as a quantitative reconciliation, either by schedule or other clearly understandable method, of the differences between the non-GAAP financial measure presented and the most directly comparable financial measure or measures calculated and presented in accordance with GAAP. The SEC's requirements for the use of non-GAAP financial measures are discussed in greater detail in the section of this handbook entitled "Regulation of Analyst Communications and Other Voluntary Disclosures."

Real-Time Disclosure of Information

Section 409 of SOX requires companies to disclose to the public on a rapid and current basis such additional information concerning material changes in financial condition or operations as the SEC determines is necessary or useful for the protection of investors and in the public interest. In response to Section 409, the SEC updated its requirements for current reporting on Form 8-K to require that additional events be reported on Form 8-K and to accelerate the reporting deadline for certain items. These requirements, which are discussed further in the section of this handbook entitled "Periodic and Current Reporting under the Exchange Act," generally require a company to report certain material events within four business days of their occurrence, except for Regulation FD items and certain other material events for which prompt or simultaneous disclosure may be required. Among the reportable events which were added to Form 8-K as part of the SEC's response to SOX are:

- any earnings release or announcement disclosing material non-public financial information about completed annual or quarterly fiscal periods;

- the entry into, termination of, or a material amendment to a material contract;
- the incurrence of any material direct or contingent financial obligation (including an off-balance sheet arrangement) and the triggering of any provision of that obligation that would increase or result in the acceleration of the company's liability thereunder;
- any amendment to the company's organizational documents, such as its articles of incorporation or bylaws;
- any event which may result in the company's shares being delisted;
- certain unregistered sales of the company's equity securities;
- any material modifications to the rights of the company's security holders;
- a determination by the company or its independent auditor that the company's security holders can no longer rely on the company's financial statements; and
- the appointment or departure of any executive officer or director.

Whistleblower Protections

In addition to requiring audit committees to implement whistleblower procedures, SOX contains certain additional provisions to protect whistleblowers. Section 806 of SOX prohibits companies from discriminating or retaliating against an employee for lawfully providing information regarding conduct the employee reasonably believes is a violation of the securities laws or financial fraud statutes to a federal regulatory or law enforcement agency, any member or committee of Congress, or a person with supervisory authority over the employee or authorized by the company to investigate the conduct. Affected employees are entitled to civil recoveries. Under Section 1107 of SOX, it is a criminal offense to retaliate against informants for providing truthful information to a law enforcement officer relating to the commission or possible commission of a federal offense.

Recent Development: The Dodd-Frank Act expands the SOX whistleblower protections by:

- extending whistleblower protections to employees of consolidated subsidiaries and affiliates of public companies;
- extending the statute of limitations for SOX whistleblower claims from 90 to 180 days after the employee became aware of the retaliatory conduct;
- prohibiting the waiver of whistleblower protections by any agreement, policy or condition, including a pre-dispute arbitration agreement; and
- clarifying a whistleblower claimant's right to a jury trial.

In addition to amending the SOX whistleblower provisions, the Dodd-Frank Act adds extensive new whistleblower protections in Section 21F to the Exchange Act. These provisions are discussed in more detail in the section of this handbook entitled "The Dodd-Frank Wall Street Reform and Consumer Protection Act – Whistleblower Protections."

ATTORNEY REPORTING AND RELATED CONDUCT RULES

Section 307 of SOX required the SEC to set minimum standards of professional conduct for attorneys appearing and practicing before the SEC in any way in the representation of public companies. The SEC issued standards which require any such attorney to report evidence of a material violation of United States federal or state securities laws, a material breach of fiduciary duty arising under United States federal or state law or similar material violations of United States federal or state law by the company or any of its officers, directors, employees or agents. In general, the report must be made to the company's chief legal officer (CLO). If a company does not have a CLO, its CEO is deemed to be the CLO. If the CLO does not provide an appropriate response to the attorney's report, the attorney must report the evidence "up the ladder" to the company's audit committee, to another committee comprised solely of independent directors if the company does not have an audit committee, or the entire board of directors if the company has no independent board committee.

If a company has established a qualified legal compliance committee (QLCC), the attorney may make its initial report to the QLCC instead of the CLO. If the attorney makes its initial report to the QLCC or if the CLO refers the attorney's initial report to

the QLCC, the attorney will not be required to make any further report. The rules establish certain reporting responsibilities as between supervising attorneys and their subordinates. The rules apply to in-house lawyers as well as outside counsel.

> **Practice Tip:** An attorney that is retained by a company to investigate evidence of a material violation, or to defend it (or its officers, directors, employees or agents) in a proceeding relating to evidence of a material violation, may be required to comply with the reporting obligations unless the attorney is retained by a QLCC and certain other conditions are satisfied.

Form of Section 302 Certification

I, [identify the certifying individual], certify that:

1. I have reviewed this [specify report] of [identify registrant];

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our

supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: ________

____

[Signature]
[Title]

STOCK EXCHANGE LISTING REQUIREMENTS

Companies with securities listed on a stock exchange must comply with the listing requirements of the applicable stock exchange in addition to applicable federal securities laws and related SEC rules and regulations. Listing rules vary from exchange to exchange, and require compliance with certain quantitative criteria such as minimum numbers of security holders, publicly held shares, share price and public float, as well as certain corporate governance and responsibility and public disclosure requirements. Failure to comply with applicable stock exchange listing standards would subject a listed company to de-listing[1].

This section of this handbook outlines the principal corporate governance and responsibility and public disclosure requirements a company must satisfy in order to maintain its continued listing on the New York Stock Exchange and the NASDAQ Stock Market, the dominant stock exchanges in the United States. This handbook does not address initial listing requirements that a company must satisfy in order to be accepted for listing initially on a stock exchange or financial and other quantitative standards applicable for continued listing. Under the Dodd-Frank Act, enacted in July 2010, the NYSE and NASDAQ will be required to adopt certain amendments to their corporate governance listing standards, following rulemaking by the SEC. These amendments are reflected in the discussions that follow. See also the section of this handbook entitled "Dodd-Frank Wall Street Reform and Consumer Protection Act" for further discussion of the corporate governance requirements under the Dodd-Frank Act.

NYSE RULES

Corporate Governance

Majority of Independent Directors; Definition of Independence. A majority of the members of the board of directors of a NYSE listed company must qualify as "independent directors."

For a director to qualify as independent for this purpose, the board must determine that the director has "no material relationship with the listed company (including any parent or subsidiary in a consolidated group)." A material relationship may include a commercial, industrial, banking, consulting, legal, accounting, charitable or familial relationship. However, significant stock ownership is not, by

[1] In light of continuing adverse market conditions, which have resulted in many companies falling out of compliance with listing requirements, national securities exchanges have amended certain of their rules to provide for increased leniency and flexibility in continued listing and compliance requirements.

itself, a material relationship. The NYSE has enumerated the following relationships that disqualify a director from being independent:

(a) the director is, or has been within the last three years, an employee of the company, or has an immediate family member who is, or has been during the last three years, an executive officer of the company, although employment as interim chairman, CEO or another executive officer will not disqualify a director from being independent following that employment;

(b) the director or an immediate family member received more than $120,000 of direct compensation from the company in any 12-month period during the past three years (excluding board and committee fees and pension or other deferred compensation for prior service, provided that the compensation is not contingent on continued service);

(c) either (A) the director is a current partner or employee of a firm that is the company's internal or external auditor; (B) the director has an immediate family member who is a current partner of such a firm; (C) the director has an immediate family member who is a current employee of such a firm and personally works on the company's audit; or (D) the director or an immediate family member was within the last three years a partner or employee of such a firm and personally worked on the company's audit within that time;

(d) the director or an immediate family member is, or has been with the last three years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on that company's compensation committee; or

(e) the director is a current employee, or has a family member that is a current executive officer, of another company that made payments to, or received payments from, the listed company that exceeded, in any of the past three fiscal years, the greater of $1 million and 2% of the other company's consolidated gross revenues.

In computing compensation under (b), the following compensation need not be included: (i) compensation paid to the director for prior employment as interim chairman, CEO or other executive officer, and (ii) compensation paid to an immediate family member for employment as an employee of the listed company (other than as an executive officer). For purposes of (e), contributions by a listed company to tax-exempt organizations are not considered payments. The listed company must,

however, disclose any such contributions it makes 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.

It is important to note that compliance with the bright line rules is not enough to ensure compliance with the independence standards. The board is required to consider all facts and circumstances relevant to determining whether a director is independent of company management. The board should also analyze not just the board member's or nominee's relationship to the listed company, but also the relationship to the listed company of organizations with which the board member or nominee is affiliated.

Practice Tip: A director's independence may be impaired not just by immediate family relationships, but also by personal relationships with members of senior management. The commentary to NYSE Rule 303A.02 notes that the focus of the evaluation is independence from management. Accordingly, relationships between a director and a member of senior management that are material to either party should be considered by a board of directors in evaluating a director's independence.

Board Executive Sessions. The non-management directors of a NYSE listed company must meet at regularly scheduled executive sessions without management. Instead of regularly scheduled non-management executive sessions, the board of a NYSE listed company may hold regularly scheduled executive sessions of its independent directors. A board that satisfies its executive session requirements with non-management directors' sessions must, in addition, hold an executive session of only independent directors at least once a year. A NYSE listed company is required to establish a method for shareholders and other interested parties to communicate directly with the company's non-management or independent directors. Companies may utilize the same whistleblower procedures established by their audit committees, as required by SEC rules, to satisfy this NYSE requirement.

Nominating/Corporate Governance Committee. The board of a NYSE listed company must have a nominating/corporate governance committee composed entirely of independent directors. The nominating/corporate governance committee must have

a written charter that addresses its purpose and responsibilities, as well as an annual self-evaluation. At a minimum, the responsibilities of the nominating/corporate governance committee must be to: (i) identify qualified director nominee candidates, consistent with criteria approved by the board; (ii) select or recommend that the board select director nominees for the annual shareholders' meeting; (iii) develop and recommend to the board corporate governance guidelines; and (iv) oversee the evaluation of the board and management. If a listed company is legally required by contract or otherwise to provide third parties with the ability to nominate directors (for example, preferred stock rights to elect directors upon a dividend default, shareholder agreements and management agreements), the selection and nomination of such directors need not be subject to the nominating committee process.

Compensation Committee. The board of a NYSE listed company must have a compensation committee composed entirely of independent directors. The compensation committee must have a written charter that addresses its purpose and responsibilities, as well as an annual self-evaluation. At a minimum, the responsibilities of the compensation committee must be to: (i) review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance and, either as a committee or together with other independent directors (as directed by the board), determine the CEO's compensation; (ii) make recommendations to the board with respect to non-CEO executive officer compensation, as well as incentive-compensation and equity-based plans that are subject to board approval; and (iii) prepare the compensation committee report required to be included in the company's proxy statements under SEC rules, as discussed further in the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Process."

In addition to the compensation committee independence requirements under existing NYSE rules, Section 952 of the Dodd-Frank Act requires that, with certain exceptions, each member of a public company's compensation committee must be an independent member of the board of directors. The Dodd-Frank Act further directs the SEC to define independence by considering several factors; as a result, SEC rulemaking in furtherance of this new requirement may impose independence requirements for compensation committee members in addition to those set forth under existing NYSE rules. Section 952 of the Dodd-Frank Act also provides new authority for compensation committees to retain independent advisors, requires that the committees consider several factors that may affect the independence of those advisors

and requires disclosure regarding the independence of compensation consultants retained by the committees. These provisions are discussed in more detail in the sections of the Dodd-Frank Wall Street Reform and Consumer Protection Act chapter of this handbook entitled "Compensation Committee Independence and Authority to Retain Advisors" and "Compensation Consultants and Advisors."

Audit Committee. The board of a NYSE listed company must have an audit committee of at least three members. Each member of the audit committee must be an independent director. In order to be independent, a director must be independent according to the NYSE standard discussed above, and must also satisfy the independence criteria adopted by the SEC pursuant to SOX (which, as discussed further in the section of this handbook entitled "The Sarbanes-Oxley Act," means, generally, that the director cannot receive any payment from the company other than for board or committee service and cannot be an "affiliated person" of the company or any subsidiary). Each member of the audit committee must also be or, within a reasonable period of time following appointment, must become "financially literate," and at least one member must have "accounting or related financial management expertise." The board has discretion, in the exercise of its business judgment, to interpret whether a director is financially literate or has accounting or related financial management expertise. The NYSE rules do not require that the audit committee of a NYSE listed company include members that are "financial experts" (as defined in the SEC rules). However, the board of a NYSE listed company may presume that a person who is an "audit committee financial expert" as defined by the SEC has the "accounting or related financial management expertise" required by the NYSE rule. If a director serves on the audit committees of more than three public companies, the board must determine that this simultaneous service would not impair the director's ability to serve effectively on the company's audit committee.

The audit committee must have a written charter which addresses the audit committee's purpose and responsibilities, as well as an annual self-evaluation. At a minimum, the purpose of the audit committee must be to: (i) assist board oversight of the integrity of the company's financial statements and compliance with legal and regulatory requirements, independent auditor's qualifications and independence and the performance of the company's internal audit function and external auditors; and (ii) to prepare the audit committee reports required to be included in the company's periodic SEC filings. The responsibilities of the audit committee must include, at a minimum, the auditor oversight, whistleblower and advisor engagement and funding

requirements set forth in the SEC rules (which are discussed in the section of this handbook entitled "The Sarbanes-Oxley Act"), as well as certain additional obligations set forth in the NYSE rules.

Corporate Governance Guidelines. The NYSE requires all listed companies to adopt corporate governance guidelines, which must address the following subjects:

- director qualification standards;
- director responsibilities;
- director access to management and independent advisors;
- director compensation;
- new director orientation and continuing education for the board;
- management succession; and
- an annual self-evaluation by the board.

Code of Business Conduct and Ethics. While SOX and related SEC rules require public companies to disclose whether they have adopted a code of ethics, under the NYSE rules, a listed company must in fact adopt a code of business conduct and ethics for its directors, officers and employees. At a minimum, a company's code of business conduct and ethics must address:

- conflicts of interest;
- corporate opportunities;
- confidentiality;
- fair dealing;
- protection and proper use of company assets;
- compliance with laws, rules, and regulations (including insider trading laws); and
- proactive reporting of any illegal or unethical behavior.

Waivers of a company's code of business conduct and ethics for its directors and executive officers may be granted only by the company's board or a board committee.

NYSE Certifications. The CEO of each listed company must certify to the NYSE that he or she is not aware of any violation by the company of the NYSE's corporate governance listing standards, except to the extent described in the certification. The CEO must also promptly notify the NYSE in writing after any executive officer of the company becomes aware of any non-compliance with the corporate governance listing standards. In addition, each listed company must submit an executed Annual Written Affirmation to the NYSE affirming its compliance or non-compliance with the NYSE's corporate governance listing standards and, as and when required by the applicable NYSE form, an interim Written Affirmation. While the CEO certification form is a one page document, the affirmation requires that the company provide the NYSE with extensive information detailing its compliance (or any failure to comply) with the applicable requirements. Copies of the forms of certificate and affirmation can be found on the NYSE website at: http://www.nyse.com/regulation/nyse/1101074752859.html.

Certain Exemptions. The NYSE permits the following exemptions from its corporate governance standards:

Controlled Companies. A "controlled company," which is a company with a majority of the voting power for the election of directors held by an individual, a group or another company, is not required to have a majority of independent directors on its board, or to have a nominating/corporate governance or compensation committee.

Foreign Private Issuers. Companies meeting the SEC's definition of "foreign private issuers" are permitted to follow their home country practice in lieu of the NYSE's corporate governance standards. They must, however, designate an audit committee that satisfies the auditor oversight, whistleblower and advisor engagement and funding requirements set forth in Exchange Act Rule 10A-3 adopted by the SEC, and the members of which are independent according to the standard expressed in the same rule. In addition, they must publicly disclose any significant differences between their home country corporate governance practices and the NYSE's corporate governance listing standards, and must comply with the NYSE rule requiring notification of non-compliance and written affirmations in respect of the NYSE's corporate governance listing standards.

Shareholder Approval of Corporate Action; Shareholder Meetings

In addition to any applicable shareholder approval requirements under state or federal law, the NYSE requires shareholder approval of the following corporation actions, subject to certain exceptions:

- adoption of and "material revisions" to equity compensation plans (which includes individual compensation arrangements);
- certain issuances of common stock (or securities convertible into or exercise for common stock) exceeding 1% of the number of shares of common stock or the voting power outstanding, to a director, officer or substantial security holder (which will not include a holder of less than 5% of the number of shares of common stock or the voting power outstanding), a subsidiary, affiliate or other closely-related person to any of such persons or any company or entity in which any of such persons has a substantial direct or indirect interest (which will not include an interest of less than 5% of the number of shares of common stock or the voting power outstanding);
- issuance of common stock (or securities convertible into or exercisable for common stock) equal to or exceeding 20% of the number of shares of common stock or the voting power outstanding, except for the following issuances: (i) a public offering for cash; or (ii) a bona fide private financing where the issue price (or if convertible or derivative securities are issued, the conversion or exercise price) is payable in cash and equals or exceeds each of the book value and the market value of the common stock; and
- any issuance that will result in a change of control of the company.

A "material revision" of an equity compensation plan may include increasing the number of shares available, expanding the types of awards available, expanding the class of persons eligible to participate, extending a plan's term, changing the method of determining the exercise price of options under the plan, re-pricing stock options if the plan does not permit it or changing the plan to permit the re-pricing of options. A plan that does not contain a provision that specifically permits repricing of options will be considered for purposes of this listing standard as prohibiting repricing. Accordingly, any actual repricing of options will be considered a material revision of the plan even if the plan itself is not revised. A change in the method of determining "fair market value" from the closing price on the date of grant to the average of the

high and low price on the date of grant is an example of a change that the NYSE would not view as a material revision. An amendment that curtails rather than expands the scope of a plan is also not considered a material revision.

Certain employment related awards, plans and amendments are exempt from the NYSE shareholder approval requirement. To be exempt such an award, plan or amendment must be approved by the listed company's independent compensation committee or a majority of its independent directors. The company must notify the NYSE when it is relying on one of these exemptions. The following awards, plans and amendments are generally exempt from the shareholder approval requirements:

- grants of options or other equity-based compensation as a material inducement to a person being hired or rehired following a bona fide period of employment interruption (and promptly following which the listed company must disclose, in a press release, the material terms of the award, including the recipient and the number of shares involved in the grant);
- changes to convert, replace or adjust outstanding options or other equity compensation awards, in order to reflect a merger or acquisition transaction;
- grants with respect to equity of a listed company based on shares available under a pre-existing equity compensation plan of a company merged into or acquired by the listed company, where the acquired company is not a listed company following the merger or acquisition transaction and the pre-existing plan had been approved by its shareholders, provided that, (A) the number of shares available for grants must be appropriately adjusted to reflect the merger or acquisition transaction, (B) the time during which the shares are available cannot be extended beyond the period of availability under the pre-existing plan, and (C) awards cannot be granted to persons who, immediately before the merger or acquisition transaction, were employed by the listed company or its subsidiaries; and
- tax qualified plans meeting the requirements of Section 401(a) or Section 423 of the Internal Revenue Code and certain "parallel excess plans," which are "pension plans" under ERISA that are designed to provide excess benefits in conjunction with qualified plans under Section 401(a) and amendments to such plans.

To qualify for the exemption for pre-existing plans, the plan cannot be adopted in contemplation of the merger or acquisition transaction. Moreover, shares reserved for

listing in connection with a transaction pursuant to either of the merger or acquisition related exemptions must be included when determining whether 20% or more of the listed company's shares are being issued in connection with the transaction and therefore, whether shareholder approval is required under the separate requirement for shareholder approval of such issuances.

The "market value" of the company's common stock is defined as the last official closing price on the NYSE prior to the binding agreement to issue the securities. Companies are not permitted to vary this calculation. Shareholder approval is required for the issuance of convertible securities that may convert into 20% or more of the company's common stock or voting power no matter how unlikely it is that the share issuance might result in the issuance of a number of shares that equal or exceed the 20% threshold.

A listed company may apply for an exception to the shareholder approval requirements when the delay in securing shareholder approval would seriously jeopardize the financial viability of the enterprise. The company's audit committee must expressly approve the company's reliance on this exception. A company relying on this exception must mail to its shareholders written notice of its omission to seek shareholder approval and of the audit committee's express approval of the exception. The notice must be mailed no later than 10 days before issuance of the securities for which shareholder approval was not sought.

The NYSE mandates certain other procedures relating to shareholder voting. Listed companies must hold an annual shareholders' meeting during each fiscal year, and solicit proxies and provide proxy statements for all shareholders' meetings.

As discussed in more detail in the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Process – Broker Voting," many shareholders hold their shares through "street name" arrangements, where shareholders retain beneficial ownership, but their banks, brokers or other nominees serve as registered owners of the shares. The registered owners then typically vote at shareholders' meetings based on instructions received from the beneficial owners. Registered owners that are member organizations of the NYSE, which generally include broker-dealers that are members of FINRA, may also vote on certain routine proposals even if beneficial owners of the shares do not provided specific voting instructions. Historically, routine proposals included non-contested director elections and executive compensation matters, such as shareholder advisory votes on executive

compensation (or “say-on-pay”). However, in 2009, the NYSE amended its rules to prohibit its member organizations from voting without specific client instructions on director elections and consistent with the discretionary voting restrictions in Section 957 of the Dodd-Frank Act, the NYSE has more recently amended its rules to prohibit member organizations from voting shares without specific client instructions on matters related to executive compensation.

Review of Related Party Transactions

The NYSE rules require that an “appropriate group” within a listed company review and evaluate each related party transaction. The company must determine whether or not a particular relationship serves the best interest of the company and its shareholders and whether it should be continued or eliminated. The NYSE rules do not specify who should comprise the “appropriate group” to review related party transactions; however, the rules indicate that the audit committee or a comparable body would be appropriate.

Public Disclosure and NYSE Notification

NYSE listed companies must promptly notify the NYSE of any non-compliance with the NYSE’s corporate governance listing standards. Listed companies must also publicly disclose their nominating/corporate governance, compensation and audit committee charters and their codes of business conduct and ethics, as well as any waivers of their codes of business conduct and ethics. The NYSE requires that certain documents and information be posted on a listed company’s website, and generally permits other documents and information to be disclosed with website postings. Certain disclosures must, however, be contained in a listed company’s SEC filings. The January 1, 2010 amendments to the NYSE’s corporate governance standards expanded the ability of NYSE-listed companies to make corporate governance related disclosures on their websites.

Under the NYSE rules, “a listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities.” The NYSE views this expectation as one of the fundamental purposes of its listing agreement. The NYSE lists the following events as indicative of circumstances that should be immediately disclosed: annual and quarterly earnings, dividend announcements, mergers, acquisitions and tender offers, stock splits, major management changes, and any substantive items of unusual or non-recurrent nature. News of the following occurrences will also often require

immediate disclosure: major new products, contract awards, expansion plans, and discoveries. Under the NYSE rules, a "listed company should also act promptly to dispel unfounded rumors that result in unusual market activity or price variations." The disclosure must be made in a Regulation FD compliant manner. Refer to the section of this handbook entitled "Regulation of Analyst Communications and Other Voluntary Disclosures" for discussion of Regulation FD. A company may delay or refrain from the described public disclosures in certain limited circumstances.

The NYSE rules discuss certain timing and telephonic notification requirements in connection with required disclosures. These requirements are intended to ensure timely public disclosure. They also permit the NYSE to consider the potential impact of a pending disclosure on trading in a listed company's securities, and whether trading should be temporarily halted.

In addition to complying with the NYSE's public disclosure requirements, NYSE listed companies must give the NYSE prompt or advance written notice of certain actions and events, including changes in transfer agent or registrar, auditors, collateral securing listed securities and, directors and executive officers; dividends and stock splits; and the record date for shareholders' meetings.

NASDAQ Rules

The NASDAQ Stock Market has a three market tier classification system for listed issuers, which consists of The NASDAQ Global Market, The NASDAQ Global Select Market and The NASDAQ Capital Market. These market tiers are differentiated by their initial and maintenance listing standards, with the Global Select Market having the most stringent standards. While each NASDAQ market tier has different quantitative initial and maintenance listing standards, NASDAQ listed issuers are generally required to comply with the same corporate governance and public disclosure requirements.

Corporate Governance

Board of Directors; Definition of Independence. The board of directors of each NASDAQ listed company is required to have a majority of "independent" directors.

In order for a director to be independent under NASDAQ rules, the board of directors must make an affirmative determination that no relationship exists that, in the opinion of the board, would interfere with the director's ability to exercise independent

judgment in carrying out his or her responsibilities as a director. NASDAQ rules provide that a director cannot be independent if the director:

- is, or at any time during the past three years was, employed by the company (which includes, for purposes of NASDAQ's independence rules, any parent and controlled consolidated subsidiary of the company);
- accepted or has a family member who accepted any compensation from the company in excess of $120,000 during any period of twelve consecutive months within the three years preceding the determination of independence, other than:
  - compensation for board or board committee service,
  - compensation paid to a family member who is an employee (other than an executive officer) of the company, or
  - benefits under a tax-qualified retirement plan, or non-discretionary compensation;
- is a family member of an individual who is, or at any time during the past three years was, employed by the company as an executive officer;
- is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or $200,000, whichever is more, other than payments arising solely from investments in the company's securities, or payments under non-discretionary charitable contribution matching programs;
- is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the company served on the compensation committee of that other entity; or
- is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years.

For purposes of NASDAQ's independence rules, a family member of a person includes that person's spouse, parents, children and siblings, whether by blood or adoption, and in-laws (mother-, father-, sister- and brother-in-law) or anyone residing in that person's home.

Executive Sessions of Independent Directors. The independent members of the board are required to meet in regularly scheduled executive sessions, outside of the presence of management. NASDAQ suggests (but does not require) that these executive sessions be held at least twice a year in conjunction with regularly scheduled board meetings.

Director Nominations. NASDAQ requires any nominee for election as a director be selected (or recommended to the full board for selection) by either a majority of the board's independent directors or a nominating committee comprised solely of independent directors. Independent directors do not need to be involved in the selection of a director nominated by a third party who has the legal right to make such a nomination. NASDAQ listed companies must adopt a nominating committee charter, or in the absence of a nominating committee, a board resolution, that addresses the nominations process and any related matters required to be addressed under federal securities laws.

Executive Compensation. NASDAQ rules require that the compensation of a listed company's executive officers, including its chief executive officer, be determined (or recommended to the full board for determination) by either a majority of the board's independent directors or a compensation committee comprised solely of independent directors. Under NASDAQ rules, the chief executive officer may not be present during any voting or deliberations relating to his or her compensation. As discussed above with respect to the compensation committees of NYSE listed companies, Section 952 of the Dodd-Frank Act imposes new independence requirements on the compensation committees of public companies as well as other provisions relating to the advisors of such committees. As a result, NASDAQ listed companies will be required to establish independent compensation committees which would have authority to operate in a manner similar to their audit committees, in accordance with SEC rules to be adopted. These provisions are discussed in more detail in the sections of the Dodd-Frank Wall Street Reform and Consumer Protection Act chapter of this handbook entitled "Compensation Committee Independence and Authority to Retain Advisors" and "Compensation Consultants and Advisors."

Audit Committee. Each NASDAQ listed company must have an audit committee comprised of at least three members, each of whom must:

- be independent, as defined under both NASDAQ rules and, as is the case for NYSE listed companies, Rule 10A-3(b)(1) under the Exchange Act (which means, generally, that the director cannot receive any payment from the company other than for board or committee service and cannot be an "affiliated person" of the company or any subsidiary);
- not have participated in the preparation of the financial statements of the company or any of its current subsidiaries at any time during the past three years; and
- be able to read and understand fundamental financial statements, including a balance sheet, income statement and cash flow statement.

At least one member of the audit committee must be "financially sophisticated" by virtue of either past employment experience in finance or accounting, a required professional certification in accounting, or any other comparable experience or background, including experience as a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

The board of each NASDAQ listed company must adopt a formal written audit committee charter and the adequacy of that charter must be reviewed and reassessed by the audit committee on an annual basis. The audit committee charter must specify:

- the scope of the audit committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements;
- the audit committee's responsibility for:
  - ensuring its receipt of a formal written statement from the company's outside auditor identifying all relationships between the auditor and the company, consistent with Independence Standards Board Standard 1,[2]
  - actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor, and

[2] The Independence Standards Board is an independent standard setting body that was established by the American Institute of Certified Public Accountants to establish independence standards applicable to audits of public companies.

  - taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor.

- the audit committee's purpose of overseeing the accounting and financial reporting processes of the company and the audits of its financial statements; and
- the specific responsibilities and authority necessary to comply with requirements for audit committees set forth in SOX (as implemented in Rule 10A-3(b) under the Exchange Act), which are discussed further in the section of this handbook entitled "The Sarbanes-Oxley Act", concern responsibilities relating to:
  - registered public accounting firms,
  - complaints relating to accounting, internal accounting controls or auditing matters,
  - the authority to engage advisors, and
  - funding as determined by the audit committee.

Independence Requirements: Cure Periods and Exceptions. A listed company must immediately notify NASDAQ upon learning that it is not in compliance with any NASDAQ listing standards, including those relating to the number of independent directors on the board or the audit committee. NASDAQ rules provide a listed company with the opportunity to cure any such noncompliance caused by a vacancy or certain events that are outside of the company's reasonable control.

NASDAQ permits listed companies, under exceptional and limited circumstances, to appoint one director who is not independent (but who is not a current officer or employee of the company, or a family member of an officer or employee) to a nominating committee or a compensation committee that is comprised of at least three members, provided in each case that:

- the board has determined that such individual's membership on the committee is in the best interests of the company and its shareholders; and
- the board discloses, in the proxy statement for the next annual meeting of shareholders, the nature of the relationship and the reasons for the board's determination.

Any member of the nominating or compensation committee who is appointed under this exception may not serve longer than two years.

Additionally, any NASDAQ listed company that is a "controlled company" – where a majority of the voting power for its directors is held by an individual, group, or entity – is not required to satisfy NASDAQ's independence rules regarding board composition, the selection of director nominees and the determination of executive compensation. Any listed company relying on this exemption must disclose in its proxy statement that it is a controlled company and its basis for making such a determination.

Code of Conduct. Each NASDAQ listed company must adopt, and make publicly available, a code of conduct that is applicable to all of its directors, officers and employees. The code of conduct must qualify as the "code of ethics" contemplated by SOX, as discussed further in the section of this handbook entitled "The Sarbanes-Oxley Act." The board of directors must approve any waiver of the code of conduct for directors and executive officers and all such waivers must be disclosed in a Form 8-K, or for a foreign private issuer, in a Form 6-K or its next Form 20-F or 40-F. The code of conduct is required to contain an enforcement mechanism that ensures prompt and consistent enforcement, protection for persons who report potential violations, clear and objective standards for compliance and a fair process for determining whether violations have occurred.

Shareholder Meetings. NASDAQ listed companies must hold an annual meeting of shareholders no later than one year after the end of its fiscal year. In connection with the solicitation of proxies for any meeting of shareholders, a listed company must deliver to shareholders a proxy statement that complies with all applicable SEC rules and requirements and provide copies of the proxy statement to NASDAQ. A quorum for any such meeting, as set forth in the company's bylaws, may not be less than 33 1/3% of the outstanding shares of the company's voting stock.

Review of Related Party Transactions. Each NASDAQ listed company, through its audit committee or another independent body of the board, must conduct an appropriate review and provide oversight of all related party transactions for potential conflicts of interest. For purposes of this rule, the term "related party transaction" refers to transactions required to be disclosed pursuant to Item 404 of Regulation S-K, which includes any financial transaction, arrangement or relationship involving the company (including any indebtedness or guarantee of indebtedness) in which the amount involved exceeds $120,000, and in which any related person had or will have a direct or indirect

material interest. Item 404 of Regulation S-K is discussed further in the section of this handbook entitled "Periodic and Current Reporting under the Exchange Act."

Shareholder Approval Requirements. NASDAQ listed companies must obtain shareholder approval prior to issuing securities:

- for any acquisition that requires the issuance of 20% or more of the pre-transaction outstanding shares of the company, or 5% or more of the pre-transaction outstanding shares when a related party has a 5% or greater interest in the acquisition target;
- when the issuance would result in a change of control;
- as equity-based compensation for officers, directors, employees or consultants; and
- in private placements at a price less than the greater of book or market value, where the issuance (together with sales by officers, directors, or substantial shareholders, if any) equals 20% or more of the pre-transaction outstanding shares.

Subject to limited exceptions, NASDAQ requires that shareholders approve any equity compensation plan or arrangement pursuant to which an officer, director, employee or consultant may receive stock. Once an equity compensation plan or arrangement has been approved by shareholders, any material amendment to that plan or arrangement would also require shareholder approval. For example, shareholder approval would be required for:

- any material increase in the number of shares to be issued under an equity compensation plan,
- any material change that increases benefits to plan participants, such as a change to permit a repricing of outstanding options or to extend the duration of the plan;
- any material expansion of the class of eligible participants in the plan; and
- any expansion in the types of equity awards provided for under the plan.

NASDAQ will generally not require shareholder approval for inducement grants to new employees or grants that are made pursuant to tax qualified non-discriminatory benefit plans or parallel nonqualified plans, provided in each case that those grants are

approved by an independent compensation committee or a majority of the board's independent directors. In addition, shareholder approval may not be required (i) to convert, replace or adjust outstanding options or other equity compensation awards to reflect a merger or acquisition, or (ii) to use shares available under certain plans acquired in such a transaction for certain post-transaction grants.

Practice Tip: NASDAQ's shareholder approval requirements apply not just to broad-based equity compensation plans, but also to any "arrangement" that could result in the receipt of stock by an officer, director, employee or consultant. For example, options or stock granted to an officer or employee pursuant to the terms of an employment agreement or other arrangement should ordinarily be issued pursuant to a shareholder approved plan, unless the grant is an inducement offered to a new employee or another exception applies.

Shareholder approval is not required for any "public offering" of securities, which generally includes any firm commitment underwritten securities offering that has been registered with the SEC (or a registered offering that has been publicly disclosed and distributed in the same general manner and extent as a firm commitment underwritten securities offering).

A listed company may also apply in writing for an exception to the shareholder approval requirements for a specified issuance of securities when:

- the delay required to obtain stockholder approval would seriously jeopardize the financial viability of the enterprise; and
- the audit committee (or another designated group of disinterested, independent directors) expressly approves the company's reliance on this exception.

If NASDAQ approves the exception, the company must mail to shareholders and publicly announce certain information relating to its issuance of securities and reliance on this exception.

Practice Tip: Special care should be taken to ensure that shareholder approval is not required in connection with a private placement of "Future Priced Securities," which are convertible securities that have a conversion price that is generally linked to a percentage discount to the market price of the underlying common stock. When required, shareholder approval must be obtained prior to the issuance of the Future Priced Securities (and not the underlying common stock). The lower the price of the underlying common stock at the time of conversion, the more shares into which the Future Priced Security is convertible. When determining whether shareholder approval is required for an issuance of Future Priced Securities, NASDAQ will look to the maximum potential issuance of shares upon conversion (no matter how unlikely the outcome) to determine whether there will be an issuance of 20% or more of the issuer's outstanding common stock.

In accordance with the broker voting restrictions set forth in the Dodd-Frank Act, NASDAQ has revised its broker voting rules to prohibit brokers from voting shares they do not beneficially own in matters regarding the election of directors, executive compensation and any other "significant matter," as determined by the SEC, without specific voting instructions from beneficial owners. The Dodd-Frank Act provision and the NASDAQ rule change are discussed in more detail in the section of this handbook entitled "Proxy Statement and Annual Report Disclosures and Processes – Broker Voting."

Exemption for Foreign Private Issuers

Subject to certain conditions, a foreign private issuer may follow its home country corporate governance practices in lieu of complying with certain of NASDAQ's corporate governance requirements. As one of the conditions to taking advantage of this exemption, a foreign private issuer must have an audit committee that complies with NASDAQ's audit committee requirements, except that the committee members' independence may be determined only by reference to the independence standards in Exchange Act Rule 10A-3 (subject to any relevant exceptions thereunder), without reference to NASDAQ's additional independence requirements.

Communications and Disclosure

A NASDAQ listed company must (except in unusual circumstances) promptly disclose any material information that would reasonably be expected to affect the value of its securities or influence investors' decisions. The disclosure must be made in a Regulation FD compliant manner.

In order to reduce duplicative Form 8-K filings in FD-compliant public disclosures, NASDAQ has amended certain of its rules to permit disclosure either through a press release or by filing a Form 8-K where required by SEC rules. Whereas NASDAQ previously required listed companies to disclose certain information through a press release or the news media, the amendments, effective March 15, 2010, eliminated the need to file a press release in certain situations where the company is already required to disclose the information in a filing with the SEC. Where an SEC filing is not required, however, companies must continue to make their required public disclosure by issuing press releases. The amended rules permit companies to satisfy their NASDAQ public disclosure requirements by making the following disclosures by filing a Form 8-K where required by the SEC:

- receipt of a notice that the company does not meet a listing standard or that NASDAQ intends to delist the company and receipt of a public reprimand letter (although if the company receives a notice that it is late in filing a periodic report with the SEC, NASDAQ rules require the company to issue a press release regarding this notice, in addition to filing any Form 8-K required by SEC rules);
- receipt of an exemption to the shareholder approval requirements because compliance would jeopardize the company's financial viability (although NASDAQ still requires that companies receiving such an exemption mail this notice to all shareholders at least 10 days before issuing securities in reliance on the exemption); and
- any change in the terms of a listed unit.

The amended rules also eliminate the requirement that a company issue a press release announcing its receipt of an audit opinion expressing doubt about its ability to continue as a going concern. NASDAQ has determined this press release is not necessary because the SEC already requires that this disclosure be included in a company's annual report, which is filed with the SEC and distributed to shareholders.

Additionally, NASDAQ listed companies must provide NASDAQ's MarketWatch with at least ten minutes advance notice prior to the planned disclosure of certain material news.

The advance notice requirement is intended to give NASDAQ the opportunity to consider whether a temporary trading halt is necessary to allow for the complete dissemination of the planned disclosure. Notifications to MarketWatch, which monitors the trading activity of NASDAQ listed companies, must be made electronically through its electronic submission system (available on www.nasdaq.net). While companies are encouraged to provide advance notification to MarketWatch whenever they believe, based on the significance of the information to be disclosed, that a temporary trading halt may be necessary, advance notification to MarketWatch is always required when disclosing material news of the following nature:

- financial-related disclosures, including quarterly or yearly earnings, earnings restatements, pre-announcements or guidance;
- corporate reorganizations and acquisitions, including mergers, tender offers, asset transactions and bankruptcies or receiverships;
- new products or discoveries, or developments regarding customers or suppliers;
- senior management changes of a material nature or change in control;
- resignation or termination of independent auditors or withdrawal of a previously issued audit report;
- events regarding the company's securities (*e.g.*, defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders or public or private sales of additional securities);
- significant legal or regulatory developments; and
- any event requiring the filing of a Form 8-K.

Practice Tip: Pursuant to a 2010 NASDAQ rule change, NASDAQ has clarified that companies listed on the NASDAQ Stock Market will be required to provide NASDAQ with prompt notification after an executive officer of the company becomes aware of *any* noncompliance with NASDAQ's corporate governance requirements, whether or not the company believes that the noncompliance is material. Thus, NASDAQ-listed companies may want to assess their internal reporting procedures to ensure that all executive officers are instructed to report to the appropriate internal contact any non-compliance with the NASDAQ corporate governance listing standards.

TRADING IN ISSUER STOCK

Under Section 10(b) of the Exchange Act and Rule 10b-5, a public company and its officers, directors and other employees may not trade in company securities on the basis of material nonpublic information. This section of the handbook provides an overview of certain SEC safe harbor rules designed to assist issuers and their insiders with avoiding 10b-5 liability and policies and procedures that issuers typically adopt to help prevent insider trading violations. In addition, this section also touches on Rule 144 under the Securities Act which provides a safe harbor for company insiders and certain other security holders seeking to sell securities in unregistered transactions. Certain other restrictions and requirements relating to purchases and sales of securities by company insiders are addressed in other sections of this handbook. See "Ownership and Trading Reports by Management and Large Shareholders." See also, "Addressing Potential Conflicts of Interests" under the section of this handbook entitled "The Sarbanes-Oxley Act" for a discussion of the prohibition on certain transactions by insiders during pension black-out periods. Public companies and their officers, directors and other affiliates must also be mindful of engaging in other conduct that may constitute or be viewed as manipulative or deceptive within the meaning of the securities laws, including in connection with their purchases of company securities.

Trading on the Basis of Material Nonpublic Information

What is Material Information?

For purposes of determining whether a person is engaging in insider trading, information is material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision regarding the purchase or sale of the issuer's securities. The information does not have to be such that it would have caused a reasonable investor to make a different decision. Whether particular information is material will depend on the facts and circumstances; however there are various categories of information that are particularly sensitive and should generally be viewed as material, subject to a further assessment of the circumstances at the time such information becomes known. Information that may be material includes:

- earnings information;
- projections of future earnings or losses;
- variations in projections that have been made public;
- new product launches or announcements, new developments or discoveries;

- news of a pending or proposed merger, acquisition, disposition, divestiture, joint venture or change in assets;
- impending bankruptcy or financial liquidity problems;
- gain or loss of a substantial customer or supplier;
- significant product defects or modifications;
- significant and unanticipated changes in pricing, sales, costs or expenses;
- proposed stock splits or consolidations;
- proposed new equity or debt offerings;
- significant litigation exposure due to actual or threatened litigation; and
- changes in senior management.

Insider Trading Policies and Programs

Public companies generally do and should establish insider trading compliance programs designed to prevent insider trading. There are many factors that a public company should take into consideration in designing an insider trading policy and program.[3] These include an assessment of: (i) the size of the company; (ii) the

[3] In addition to adopting policies and procedures to prevent insider trading by their officers, directors and other employees, public companies must also consider whether they have appropriate safeguards in place when disclosing nonpublic information to parties that may not be insiders. In a highly publicized case, *SEC v. Cuban*, Mark Cuban, a 6.5% shareholder of a public company sold his stake in the company shortly after learning from the company's chief executive officer and advisors to the company that the company would be conducting a private offering of its securities. Cuban agreed to keep confidential the information about the proposed offering, but argued that he did not agree not to trade on the basis of the information or while it remained nonpublic, and therefore, did not have the requisite duty of trust and confidence to the company and its shareholders to support a claim for insider trading. The District Court in Dallas, Texas agreed with Cuban, finding that he had not agreed to refrain from trading. The Fifth Circuit Court of Appeals has since overruled the District Court and remanded the case for further consideration of whether Cuban, in his conversations with the chief executive officer, did agree to refrain from trading, and therefore undertook a duty of trust and confidence that would have barred him from trading while in possession of the disclosed information. Notably, both the District Court and the Court of Appeals analyzed the case on the basis that Cuban was not an insider of the company. It remains an open question whether a third party can trade with impunity on information provided under a confidentiality agreement that does not expressly prohibit trading. See, *SEC v. Cuban*, No. 09-10996, 2010 U.S. App. LEXIS 19563 (5th Cir. Sept. 21, 2010).

potential for large volumes of trading in its securities; (iii) the number of insiders who have access to material nonpublic information; (iv) the existence of any previous insider trading violations; (v) the ability of officers, directors and employees to comply with the adopted policies; and (vi) whether the policies will be applied to all, most or a more limited number of employees. An effective compliance program may include the following recommended elements:

- established time frames during the issuer's corporate disclosure calendar in which trading by officers, directors and other employees may be appropriate (*i.e.*, trading windows);
- restrictions on access to sensitive documents, such as limitations on dissemination of information to employees on a "need to know" basis;
- preclearance procedures administered by a designated compliance officer prior to executing a trade;
- restrictions on trading by family members in the issuer's stock;
- procedures for issuer approval of insider 10b5-1 plans;
- educational programs that provide appropriate training and education to employees on the law of insider trading and potential liability;
- restricting employees from making recommendations or expressing opinions about an issuer's stock;
- prohibitions against certain types of transactions, such as short-term trading, short sales, margin purchases and transactions in derivative securities to avoid the appearance of speculation in the issuer's securities; and
- designation of a compliance officer responsible for establishing, monitoring and enforcing the issuer's compliance policies.

Trading Windows

When adopting insider trading policies, companies generally establish time periods in which employees and directors may be permitted to execute trades in the company's securities. The adopted window periods are established by determining the times during the year that employees and directors are less likely to be in possession of material nonpublic information. The trading windows vary from company to company, but generally open after material information of the issuer has been publicly disclosed

and close prior to periods of increased sensitivity to issuer information. Sensitive time periods include the period prior to the end of an issuer's fiscal quarter or year where an insider may have information concerning the issuer's results, and therefore windows typically close some number of weeks prior to the end of an issuer's fiscal quarter and re-open one to three trading days after the issuer's earnings release. An open trading window does not give insiders a green light to automatically trade in the issuer's stock, however. Even though a trading window may be open, employees and other insiders may still possess material nonpublic information, and would still be prohibited from trading. Insider trading programs and policies must therefore also incorporate mechanisms to prevent employees and other insiders from trading during open window periods if in possession of material nonpublic information. These typically include notices and reminders to individuals who are in possession of particular information, imposition of "black-out" periods, and requiring pre-clearance of trades even during open window periods.

10b5-1 Plans and Procedures

With the adoption of Rule 10b5-1, the SEC effectively established a presumption that if a person is aware of material nonpublic information at the time the person trades in securities of an issuer, then the person will be deemed to have traded "on the basis of" such information. Rule 10b5-1 established certain affirmative defenses that could rebut this presumption.

Rule 10b5-1 permits companies and company insiders to establish trading plans allowing transactions to be effected within a "safe harbor" from 10b-5 liability even though executed at a later time when the company or individual possesses material nonpublic information. For the safe harbor to be available, the company or insider must demonstrate that before becoming aware of the material nonpublic information, the company or insider (i) entered into a binding contract to trade in the issuer's securities, (ii) provided instructions to another person to execute the trades for the person's account, or (iii) adopted a written plan for trading the securities. In addition, the contract, instructions or plan (x) must have expressly specified the amount, price and date for the transaction or provided a written formula or mechanism for determining such information, or (y) must not have permitted the person to exercise any subsequent influence over how, when or whether to effect purchases or sales. Finally, the actual trade must have been executed pursuant to such contract, instruction or plan.

Practice tip: A transaction is not "pursuant to" a contract, instruction or plan if the insider alters or deviates from the contract, instruction or plan in connection with the transaction or entered into or altered a corresponding hedging transaction.

Rule 10b5-1 plans have become a common mechanism to facilitate insiders' transactions. Generally, the insider's broker will provide a template 10b5-1 plan which can be customized based on the insider's needs. Issuers may also develop recommended 10b5-1 plan templates for their insiders. As part of its insider trading policies, an issuer may wish to impose an approval requirement to determine whether an employee's or director's 10b5-1 plan meets the requirements of Rule 10b5-1. Key procedures issuers should implement within their compliance policies to monitor their insiders' 10b5-1 plans are:

- ***Plan approval***. The general counsel or compliance officer of the issuer should review the insider's proposed 10b5-1 plan prior to execution.
- ***Timing of adoption***. Plans should not be entered into at a time when the insider is aware of material nonpublic information. This is true even if the plan is structured so that plan transactions will not begin until after the material nonpublic information is made public.
- ***Cooling-off period***. The time between the establishment of a plan and commencement of trades should be at least 30 days.
- ***Trading windows***. Insiders should not be permitted to enter into 10b5-1 plans outside of ordinary open trading windows.
- ***One insider, one plan***. Limitations on the ability of insiders to enter into multiple, overlapping 10b5-1 plans should be implemented.
- ***Disclosure***. Issuers should consider disclosing the adoption of 10b5-1 plans by their Section 16 insiders. There is no need to provide the details of the plan. Required Form 4 filings of Section 16 insiders for sales made under Rule 10b5-1 plans should specifically note that the sales were made under the 10b5-1 plan.
- ***Cancellation of transactions***. Insiders should not have the ability to override plan transactions.

- ***Modifications and Terminations***. Modifications and terminations to a plan should not be permitted other than during open trading windows. Frequent changes to the plan could affect its validity.
- ***Execution broker***. A broker for insiders to use in executing trades should be specified or insiders should be required to obtain issuer approval of the broker they intend to use.
- ***Documentation***. Insiders should be required to provide the issuer with the date on which they adopted their 10b5-1 plans for purposes of confirming that they were not in possession of material nonpublic information at such time.

Rule 10b5-1 establishes a further affirmative defense for corporate defendants in insider trading cases. The defense is available if the defendant can demonstrate that (i) individuals making trading decisions on its behalf were not in fact aware of material nonpublic information; and (ii) the defendant implemented reasonable policies and procedures to ensure that individuals making investment decisions would not violate insider trading laws. The policies and procedures may seek to restrict purchases or sales while individuals are in possession of material nonpublic information, or to prevent the individuals from becoming aware of material nonpublic information. This defense is not available to defendants who are individuals.

Resales of Restricted and Control Securities

Rule 144

Generally, any security holder seeking to sell securities must either register the sale under the Securities Act or qualify for an exemption from registration. Section 4(1) of the Securities Act provides an exemption for ordinary trading of securities by persons that are not issuers, underwriters or dealers. However, the expansive definition of the term “underwriter” creates the risk that an issuer’s affiliates and other security holders will be treated as “statutory underwriters,” and therefore will be unable to utilize this exemption. Rule 144 under the Securities Act provides a “safe harbor” under Section 4(1) that, provided all the applicable conditions to the Rule are satisfied, allows for the public resale of securities without registration under the Securities Act. The Rule 144 safe harbor protects sales of “restricted securities,” which generally are securities that have been acquired in an unregistered sale from the issuer or from an affiliate of the issuer (*e.g.*, securities acquired from the issuer in a private placement). Rule 144 also protects sales of “control securities,” which are any securities of an issuer held by its

affiliates, including its executive officers and directors. Even if securities are acquired in a registered sale or in the open market, they are considered "control securities" once held by an affiliate. An affiliate also must deal with the concern that its ability to sell securities may be negatively impacted as a consequence of the Rule 144 definition of "restricted securities" under which a person that purchases control securities from the affiliate in a transaction that is not registered under the Securities Act acquires restricted securities, even if the securities were not restricted in the affiliate's hands.

To address the risks described above, executive officers, directors and other affiliates of public companies typically rely on the Rule 144 safe harbor to resell their securities to the public. Securities sold by an affiliate in compliance with Rule 144 will not be restricted securities in the hands of the purchaser. To qualify for the Rule 144 safe harbor, a resale transaction by an affiliate must satisfy the following conditions:

- ***Availability of Current Public Information***. At the time of the resale transaction, adequate current public information about the issuer must be available. This requirement is met if during the 12 months preceding the sale or such shorter period as the issuer has been a reporting company, the issuer has filed all required Exchange Act reports (other than current reports on Form 8-K) and submitted electronically and posted on its website, if any, all required XBRL files.

- ***Holding Period***. If an affiliate of a public company holds "restricted securities," those securities must be held for no less than six months from the date they were acquired before they can be resold. The holding period begins on the date the securities were purchased and fully paid for. Note that any unrestricted securities of an issuer that are held by an affiliate, including those acquired by the affiliate in the marketplace or in a registered offering (including securities registered under a Form S-8 that were issued pursuant to an equity compensation plan), would not be subject to the holding period requirement, although they are still control securities that could only be resold under Rule 144 if the other applicable conditions have been satisfied.

- ***Sales Volume***. The amount of securities to be sold by an affiliate, together with all securities of the same class sold during the preceding three-month period, may not exceed the greater of (i) 1% of the total number of shares outstanding of the class being sold, or (ii) the average weekly trading volume of the class of shares during the four full calendar weeks preceding the

transaction. For debt securities, the volume of sales during any three-month period may not exceed 10% of the class of debt securities outstanding.

- ***Manner of Sale Requirements***. Generally, control securities may only be sold in routine trading transactions where the broker receives no more than a normal commission and where neither the affiliate seller nor the broker has solicited orders to buy the securities. These requirements do not apply to an affiliate's sale of debt securities.
- ***Form 144 Filing***. When placing an order to sell with a broker, affiliates must file a notice on Form 144 unless the sale, when combined with all other sales by the affiliate within a three month period, involves less than 5,000 shares *and* the aggregate dollar amount of such sales do not exceed $50,000. Although the filing of a Form 144 does not obligate the filer to sell any shares, if the shares listed on the Form 144 are not sold within three months of the filing, an amended Form 144 must be filed. A Form 144 may be filed with the SEC in paper form or, at the affiliate's option, electronically using the SEC's EDGAR filing system.

Rule 144 may also be relied on by non-affiliates selling restricted securities of public company issuers. Only the current public information and holding period conditions apply to these sales; however, after one year following a non-affiliate's acquisition of restricted securities from the issuer or an affiliate of the issuer, the non-affiliate may sell the securities without regard to any of the Rule 144 conditions, including the current public information condition. A person seeking to rely on the Rule 144 exemption as a non-affiliate cannot be an affiliate at the time of the Rule 144 sale and cannot have been an affiliate during the three months preceding the sale. The SEC has amended Rule 144 to clarify that the Rule is also available for resales of securities of issuers that are not public companies (or have been subject to the Exchange Act's reporting requirements for fewer than 90 days). These transactions are subject to a one year holding period requirement and somewhat less stringent conditions than for public company securities.

Restricted securities that are sold in compliance with Rule 144 cease to be restricted upon such sale.

Sales of Restricted Shares Outside of Rule 144

Rule 144 is not the exclusive method for security holders to resell securities without registration under the Securities Act. Even if the Rule 144 safe harbor is unavailable, the Section 4(1) exemption may be relied upon for sales by persons other than issuers, underwriters and dealers. However, the Section 4(1) exemption has been interpreted as generally permitting only ordinary trading activity, such as that conducted in open market. As a result, Section 4(1) would be unavailable for private sales involving control or restricted securities. While Section 4(2) of the Securities Act exempts from registration "transactions by an issuer not involving a public offering," on its face, the Section 4(2) exemption is only available to issuers conducting a private sale and does not exempt private sales by any person other than an issuer. In the absence of an express statutory exemption, private sales of restricted or control securities by persons other than an issuer are often structured using a hybrid of the Section 4(1) and Section 4(2) exemptions referred to as a "Section 4(1-1/2) exemption." While the Section 4(1-1/2) exemption is not statutory nor has it been formally adopted by the SEC, the SEC has long recognized its use for exempting private sales where certain conditions for sales under both Section 4(1) and Section 4(2) have been satisfied. Generally, sales that are made in reliance on the Section 4(1-1/2) exemption should be subject to restrictions on general solicitation and advertising and be made to a limited number of qualified purchasers who have been provided with (or have access to) the information necessary to make an investment decision and who agree to be bound by a holding period and/or transfer restrictions.

Generally, restricted securities sold other than in compliance with Rule 144 continue to be restricted after the sale. If the sale is by an affiliate, a new holding period will commence for purposes of further resales under Rule 144. If the sale is by a non-affiliate, the purchaser may tack the seller's holding period rather than start a new one.

Issuer Stock Repurchases

Stock purchases by an issuer and its affiliates are subject to the anti-manipulation provisions of Sections 9(a)(2) and 10(b) of the Exchange Act and Rule10b-5 under the Exchange Act, which make it illegal to (i) manipulate the price of a security registered on a national securities exchange by creating actual or apparent trading in such security or by raising or depressing the price of such security in order to induce others to buy or sell the security, and (ii) use any manipulative or deceptive device or otherwise engage in fraud in connection with the purchase or sale of any security.

Rule 10b-18

Rule 10b-18 under the Exchange Act provides issuers with a safe harbor from liability for violations of Sections 9(a)(2) and 10(b) and Rule 10b-5 when the issuer purchases its securities in open market transactions. An issuer taking advantage of Rule 10b-18 will be protected from claims that the manner, timing, price or volume of its purchases violate Section 9(a)(2) or 10(b). Note, however, that Rule 10b-18 is not a safe harbor from liability for trades on the basis of material nonpublic information. Rule 10b-18 is available to issuers, as well as their affiliates. Likewise, purchases by issuers and their affiliates are aggregated for purposes of Rule 10b-18.

To avail itself of the safe harbor protections of Rule 10b-18, an issuer and its affiliated purchasers must satisfy the following four conditions:

- ***Manner of Repurchase***. When soliciting purchases, the issuer must use a single broker or dealer per day to bid for or purchase the issuer's stock. After-hour purchases that comply with the manner, price and volume limitations of Rule 10b-18 may be effected through a different broker or dealer.
- ***Timing***. The issuer's purchase cannot be the opening transaction in the issuer's security that is reported in the consolidated system on any trading day. Additionally, the issuer's purchase cannot be made during the last 30 minutes before scheduled closing of the principal market on which the securities trade or of the market on which the trade is effected, except that if (i) the average daily trading volume for the security for the previous four full calendar weeks (ADTV) is $1 million or more and (ii) the security has a public float of $150 million or more, the issuer may execute stock repurchases up to 10 minutes prior to the scheduled close of trading.
- ***Price***. Generally, the highest price the issuer may pay cannot exceed the highest independent bid or the last independent transaction price, whichever is higher, at the time of the transaction. The determination of the applicable independent bids and prices depends on whether transactions in the security are reported in the consolidated system or disseminated or displayed on a national securities exchange or inter-dealer quotation system or not reported in either manner. The price condition is intended to prevent the issuer from leading the market through its repurchases by limiting the issuer's purchase prices to prices based on independent reference prices.

- ***Trading Volume Limitation***. The aggregate amount of stock that may be repurchased by the issuer and its affiliated purchasers on any single day may not exceed 25% of the ADTV). Issuers may, however, execute one block purchase per week in lieu of making purchases in accordance with the 25% trading volume limitation on that day. The block purchase may not be included when calculating the security's ADTV for purposes of the safe harbor.

Issuers seeking to rely on the Rule 10b-18 safe harbor should incorporate procedures to keep track of the purchases made by their affiliates in order to make the required calculations under Rule 10b-18.

The failure to meet any of the foregoing conditions for a particular transaction will result in the loss of the Rule 10b-18 safe harbor for all transactions by the issuer and its affiliates for that trading day. Failure to satisfy the safe harbor requirements does not mean, however, that the purchases were manipulative; rather, it means that such purchases must be analyzed on a facts and circumstances basis.

The Rule 10b-18 safe harbor is not available for certain transactions, including purchases occurring during a specified period after the issuer has announced a merger transaction or as part of an issuer tender offer or a third party tender offer for registered securities.

In January 2010, the SEC proposed and published for comments amendments intended to clarify and modernize the safe harbor provisions of Rule 10b-18. As proposed, the amendments would:

- modify the timing condition to preclude Rule 10b-18 purchases as the opening purchase in the principal market for the security and in the market where the purchase is effected (in addition to the current prohibition against effecting Rule 10b-18 purchases as the opening purchase reported in the consolidated system);
- relax the price condition to permit issuers flexibility to make purchases at volume weighted average prices (VWAP) and at blended prices established through electronic trading systems, instead of the strict restriction based on the highest independent bid or price for the security;
- enable issuers to claim the protection of the safe harbor for complying transactions under certain circumstances when all of their transactions on

that day do not strictly comply with the safe harbor conditions due to "flickering quotes;" and

- extend the time during which the safe harbor is not available in connection with an acquisition by a special purpose acquisition company.

Key Considerations Prior to Initiating Stock Repurchase Programs

Prior to initiating or amending a stock repurchase program, issuers should carefully consider additional laws and rules relevant to their and their affiliates' purchases of their securities, including:

- insider trading prohibitions;
- SEC disclosure requirements applicable to the issuer;
- applicable stock exchange notification and reporting requirements;
- Regulation M under the Exchange Act, which prohibits an issuer or affiliated purchaser from purchasing the issuer's securities which are subject to "distribution" during a defined restricted period; and
- tender offer rules.

OWNERSHIP AND TRADING REPORTS BY MANAGEMENT AND LARGE SHAREHOLDERS

Beneficial owners of greater than 5% of a class of a public company's registered equity securities are subject to ownership reporting obligations under either Section 13(d) or Section 13(g) of the Exchange Act. These reporting obligations were adopted to alert a public company and the marketplace in general to large, rapid accumulations of registered equity securities which could represent a potential change in corporate control. At the same time, a public company's directors, executive officers and greater than 10% beneficial shareholders are subject to certain ownership reporting obligations and trading restrictions under Section 16 of the Exchange Act. Section 16 is designed to deter corporate insiders from trading on material, nonpublic information for their personal gain. Under Section 16, insiders are required to publicly report their ownership of and transactions involving the company's equity securities. In addition, insiders are subject to strict liability for profits realized from short-swing trades in the company's equity securities and are prohibited from selling those securities short. We address the different reporting and trading requirements of Sections 13(d) and (g) and Section 16 of the Exchange Act below.

Sections 13(d) and (g) of the Exchange Act

Under Section 13(d) of the Exchange Act, any person who acquires beneficial ownership of greater than 5% of any class of a company's voting equity securities registered under Section 12 of the Exchange Act is required to file a report with the SEC on Schedule 13D or, if eligible, on short-form Schedule 13G. In addition, Section 13(g) of the Exchange Act requires a person to file a Schedule 13G with the SEC if that person beneficially owns greater than 5% of a class of a company's registered voting equity securities as of the end of the calendar year but has not made an acquisition subject to Section 13(d). Generally, shares that are publicly traded in U.S. markets are registered under Section 12, including shares underlying a foreign company's American Depositary Receipts (ADRs). In this section we refer to a class of a company's voting equity securities registered under Section 12 of the Exchange Act as reportable securities.

Practice Tip: ADRs are not considered a separate class from their underlying shares for purposes of the reporting obligations of Sections 13(d) and (g). These reporting obligations apply to acquisitions of ADRs if the underlying shares are registered under Section 12 of the Exchange Act and represent, in the aggregate, more than 5% of all outstanding shares of the same class.

Beneficial Ownership. For purposes of Sections 13(d) and (g), a person is deemed to have beneficial ownership of any reportable securities over which such person has or shares voting power or investment power, whether directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise. Voting power includes the power to vote or direct the voting of the shares, while investment power includes the power to dispose of or direct the disposition of the shares. Parties who share voting or investment power over a company's reportable securities are each deemed to beneficially own those reportable securities.

A person also is deemed to beneficially own reportable securities that the person has the right to acquire within 60 days. Therefore, if a person enters into a contingent agreement which gives that person the right to acquire reportable securities within 60 days, or owns options or convertible securities that can be exercised for or converted into reportable securities within 60 days, the person is deemed to beneficially own those reportable securities for purposes of Sections 13(d) and (g) once all material contingencies over which the person has no control have been waived or satisfied. Reportable securities that a person may acquire within 60 days are added to the total number of outstanding reportable securities when calculating such person's percentage ownership.

Practice Tip: A person who owns convertible securities that are convertible into greater than 5% of a company's reportable securities within 60 days may not be obligated to file a beneficial ownership report if the conversion rights restrict the person from beneficially owning more than 5% of the company's reportable securities at any one time. To effectively prevent a person from becoming a greater than 5% beneficial owner and incurring a reporting obligation under Section 13(d) or (g), the conversion cap must be valid and binding. Factors indicating that a conversion cap is valid and binding include whether it is provided in the company's certificate of designation or governing instruments, reflects limitations established by another regulatory scheme applicable to the company, or is the product of bona fide negotiations between the parties. In contrast, a conversion cap may be disregarded as illusory if it may be waived by the company or the security holder, lacks an enforcement mechanism, has not been adhered to in practice, or can be avoided by transferring the securities to an affiliate of the holder.

Recent Development: Section 766 of the Dodd-Frank Act provides that a person who purchases or sells a "security-based swap" (SBS) will not be deemed to acquire beneficial ownership of an equity security under Section 13 of the Exchange Act unless the SEC, by rule, determines that the purchase or sale of the SBS or class of SBS provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of Section 13 to treat the purchase or sale of the SBS or class of SBS as the acquisition of beneficial ownership of the equity security. An SBS is broadly defined as a swap based on (i) a single security or loan, (ii) a narrow-based index of securities or (iii) events relating to a single issuer or issuers of securities in a narrow-based security index. As this handbook goes to publication, the SEC has not issued rules providing for the purchase or sale of an SBS to be deemed the acquisition of beneficial ownership of an equity security. The SEC has, however, issued proposed Regulation SBSR, which would provide for the reporting of SBS information to registered SBS data repositories or the SEC and the public dissemination of SBS transaction, volume, and pricing information.

Section 13(d) or (g) Group. When two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of reportable securities, they are characterized as a "group" under Rule 13d-5, and the holdings of the group are then aggregated to determine whether the 5% reporting threshold has been exceeded. Each member of the group is deemed to share beneficial ownership of all securities owned by the group. A person who does not beneficially own any reportable securities, however, cannot become a member of a group for purposes of Section 13(d) or (g), even if the person agrees to act together with members of the group for the purpose of acquiring, holding, voting or disposing of a company's reportable securities.

Practice Tip: Courts are likely to view certain activities by two or more persons as indicating the formation of a group for purposes of Section 13(d) or (g) reporting. These include concerted actions to facilitate or defeat a takeover attempt, efforts to influence decisions by a company's board of directors, coordinated trading activities that appear to further a common objective, and close collaboration or cooperation with respect to a company's management or securities. For example, purchasers in a round of private financing could be deemed a group for Section 13(d) or (g) reporting purposes if they share a representative on a company's board of directors or have an agreement to vote their shares in favor of the company's director nominees.

Recent Development: The SEC staff recently issued a no-action letter clarifying that certain stockholder arrangements will not result in the creation of a group for purposes of Section 13(d) or (g). In particular, the SEC staff indicated that a majority stockholder's unilateral offer to individual stockholders of pro rata tag-along rights in return for an irrevocable proxy to vote such stockholders' shares with respect to certain corporate matters did not create an agreement to act together for the purpose of acquiring, holding, voting or disposing of reportable securities. Under the facts of the no-action letter, the majority stockholder would enter into separate tag-along and proxy agreements with each individual stockholder that accepted its offer, and would report any shares with respect to which it is granted an irrevocable proxy as indirectly beneficially owned by it for Section 13(d) or (g) reporting purposes. Because the individual stockholders would have divested themselves of voting power, and would make a separate determination of whether to sell in the tag-along offering, they would not be acting together with the majority stockholder. In addition, the letter confirmed that individual agreements between a stockholder and the issuer regarding such matters as transfer restrictions, repurchase rights, and piggyback registration rights would not create a group, as an issuer cannot be a group member. The letter also indicates, however, that drag-along rights and mutual voting agreements may result in creation of a group.

Parent/Subsidiary Disclosure Obligations. When a subsidiary in a multi-tiered organizational structure acquires greater than 5% of a company's reportable securities, each entity above the subsidiary in the organizational chain is typically attributed beneficial ownership of the securities held by the subsidiary and joins in its Schedule 13D or 13G filing. All relevant facts and circumstances are considered when determining whether attribution of beneficial ownership is warranted.

A Schedule 13D (but not a Schedule 13G) filed by a subsidiary typically must include background information for each executive officer and director of the subsidiary, as well as the executive officers and directors of the subsidiary's ultimate parent entity and each other entity that directly or indirectly controls the subsidiary. Background information also would be required for any controlling shareholder of the subsidiary's parent. Generally, a shareholder who owns 10% or more of the outstanding voting securities of an entity is presumed to control that entity, although that presumption is rebuttable based on facts and circumstances.

All forms of beneficial ownership are aggregated when determining whether the 5% ownership threshold has been exceeded. Accordingly, when calculating beneficial ownership, a person must include all reportable securities over which the person has direct or indirect voting or investment power, including securities the person can acquire within 60 days and, if applicable, all securities owned by other group members.

Practice Tip: A person's obligation to file a beneficial ownership report under Sections 13(d) or (g) may be triggered by an involuntary change in circumstances, such as company repurchases which reduce the number of its outstanding reportable securities. Where a person becomes the beneficial owner of more than 5% of a company's reportable securities due to an involuntary change in circumstances rather than an acquisition of securities, the person may report its ownership on short-form Schedule 13G pursuant to Rule 13d-1(d). In contrast, a person who influenced or controlled the change in the aggregate number of outstanding securities which resulted in their beneficial ownership exceeding 5%, such as an officer or director of the company, must report its ownership on Schedule 13D.

Schedule 13D

Schedule 13D disclosures are designed to function as an early warning system to alert a public company and its investors to the potential control intentions of persons making significant acquisitions of the company's shares. A Schedule 13D must be filed electronically with the SEC via EDGAR within 10 days of an acquisition which brings a person's beneficial ownership of reportable securities above the 5% threshold.

Recent Development: Section 929R of the Dodd-Frank Act amended Section 13(d) of the Exchange Act to authorize the SEC to establish by rule a shorter time period within which a Schedule 13D must be filed. As this handbook goes to publication, the SEC has not proposed any rule change that would shorten the current 10-day reporting window.

Practice Tip: The Schedule 13D must be filed within 10 days of the trade date of the transaction that creates the reporting obligation. Although under contract law a person may not receive legal ownership of reportable securities until the date the transaction is settled, at a minimum the person may exercise investment power over the acquired securities as of the trade date. The first calendar day after the trade date is considered day number one for purposes of calculating the applicable 10-day period.

Schedule 13D requires the disclosure of certain background information about the reporting person and the source of funds used to acquire the company's reportable securities. In addition, the reporting person is required to disclose the purpose for which the reportable securities were acquired in order to notify investors and the company whether the person intends to change or influence the company's management and policies. Generally, the information required to be disclosed consists of the following:

- the beneficial owner's identity, residence, and citizenship, as well as certain additional background information;
- the number of reportable securities owned, and any rights to acquire reportable securities either by the person filing the statement or by each associate of such person;
- the source and amount of the funds used to make the purchase; in particular, disclosure of funds that were borrowed in order to acquire the reportable securities;
- the purpose of the acquisition and plans or proposals to, among other things, acquire control of the company, change its present board of directors, sell its assets, initiate a merger, liquidate the company, or make major changes to its business; and
- information regarding any contracts, arrangements, or understandings entered into with respect to the company's securities.

Practice Tip: The SEC has cautioned that a plan or proposal, as those terms are used in Schedule 13D, may be deemed to exist prior to the execution of a formal agreement or commencement of a particular transaction. Accordingly, a reporting person who has included generic disclosure in its Schedule 13D reserving its right to acquire additional reportable securities, seek a change of management, or engage in any action enumerated in Item 4 of Schedule 13D may need to amend that disclosure when the reporting person has formulated a specific intention with respect to the action in question.

An amendment must be filed "promptly" upon the occurrence of any material change in the information set forth in a Schedule 13D, including a material increase or decrease in the number of reportable securities beneficially owned by the reporting person. An acquisition or disposition of 1% or more of the outstanding shares of the registered class is deemed material for purposes of the rule. Changes of less than 1% could also be considered material depending on the circumstances. Although the term "promptly" is not defined, amendments should generally be filed within one or two business days, as any delay beyond the date the amendment reasonably can be filed may not be considered prompt.

Schedule 13G

A person who would otherwise be required to file a Schedule 13D may file a short-form Schedule 13G if the person is a "Qualified Institutional Investor," "Passive Investor," or an "Exempt Investor." The Schedule 13G must be filed electronically with the SEC via EDGAR. The requirements pertaining to each category of persons eligible to file on Schedule 13G are discussed below.

<u>Qualified Institutional Investor</u>. This category includes institutional investors specified in Rule 13d-1(b), such as U.S.-regulated banks, U.S.-registered broker-dealers, and investment advisers registered under applicable state or federal law. A foreign institution that is functionally equivalent to any of the qualifying U.S. institutions may report on Schedule 13G as a Qualified Institutional Investor if it certifies that it is subject to a regulatory scheme that is substantially comparable to the one applied to its U.S. counterparts and undertakes to furnish to the SEC staff, upon request, information that would otherwise be disclosed in a Schedule 13D. To be eligible to file on Schedule 13G pursuant to Rule 13d-1(b), a Qualified Institutional Investor must certify that it acquired

the reportable securities in the ordinary course of its business and not with the purpose or effect of changing or influencing the control of the company.

Practice Tip: A Qualified Institutional Investor may certify that it has acquired reportable securities in the ordinary course of its business only where the acquisition is for passive investment or ordinary market-making purposes. A Qualified Institutional Investor may not, however, make such a certification if it acquires reportable securities or interests in reportable securities with the purpose of influencing the management or direction of a company or the outcome of a particular transaction – such as acquiring securities in order to vote them in favor of a merger or other business combination transaction. This is true even if the investor routinely acquires securities for those purposes as part of its business or investment strategy.

A Qualified Institutional Investor that elects to use Schedule 13G generally must file within 45 days after the end of the calendar year in which it beneficially owns in excess of 5% of a company's reportable securities as of the end of that year. A Qualified Institutional Investor must amend its Schedule 13G within 10 days after the end of any month in which its beneficial ownership, computed as of the last day of the month, increases or decreases by more than 5%. A Qualified Institutional Investor also must file an amended Schedule 13G within 45 days after the end of the calendar year if there are any changes in the information previously reported.

Practice Tip: A Qualified Institutional Investor will not lose its Schedule 13G eligibility as a result of its beneficial ownership exceeding 20%, so long as it can certify that it holds the securities in the ordinary course of business and with the requisite passive investment intent. Nevertheless, a Qualified Institutional Investor that beneficially owns more than 20% may have difficulty making the required certifications in light of its sizeable holdings.

A Qualified Institutional Investor will lose its Schedule 13G eligibility on any date that it ceases to:

- meet the institutional eligibility criteria of Rule 13d-1(b);
- hold the securities in the ordinary course of business; or
- hold the securities as a passive investment.

A Qualified Institutional Investor that loses its Schedule 13G eligibility must file a Schedule 13D within 10 days of the date on which it loses its eligibility. If the loss of eligibility is due to a change from passive investment to a control purpose or effect, the investor is subject to a "cooling-off" period during which it may not vote or direct the voting of the reportable securities or acquire beneficial ownership of any additional equity securities of the company or an entity controlling the company. The "cooling-off" period begins on the date on which the investor changes its investment intent and lasts until the expiration of the 10th day after the date on which it files its Schedule 13D. A Qualified Institutional Investor that loses its Schedule 13G eligibility may resume filing on Schedule 13G once it re-establishes its eligibility.

Practice Tip: Only a person who was initially eligible to report its beneficial ownership on a Schedule 13G and was later required to file a Schedule 13D may switch to reporting on a Schedule 13G. In such a case, the filing of the Schedule 13G will be deemed to amend the Schedule 13D, and no formal Schedule 13D amendment will be required. In the event that a person is not initially eligible to file a Schedule 13G and consequently files a Schedule 13D to report its holdings, then subsequently falls below the 5% threshold and files an amendment to the Schedule 13D to report this fact, it may thereafter qualify to file a Schedule 13G if its beneficial ownership of the reportable securities again rises above the 5% threshold (provided that it otherwise meets the eligibility criteria for use of Schedule 13G at such time).

Passive Investor. Any person who beneficially owns more than 5% (but less than 20%) of a company's reportable securities that were not acquired and are not held with the purpose or effect of changing or influencing the control of the company is eligible to file on Schedule 13G as a Passive Investor under Rule 13d-1(c).

Practice Tip: Officers or directors who beneficially own more than 5% of a class of their company's reportable securities are generally ineligible to file a Schedule 13G as a Passive Investor. The SEC has taken the position that regardless of any specific control intent, the ability of officers and directors to directly or indirectly influence a company's management and policies will generally render them unable to certify that the securities are not held with a control purpose or effect.

A Passive Investor that chooses to file a Schedule 13G must do so within 10 days of acquiring more than 5% of a company's reportable securities. The filing must be amended promptly when the investor acquires greater than 10% of the securities and thereafter promptly whenever beneficial ownership increases or decreases by more than 5%. As is the case for Qualified Institutional Investors, a Passive Investor must amend its Schedule 13G within 45 days after the end of the calendar year if there are any changes in the information previously reported.

A Passive Investor will lose its Schedule 13G eligibility on the date that it:

- acquires 20% or more of the company's reportable securities; or
- ceases to hold the securities as a passive investment.

Although the 20% threshold for loss of Schedule 13G eligibility creates no presumption as to whether an investor has a control purpose or effect, the SEC has noted that it would be unusual for an investor to be able to certify that it is a Passive Investor when its beneficial ownership approaches 20%. A Passive Investor that loses its Schedule 13G filing eligibility must file a Schedule 13D within 10 days of the date on which it loses its eligibility and will be subject to a "cooling-off" period until the expiration of the 10th day following its Schedule 13D filing. Like a Qualified Institutional Investor, a Passive Investor that loses its Schedule 13G filing eligibility may resume filing a Schedule 13G once it re-establishes its eligibility.

Practice Tip: Because a Passive Investor's Schedule 13G eligibility is conditioned on its beneficial ownership of reportable securities not exceeding 20% of the class, a Passive Investor that becomes a member of a group with aggregate beneficial ownership in excess of 20% will lose its Schedule 13G eligibility, regardless of whether the Passive Investor or the group as a whole seeks to maintain a passive investment. In that case, the Passive Investor must file a Schedule 13D with the SEC within 10 days of becoming a group member.

Recent Development: A Qualified Institutional Investor or Passive Investor will not lose its Schedule 13G eligibility solely as a result of engaging in activities in connection with a director nomination under Rule 14a-11, which gives shareholders the right, under certain circumstances, to include a nominee or nominees for director in a public company's proxy materials. However, other control-related activities outside of a Rule 14a-11 nomination may result in loss of Schedule 13G eligibility. These include approaching a company's board and urging them to consider strategic alternatives, or submitting a nomination pursuant to an applicable state or foreign law provision or a company's governing documents. For more information on Rule 14a-11, see "Proxy Statement and Annual Report Disclosures and Process – Recent Development – Final Proxy Access Rule."

Exempt Investor. A person who beneficially owns more than 5% of a company's reportable securities at the end of a calendar year but who has not made an acquisition subject to Section 13(d) is considered an Exempt Investor and is subject to reporting obligations under Section 13(g) and Rule 13d-1(d). Examples include investors who acquired their securities in a public company before the class of securities was registered in an IPO, as well as investors who acquired not more than 2% of a company's reportable securities within the preceding 12-month period. There are no restrictions on an Exempt Investor's investment intent or beneficial ownership percentage.

Exempt Investors must file their initial Schedule 13G within 45 days of the end of the calendar year in which they become subject to reporting obligations under Section 13(g) and Rule 13d-1(d). For instance, a pre-IPO investor who holds more than 5% of a class of a company's securities must file its Schedule 13G within 45 days after the end of the calendar year in which the class was registered under Section 12 of the Exchange Act. An Exempt Investor is required to amend its Schedule 13G filing within 45 days of the end of a calendar year to report any change in the information previously reported.

Practice Tip: An Exempt Investor will not lose its Schedule 13G eligibility simply because it holds reportable securities with the purpose or effect of changing or influencing control of the company. But it *will* lose its Schedule 13G eligibility if it joins with other investors to acquire, hold, vote or dispose of reportable securities with the purpose or effect of changing or influencing control of the company and the investors it joins hold in the aggregate more than 2% of the company's reportable securities. By joining the group, the Exempt Investor will be deemed to have acquired more than 2% of the company's reportable securities and will be required to file a Schedule 13D with the SEC within 10 days of becoming a group member.

Violations of Sections 13(d) or (g)

Penalties for failing to file a required Schedule 13D or 13G, or for filing a Schedule 13D or 13G containing false or misleading information, including as a result of the omission of required information, may include:

- imposition of a civil monetary penalty;
- an injunction to prevent further purchases pending corrective disclosure;
- a "cooling-off period" to allow adequate time for dissemination to and consideration of the information by the public; or
- an injunction preventing a group of bidders from voting its "tainted" shares other than in proportion to the votes cast by shares that were not "tainted."

Companies being targeted by an activist investor may wish to consider scrutinizing the investor's filings on Schedule 13D or 13G (or lack thereof) for possible Section 13(d) violations. Although Sections 13(d) and (g) do not provide an express private right of action to enforce violations of their reporting provisions, a number of courts have implied that such a right exists for purposes of seeking injunctive or other equitable relief. Accordingly, at least one federal appeals court has held that a company may sue for injunctive relief to remedy false or misleading Section 13(d) disclosures.[16] Furthermore, another federal appeals court has ruled that companies as well as members of company management have a private right of action to seek injunctive relief for Section 13(d) violations.[17] However, these decisions must be considered in light of

[16] GAF Corp. v. Milstein, 453 F.2d 709 (2d Cir. 1971).
[17] Ind. Nat'l Corp. v. Rich, 712 F.2d 1180 (7th Cir. 1983).

others which have held that Section 13(d) does not allow a company or its shareholders to a bring a private right of action for injunctive or other equitable relief.[18]

Section 16 of the Exchange Act

The general purpose of Section 16 of the Exchange Act is to deter corporate insiders – officers, directors and holders of greater than 10% of any class of a public company's equity securities – from trading in their companies' equity securities on the basis of nonpublic information. To achieve these ends, Section 16 takes a three-pronged approach. First, Section 16(a) requires insiders to publicly disclose holdings of and transactions in the company's equity securities. Second, Section 16(b) renders insiders liable to the company for the amount of any "short-swing" profits garnered in transactions involving the company's equity securities. Finally, Section 16(c) prohibits insiders from engaging in short sales of the company's equity securities.

There are three types of corporate insiders for purposes of Section 16: officers, directors, and greater than 10% shareholders. We refer to these three types of corporate insiders collectively as Section 16 insiders.

The company officers subject to Section 16 are:

- the president;
- the principal financial officer;
- the principal accounting officer (or, if there is no such accounting officer, the controller);
- any vice president in charge of a principal business unit, division or function (such as sales, administration or finance);
- any other officer who performs a significant policy-making function; and
- any other person who performs similar policy-making functions for the company.

[18] Leff v. CIP Corp., 540 F. Supp. 857 (S.D. Ohio, 1982); Liberty National Insurance Holding Co. v. Charter Co., 734 F.2d 545, 555-59 (11th Cir. 1984).

Officers of a company's parents or subsidiaries are deemed to be "officers" of the company for purposes of Section 16 if they perform policy-making functions for the company. Additionally, there is a presumption that the persons whom the company has identified as "executive officers" in the company's proxy statement or on its annual report on Form 10-K are also covered officers for purposes of Section 16.

Practice Tip: In order to avoid confusion about who is an "officer" for purposes of Section 16, the board may consider passing a resolution to identify by name those persons who fall within this category.

For purposes of Section 16, a "director" includes any director of a company or any person performing similar functions with respect to any organization. This definition should be broadly understood to encompass any person who performs the functions of a director, irrespective of the person's formal title. In addition, any person or entity that deputizes another to serve as its representative on a company's board of directors is also considered a "director" for purposes of Section 16.

A greater than 10% shareholder subject to Section 16 is any person who *beneficially owns*, directly or indirectly, more than 10% of any class of the company's equity securities registered under Section 12.

One frequent source of confusion is that beneficial ownership essentially has two meanings under Section 16. For purposes of determining whether a person is a greater than 10% shareholder subject to the reporting requirements of Section 16(a), a person is generally deemed to beneficially own any security over which the person has or shares voting or investment power. This is the same definition of beneficial ownership that is applicable under Section 13(d). As explained above, under this definition a person will generally be deemed to beneficially own a security if that person has or shares the power to: (i) vote, or direct the voting of, the security; or (ii) dispose, or direct the disposition of, the security. A person will also be deemed to beneficially own any equity securities that the person has the right to acquire within 60 days, as well as any shares beneficially owned by members of a Section 13(d) group of which the person is a member.

In contrast, for all other purposes under Section 16, including the determination of liability for short-swing profits under Section 16(b), a person will generally be deemed to "beneficially own" any equity security in which the person directly or indirectly, through any contract, arrangement, understanding, relationship or

otherwise, has or shares a direct or indirect "pecuniary interest." A person will be deemed to have a "pecuniary interest" in any class of equity securities if that person has the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in such securities. In determining whether a person has an indirect pecuniary interest in a security, there are special rules that apply in the following circumstances, among others:

- *Family Members.* There is a rebuttable presumption that a person has an indirect pecuniary interest in any securities held by members of that person's "immediate family" sharing the same household. For these purposes, a person's "immediate family" includes the person's spouse, children, stepchildren, grandchildren, parents, stepparents, grandparents, siblings, mother-in-law, father-in-law, sons-in-law, daughters-in-law, brothers-in-law and sisters-in-law.

- *General Partners of Investment Funds.* The general partner of a general or limited partnership that holds portfolio securities is deemed to have a proportionate beneficial interest in those securities equal to the greater of: (i) the general partner's share of the partnership's profits; or (ii) the general partner's share of the partnership capital account.

- *Trusts.* Depending upon the nature and structure of a trust, any of the trust or its settlor, trustees, beneficiaries or remaindermen may be deemed to have a pecuniary interest in securities held by the trust. However, a settlor, beneficiary or remainderman will not be deemed to beneficially own the securities held by the trust unless the person exercises "investment control" over such securities. Trustees, who generally have investment control over the trust's securities due to the nature of their duties, will be deemed to have a pecuniary interest in securities held by a trust in a variety of circumstances. For example, a trustee will be deemed to have a pecuniary interest in the trust's holdings if it receives certain non-qualifying performance-related fees. Likewise, a trustee will have a pecuniary interest in the trust's holdings if at least one beneficiary of the trust is a member of the trustee's immediate family. In the latter circumstance, the pecuniary interest of the immediate family member will be attributed to and reportable by the trustee.

The reporting obligations of Section 16(a), the liability provisions of Section 16(b) and the prohibition on short sales contained in Section 16(c) apply

generally to all equity securities of or relating to a public company which has any class of registered equity security. For purposes of Section 16, the SEC has by rule adopted a definition of "equity security" that is broader than the definition used for other purposes under the Exchange Act. Under Exchange Act Rule 3a11-1, the term "equity security" includes:

> . . . any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.

This definition encompasses not only the company's common stock, but also preferred stock, derivative securities (*e.g.*, stock options, warrants, convertible securities, and stock appreciation rights) and any other instrument that represents an equity stake in the company.

Section 16(a): Reporting Transactions by Insiders

As noted above, Section 16 insiders must file reports with the SEC disclosing their beneficial ownership of and transactions in a public company's equity securities. The three forms on which Section 16 insiders must make these reports – Forms 3, 4 and 5 – are described in greater detail below.

<u>Form 3: Initial Statement of Beneficial Ownership of Securities</u>. Section 16 insiders must file an initial report on Form 3 with the SEC within 10 days of becoming subject to Section 16. For a person who is elected an officer or director of a company that already has a class of equity securities registered under Section 12, the 10-day period begins when the person becomes an officer or director. Persons who are officers, directors or greater than 10% shareholders of a company that registers a class of equity securities (and did not previously have a class of registered equity securities) are required to file a Form 3 on the effective date of the company's registration statement. In any case, the Form 3 must disclose all equity securities of the company

that the Section 16 insider beneficially owned on the date the person became subject to Section 16. Even if a director or officer owns no securities on the date he or she became a Section 16 insider, he or she is still required to file a Form 3.

Recent Development: Section 929R of the Dodd-Frank Act amended Section 16 of the Exchange Act to authorize the SEC to establish by rule a shorter time period within which a new Section 16 insider would be required to file a Form 3. As this handbook goes to publication, the SEC has not proposed any rule change that would shorten the current 10-day reporting window.

Practice Tip: In order to assist incoming directors and officers in meeting their compliance obligations, companies generally require such persons to complete a questionnaire that requests information about their beneficial ownership of the company's securities.

In certain circumstances, the Section 16 insider should file an initial Form 3 earlier than is required. As discussed below, a Section 16 insider generally must report changes in his or her beneficial ownership of the company's equity securities within two business days. If the Section 16 insider's beneficial ownership of the company's equity securities changes between the date the Section 16 insider becomes subject to Section 16 and the date he or she must file a Form 3 (*e.g.*, where a new director is granted restricted stock upon his or her appointment), the SEC recommends that the Section 16 insider file an initial Form 3 concurrently with a Form 4 reporting the change, notwithstanding that the rules permit the Form 3 to be filed at a later date.

Form 4: Statement of Changes in Beneficial Ownership. After filing a Form 3, a Section 16 insider must report any subsequent change in his, her or its beneficial ownership of the company's equity securities by filing a Form 4 within two business days, unless the transaction is exempt from reporting or is eligible for deferred reporting.

Stock options are derivative securities for purposes of Section 16(a). Therefore, a Section 16 insider must report on Form 4, within two business days, any grant of options or any other acquisitions of the company's equity securities. Similarly, the Section 16 insider must report on Form 4 any exercise or conversion of a derivative security of the company.

Practice Tip: In the case of an open market purchase or sale, it is the date the transaction is executed, not the settlement date, that triggers the two-business-day deadline. Therefore, a Section 16 insider and its broker should develop a system to ensure prompt communication as soon as any transaction is executed.

Transactions that must be reported on Form 4 include, but are not limited to:

- non-exempt purchases and sales of equity securities held in the Section 16 insider's name;
- transactions involving equity securities held by others but that the Section 16 insider is deemed to beneficially own (*i.e.*, equity securities in which the Section 16 insider has a "pecuniary interest," as discussed above);
- exercises or conversions of derivative securities;
- acquisitions and grants of any of the company's equity awards (including options), even if not presently exercisable;
- entry into various other derivative transactions, including equity swaps and similar hedges;
- awards to non-employee directors made pursuant to equity incentive plans;
- equity securities received from a non-exempt dividend reinvestment; and
- dispositions of equity securities to the company (*e.g.*, the company's retention of shares to pay the Section 16 insider's tax withholding obligation upon the exercise of stock options).

Following an IPO, the directors and officers of the previously non-public company may be required to report certain pre-IPO transactions in the company's equity securities. Such a filing obligation may arise if the director or officer engages in a reportable transaction less than six months after the date that the company's registration statement became effective. In such event, the director or officer is

required to "look back" for a period of six months from the date of the reportable transaction and report on its first required Form 4 any transactions in the company's equity securities that occurred during that period. Persons who are Section 16 insiders by virtue of being greater than 10% shareholders are not subject to this six-month look-back period.

Depending upon the circumstances, a covered officer or director may also be required to report transactions in the company's equity securities that occurred after the termination of that person's officer or director status. An otherwise reportable transaction occurring after the cessation of a person's officer or director status will be reportable on Form 4 if (and only if) the transaction is not exempt from Section 16(b) and occurs within six months of an "opposite way" transaction that was also subject to Section 16(b) and occurred while the person was still a director or officer. For purposes of this rule, an acquisition and subsequent disposition (or vice versa) are considered "opposite way" transactions. In contrast, a person who is a Section 16 insider solely by virtue of being a greater than 10% shareholder ceases to be subject to Section 16 reporting requirements once the person ceases to be a greater than 10% shareholder.

The SEC has adopted a variety of exemptions from the reporting requirements of Section 16(a) based upon the nature of the transaction. These exemptions apply to the following types of transactions:

- any increase or decrease in the number of equity securities held as a result of a stock split or a stock dividend applying equally to all securities of a class;
- the acquisition of rights, such as shareholder or preemptive rights, pursuant to a pro rata grant to all holders of the same class of registered equity securities;
- transactions that effect only a change in the form of beneficial ownership without changing the person's pecuniary interest in the subject equity securities (note, however, that this exemption does not cover the exercise and conversion of derivative securities or deposits to and withdrawals from voting trusts);
- certain transactions pursuant to tax-conditioned employee benefit plans;
- acquisitions made pursuant to a dividend reinvestment plan, provided that the plan meets certain requirements specified in Rule 16a-11 under the Exchange Act;

- acquisitions or dispositions of an equity security pursuant to a domestic relations order;
- the disposition or closing of a long derivative security position as a result of cancellation or expiration, provided that the Section 16 insider receives no value in exchange for the expiration or cancellation;
- transactions effected by a person who was not a director, officer or greater than 10% shareholder at the time of the transaction;
- under certain circumstances, transactions occurring after the termination of insider status (see above discussion); and
- transactions by a greater than 10% shareholder that occur after the company's termination of its registration under Section 12 of the Exchange Act, or transactions by a director or officer that occur not less than six months after such termination.

In addition to the above exemptions, the SEC has adopted a number of exemptions based upon the status of the Section 16 insider. Depending on the circumstances, certain of these exemptions may be available to executors and other fiduciaries, odd-lot dealers, market makers, arbitrageurs, and underwriters and other persons who participate in a distribution of the company's equity securities.

Form 5: Annual Statement of Changes in Beneficial Ownership. A Section 16 insider must report certain transactions on a year-end report on Form 5 within 45 days after the end of the company's fiscal year. Some transactions, most notably gifts, are not required to be reported on Form 4, but must be reported on Form 5. A Section 16 insider is required to file a year-end Form 5 to report any transaction that the person should have reported during the fiscal year on Form 3 or Form 4, but did not. Transactions reportable on Form 5 are limited to the following:

- certain transactions occurring during the most recent fiscal year that are exempt from short-swing profit liability under Section 16(b), such as bona fide gifts of the company's equity securities, but excluding exempt transactions which involve the company;

- qualifying *de minimis* acquisitions of the company's equity securities;[19] and
- transactions that the Section 16 insider should have reported on Form 3 or Form 4 during the most recent fiscal year, but did not.

Disclosure of Reporting Delinquencies; Compliance Programs. Item 405 of Regulation S-K requires a company to disclose in its annual proxy statement and annual report on Form 10-K certain information regarding the failure of any Section 16 insider to timely file a Section 16 report during the previous fiscal year or prior fiscal years. For each such delinquent Section 16 insider, the company is required to set forth the number of late reports, the number of transactions that were not reported on a timely basis, and any known failure to file a required Form 3, 4 or 5. Although there is no official sanction placed upon the company as a result of the filing delinquencies of its insiders, such disclosures are potentially embarrassing.

Accordingly, every public company should develop and implement a strong compliance program to ensure that its directors and officers timely file all required reports. In addition to minimizing the potential for embarrassing disclosures of the type described above, a strong compliance program will assist the company's directors and officers in avoiding both short-swing liability under Section 16(b) and SEC enforcement actions to enforce Section 16(a)'s reporting requirements.

Filing Procedures and Website Posting. All Section 16(a) reports must be filed with the SEC electronically using the SEC's EDGAR filing system, and all reports become publicly available immediately upon filing. In order to file electronically, a Section 16 insider must first file a Form ID and obtain EDGAR filing codes, including a Central Index Key (CIK), a CIK Confirmation Code (CCC) and an EDGAR password. Information on becoming an EDGAR filer is available at the SEC's EDGAR Filer Management website at https://www.filermanagement.edgarfiling.sec.gov/

[19] A *de minimis* acquisition of the company's securities is eligible for deferred reporting on a year-end Form 5 if: (i) the acquisition, when aggregated with all other unreported and non-exempt acquisitions of securities of the same class within the prior six months, does not exceed $10,000 in market value; and (ii) the Section 16 insider does not, within six months thereafter, make any disposition of the securities, other than by a transaction exempt from Section 16(b). However, once these conditions are no longer met, the Section 16 insider is required to report all previously deferred small acquisitions on Form 4 within two business days of the date the conditions are no longer satisfied. Further, acquisitions of a *de minimis* amount of securities from the company, including acquisitions pursuant to an employee benefit plan sponsored by the company, are not eligible for deferred reporting on a year-end Form 5.

Directors and officers commonly authorize certain employees of the company to prepare and file all necessary Section 16(a) reports on their behalf. The power-of-attorney granting these authorizations must be filed as an exhibit to the insider's first Section 16(a) report signed under the power-of-attorney.

> **Practice Tip**: Before applying for EDGAR filing codes on behalf of an incoming director or officer, a company should: (i) consider obtaining a power-of-attorney from the person; and (ii) verify that the person has not already obtained EDGAR filing codes in connection with reporting requirements for another company.

A company that maintains a corporate website must post any Form 3, 4 or 5 filed with respect to its securities by the end of the business day after the filing. Each filing must remain accessible on the company's website for a 12-month period thereafter.

SEC Enforcement Actions. There are a number of means by which the SEC is authorized to enforce compliance with Section 16(a). First, the SEC may issue a cease-and-desist order requiring the respondent to cease and desist from committing further violations of Section 16(a). Such an order may be issued to a Section 16 insider (for failure to timely file reports) or the company that issued the securities (for failure to properly disclose filing delinquencies by its Section 16 insiders). Second, the SEC may seek civil monetary penalties in federal court under Section 21(d)(3) of the Exchange Act. Finally, the SEC may seek injunctive relief under Sections 21(d) and (e) of the Exchange Act.

Section 16(b): Liability for "Short-Swing" Profits

Under Section 16(b), any "short-swing" profit that a Section 16 insider realizes from trading in the company's securities or derivatives thereof (whether or not issued by the company) is subject to disgorgement. A "short-swing" profit is any "profit" resulting from any combination of purchase and sale or sale and purchase of the company's equity securities, including "derivative securities," within six months of each other. As noted above, "derivative securities" include puts, calls, options, equity swaps and other rights. To determine whether a Section 16 insider has realized a "profit," the highest sale price within the six-month period is matched against the lowest purchase price. Due to the manner in which "profit" is computed – the so-called "highest-in, lowest-out" method – it is possible for a Section 16 insider to suffer a loss from a series of transactions yet still be subject to short-swing profit liability.

Practice Tip: The sale or purchase of company securities by a Section 16 insider's spouse, minor children or other relatives who share the Section 16 insider's home may be matched against transactions made by the Section 16 insider, if such transactions are made within a six-month period. Section 16(b) is full of such traps and difficulties. For example, purchases or sales by others of shares in which the Section 16 insider is deemed to have a "pecuniary interest" will be matched against the Section 16 insider's own transactions.

Liability under Section 16(b) is imposed in a mechanical fashion without regard to the Section 16 insider's intent, and good faith is not a valid defense. All that is necessary for a successful claim is to show that the Section 16 insider realized profits on a short-swing transaction.

A Section 16 insider may be liable even if different shares were involved in the purchase and sale transactions or if losses were incurred on transactions in the same period. In addition, the terms "purchase" and "sale" are broadly defined and are not limited to their traditional meanings. Examples of transactions that may constitute a sale under Section 16(b) include the sale of pledged stock by a pledgee and certain conversions or redemptions of securities.

Section 16(b) is also applicable to a transaction by a covered officer or director that occurs after the person ceases to be an officer or director, provided that it is a transaction not exempt from Section 16(b) occurring within six months of an opposite-way, non-exempt transaction that occurred while the person was an officer or director. However, Section 16(b) is not applicable to transactions by an officer or director that occurred before the person became an officer or director. Similarly, transactions by a greater than 10% shareholder are only subject to Section 16(b) to the extent that they take place during the period in which the person is a greater than 10% shareholder. Accordingly, the purchase that brings a shareholder over the 10% threshold may not be matched against subsequent transactions for purposes of establishing short-swing profit liability. Likewise, a transaction that occurs after the former greater than 10% shareholder has fallen below the 10% threshold cannot be matched against a transaction that occurred prior to that time, even if the two transactions are within six months of each other.

Certain other transactions are exempt from Section 16(b), including:

- transactions exempt from the reporting requirements of Section 16(a);
- certain transactions between the company and its officers or directors (as discussed in greater detail below);
- gifts and inheritances; and
- exercises and conversions of stock options and other derivative securities.

As noted above, certain transactions between a company and its officers or directors (but not a greater than 10% shareholder) are exempt from Section 16(b). Under Rule 16b-3 under the Exchange Act, a transaction between a company (including an employee benefit plan sponsored by the company) and an officer or director of the company will be exempt from Section 16(b) if it meets certain specified conditions, as follows:

- A transaction (other than a "Discretionary Transaction"[20]) pursuant to a company's 401(k) plan, a qualified employee stock purchase plan or certain other tax-conditioned plans will generally be exempt from Section 16(b).
- A Discretionary Transaction will be exempt only if it is effected pursuant to an election made at least six months following the date of the most recent election that effected an "opposite way" Discretionary Transaction under a company plan.
- Any acquisition from the company other than a Discretionary Transaction (*e.g.*, a grant or award) will be exempt from Section 16(b) if it is: (i) approved in advance by the board or a committee of the board that is composed solely of two or more non-employee directors; or (ii) approved or ratified by a majority of the company's shareholders. Such acquisitions will also be exempt from Section 16(b) if the officer or director holds the securities acquired for a period of at least six months following the date of acquisition.

[20] A Discretionary Transaction is a transaction pursuant to an employee benefit plan that: (i) is at the volition of a plan participant; (ii) is not made in connection with the participant's death, disability, retirement or termination of employment; (iii) is not required to be made available to a plan participant pursuant to a provision of the Internal Revenue Code; and (iv) which results in either an intra-plan transfer involving an company equity securities fund, or a cash distribution funded by a volitional disposition of a company equity security.

- Any disposition to the company other than a Discretionary Transaction will be exempt from Section 16(b) if it is approved in advance in the manner prescribed in (i) or (ii) of the previous bullet.

By law, a company cannot waive or release any claim it may have against a Section 16 insider, or enter into an enforceable agreement to provide indemnification for amounts recovered. If the company fails to pursue recovery itself within 60 days, any shareholder of the company may bring an action against the Section 16 insider. An active group of plaintiffs' attorneys monitors Section 16(a) reports for short-swing transactions.

Section 16(c): Prohibition of Short Sales by Insiders

Section 16(c) prohibits Section 16 insiders from effecting "short sales" and "sales against the box" of the company's equity securities. A "short sale" is the sale of securities that the seller does not own and that the seller delivers with borrowed securities or securities which it later acquires. A "sale against the box" is the sale of securities that the seller owns but does not promptly deliver after the sale.

FOREIGN PRIVATE ISSUER REPORTING AND COMPLIANCE

Public companies are generally subject to different obligations under U.S. federal securities laws depending on whether they are classified as U.S. domestic companies or foreign private issuers. Because foreign private issuers are granted many accommodations which are unavailable to U.S. domestic companies, including generally less stringent reporting and corporate governance requirements, it is important for a company to consider whether it qualifies as a foreign private issuer. In addition to discussing the criteria for determining foreign private issuer status, the following discussion outlines the Exchange Act registration, reporting and corporate governance obligations applicable to foreign private issuers, as well as the rules by which a foreign private issuer can deregister and no longer be subject to those obligations.

Determining Foreign Private Issuer Status

To be considered a "foreign private issuer," a company must be incorporated or organized under the laws of a non-U.S. jurisdiction and must not be owned and operated primarily in the United States. A company will be considered to be owned and operated primarily in the United States if:

- more than 50% of the company's outstanding voting securities are owned by U.S. residents; and
- any of the following is true:
  - a majority of the company's executive officers or directors are U.S. citizens or residents;
  - more than 50% of the company's assets are located in the United States; or
  - the company's business is managed primarily in the United States.

Ownership Test. To determine whether the owners of a company's outstanding voting securities are U.S. residents, the company must first review its records and count the number of record holders with a U.S. address. In addition, the company must "look through" accounts held by brokers, dealers, banks and other nominees, count the number of separate accounts for which securities are held and determine the amount of securities beneficially owned by U.S. residents. A company must make this determination with respect to nominee accounts located in the United States, as well as those located in the company's home market and principal trading market. If the company cannot, after reasonable inquiry, determine the jurisdiction in which a

beneficial owner of its securities resides, it may assume that the owner resides in the jurisdiction in which its nominee has its principal place of business.

Status Review. A company that qualifies as a foreign private issuer must review its status each year at the end of its second fiscal quarter. If at that time the company no longer qualifies as a foreign private issuer, it will be treated as a U.S. domestic company beginning on the first day of the company's next fiscal year. For the remainder of the company's fiscal year, however, it may continue to file reports and be treated as a foreign private issuer. It cannot reestablish its foreign private issuer status until the end of the second fiscal quarter of the following year.

Practice Tip: If a company that qualifies as a foreign private issuer at the end of its most recently completed second fiscal quarter reincorporates in the United States, it will immediately lose its foreign private issuer status. A U.S.-domiciled company can never be a foreign private issuer, no matter how few U.S. shareholders it may have or where its assets, business, officers or directors are located. Accordingly, following reincorporation, the U.S.-domiciled company must immediately begin filing Exchange Act reports on domestic issuer forms.

Exchange Act Registration

A foreign private issuer must register a class of its securities under the Exchange Act in either of two circumstances:

U.S. Stock Exchange Listing. Under Section 12(b) of the Exchange Act, a foreign private issuer must register any class of its securities that will be listed on a U.S. stock exchange, such as the NYSE or NASDAQ. In addition to the periodic reporting requirements and other federal securities law obligations that accompany Exchange Act registration, a foreign private issuer with securities listed on a U.S. stock exchange must also abide by the listing standards of the relevant exchange. These listing standards, which generally contain favorable accommodations for foreign private issuers, are discussed more fully in the "Stock Exchange Listing Requirements" section of this handbook.

Substantial U.S. Presence. Under Section 12(g) of the Exchange Act, a foreign private issuer with more than $10 million in assets must register any class of its equity securities which is held by at least 500 persons, 300 or more of whom are U.S. residents.

Exchange Act Reporting and Other Obligations

Following the registration of a class of its securities under the Exchange Act or the registration of a transaction under the Securities Act, a foreign private issuer and its significant shareholders become subject to certain reporting requirements under the Exchange Act and to other obligations under the U.S. federal securities laws. These include:

- filing or furnishing periodic reports required by Sections 13(a) or 15(d) of the Exchange Act, such as annual reports on Form 20-F and current reports on Form 6-K;
- filing beneficial ownership reports on Schedules 13D or 13G; and
- complying with various obligations under SOX and the Dodd-Frank Act.

Annual Report on Form 20-F

A foreign private issuer with securities registered under the Exchange Act must file with the SEC an annual report on Form 20-F within six months after the end of its fiscal year. For fiscal years ending on or after December 15, 2011, the filing deadline is shortened to four months after the end of the foreign private issuer's fiscal year. The annual report must be in English and filed electronically via the SEC's EDGAR system.

The annual report on Form 20-F requires detailed disclosure about the foreign private issuer's business, management, operating results and financial condition. Among the disclosure requirements for the annual report is information about and descriptions of:

- the company's business, property and organizational structure, including its material contracts;
- the company's directors and officers, including descriptions of any arrangements pursuant to which any of them were selected for the position, their compensation for the most recent fiscal year and their accrued pension or similar benefits;
- the number of employees, including, if possible, a breakdown by categories of activities, any significant period to period change, and any arrangements for involving employees in ownership of the company;

- certain related party transactions between the company and its officers, directors and principal shareholders;
- any home country exchange control regulations and any other home country regulations that affect the company's business;
- certain disclosure regarding management's assessment of the company's disclosure and financial reporting procedures and controls, and certifications from the company's principal executive officer and principal financial officer required under Sections 302 and 906 of SOX (discussed further in the section of this handbook entitled "The Sarbanes-Oxley Act");
- the company's audit committee, its code of ethics applicable to its principal executive, financial and accounting officers, and services performed by and fees paid to its principal outside auditing firm; and
- certain selected financial information for the issuer's five most recent fiscal years.

In addition to the textual disclosure outlined above, foreign private issuers are required to include in the Form 20-F full financial statements, audited in accordance with U.S. GAAP, IFRS as issued by the IASB (without a reconciliation to U.S. GAAP), or other GAAP or IFRS standards reconciled to U.S. GAAP, for the issuer's most recent three fiscal years. Further, Item 5 of the Form 20-F annual report, entitled "Operating and Financial Review and Prospects," requires the company's management to explain the factors driving the company's financial condition and operating results and discuss the trends shaping its future prospects. This information is akin to the MD&A section in a U.S. domestic company's annual report on Form 10-K, the requirements for which are discussed more fully in the "Periodic and Current Reporting under the Exchange Act" section of this handbook. In December 2003, the SEC offered interpretive guidance[21] on preparing this section, which it views as critical to enabling investors to assess a company through the eyes of its management. Companies should carefully review that guidance in addition to the particular Form 20-F item requirements when preparing the annual report.

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[21] Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 33-8350, Exchange Act Release No. 34-48960, [2003-2004 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 87,127 (Dec. 29, 2003), *available at* http://www.sec.gov/rules/interp/33-8350.htm#P24_4941.

Current Reports on Form 6-K

In addition to the annual report on Form 20-F, foreign private issuers subject to the Exchange Act's reporting requirements are required to disclose the occurrence of one or more specified events in a current report on Form 6-K. Current reports on Form 6-K are analogous to the current reports on Form 8-K that must be filed by domestic reporting companies, and which are discussed further in the section of this handbook entitled "Periodic and Current Reporting under the Exchange Act." A foreign private issuer must report on Form 6-K any material information that it makes public in its home country or sends to a stock exchange or its shareholders. Materials filed under cover of Form 6-K include press releases, shareholder reports and other material information relating to any of the following:

> **Practice Tip:** Reports furnished under Form 6-K are not deemed to be "filed" for purposes of Section 18 of the Exchange Act and potential liability for false or misleading statements of material fact imposed under that section.

- changes in the company's business;
- changes in the company's management or control;
- acquisitions or dispositions of assets;
- bankruptcy or receivership;
- changes in the company's certifying accountants;
- the company's financial condition and results of operations;
- material legal proceedings;
- changes in securities or in the security for registered securities;
- defaults upon senior securities;
- material increases or decreases in the amount of outstanding securities or indebtedness;
- the results of the submission of a matter to a vote of security holders;
- transactions with directors, officers or principal security holders;
- the granting of options or payment of other compensation to directors or officers; and
- any other information the company considers to be of material importance to security holders.

With certain limited exceptions, Form 6-K must be submitted to the SEC electronically via EDGAR promptly following the event to be reported. Failure to promptly submit a Form 6-K report may result in a foreign private issuer becoming ineligible to offer its securities on Form F-3, the "short-form" Securities Act registration statement.

Beneficial Ownership Reporting on Schedules 13D or 13G

Shareholders who acquire beneficial ownership of more than 5% of a class of shares registered under Section 12 of the Exchange Act must file a report with the SEC on Schedule 13D or, if eligible, on short-form Schedule 13G. These reporting obligations, which are discussed more fully in the "Ownership and Trading Reports by Management and Large Shareholders" section of this handbook, apply regardless of whether the registered shares are issued by a foreign or domestic company. Shareholders who acquire a foreign private issuer's American Depositary Receipts (ADRs) must file the required Schedule 13D or 13G report if the class of shares underlying the ADRs is registered under Section 12 and the acquirer beneficially owns more than 5% of all outstanding shares of the class.

Sarbanes-Oxley Act Obligations

SOX applies to all companies that are required to file reports under the Exchange Act, regardless of whether the company is a domestic company or a foreign private issuer. As discussed more fully in the section of this handbook entitled "The Sarbanes-Oxley Act," the SOX requirements are far-reaching and have resulted in significant changes to the corporate governance and disclosure practices of Exchange Act reporting companies. Many of these changes have been implemented through amendments to the Exchange Act, while others are reflected in SEC rules and stock exchange listing requirements. Despite the general uniformity of SOX's application to U.S. companies and foreign private issuers, the SEC and the stock exchanges have adopted various exemptions to SOX requirements which benefit foreign private issuers. We note these exemptions below in the course of our discussion of the general SOX requirements which affect foreign private issuers.

Practice Tip: Foreign private issuers that furnish information to the SEC under Rule 12g3-2(b) of the Exchange Act are generally not subject to SOX. We discuss the Rule 12g3-2(b) exemption from Exchange Act reporting in greater detail below.

Enhanced Audit Committee Standards and Audit Protections

Audit Committee Standards. Foreign private issuers with securities listed on a U.S. stock exchange must comply with certain listing standards designed to improve the effectiveness and ensure the independence of the company's audit committee. Among other things, these standards require that the audit committee:

- be directly responsible for appointing, compensating and overseeing the work of the company's independent auditors and the auditors must report directly to the audit committee;
- establish procedures to receive and handle complaints regarding accounting, internal controls or auditing matters, including procedures which enable employees to submit accounting or auditing concerns confidentially and anonymously;
- have authority to engage independent counsel and other advisers;
- be provided with appropriate funding to pay administrative expenses and to compensate the auditor and other advisers; and
- be composed entirely of members who are "independent" under Rule 10A-3 of the Exchange Act and the listing requirements of the relevant exchange.

The required standards are not intended to conflict with or affect the application of any requirements imposed on a foreign private issuer by its organizational documents or home country laws and practices, and instead relate to the allocation of responsibility between the audit committee and the issuer's management. Accordingly, a foreign private issuer's shareholders may vote on, approve or ratify auditor selection, compensation and termination if permitted or required to do so by the issuer's organizational documents or home country laws and practices, so long as any recommendation or nomination that the issuer provides to shareholders on those matters comes from the audit committee. In addition, if a foreign private issuer's organizational documents or home country laws and practices prohibit or limit the degree to which its board can delegate the above responsibilities to the audit committee, or vest such responsibilities in a government entity, then the audit committee must be granted those responsibilities to the extent permitted by law.

To be considered independent under Rule 10A-3, an audit committee member generally may not be an "affiliated person" of the company or accept any consulting, advisory or other compensatory fee from the company or its affiliates other than in the

member's capacity as a director. Foreign private issuers, however, may avail themselves of certain exemptions from the definition of "independence." These exemptions, which are discussed in the section of this handbook entitled "The Sarbanes-Oxley Act," are generally designed to allow a foreign private issuer to follow the practices required by its organizational documents and home country laws and practices. For example, a foreign private issuer may include on its audit committee a non-management employee representative, a non-management affiliated person with only observer status, such as a controlling shareholder, or a non-management governmental representative. Furthermore, foreign private issuers may rely on exemptions from the independence requirements for a transitional period following an initial public offering. A foreign private issuer must disclose its reliance on any of these exemptions in its annual report on Form 20-F and evaluate the impact of the variance from the general independence requirements (see "Enhanced Disclosure Requirements" below).

Anti-Manipulation Rules. Under Rule 13b2-2 of the Exchange Act, directors and officers of a foreign private issuer, or any other person acting under the direction of a director or officer, are prohibited from taking any action to improperly influence an auditor for the purpose of rendering the company's financial statements materially misleading.

Management Certifications, Evaluations and Reports

Disclosure Controls and Procedures. Foreign private issuers must design and evaluate the controls and procedures used to ensure that information the company is required to disclose in its Exchange Act reports is accurately compiled and communicated to management in time to allow timely decisions regarding required disclosure. U.S. domestic companies are required to evaluate the effectiveness of their disclosure controls quarterly, whereas foreign private issuers must do so on a yearly basis.

Internal Control Over Financial Reporting. The foreign private issuer's annual report on Form 20-F must contain a report by management on internal control over financial reporting which includes an assessment of the effectiveness of the internal control structure and procedures for financial reporting as of the end of the fiscal year and the framework used to assess the effectiveness, and disclosure of certain changes in internal control over financial reporting. If the foreign private issuer is an accelerated filer or a large accelerated filer, the annual report must also contain an

auditor attestation report expressing an opinion on management's assessment of internal control over financial reporting.

> **Recent Development:** Pursuant to Section 989G of the Dodd-Frank Act, foreign private issuers that are smaller reporting companies or non-accelerated filers are no longer required to include an auditor attestation report on management's assessment of internal control over financial reporting in their Form 20-F. Section 989G amended SOX to require that only companies that are accelerated filers or large accelerated filers must include such an auditor attestation report in their annual report.

Management Certifications. The foreign private issuer's principal executive officer and principal financial officer must provide certain written certifications with the company's annual report on Form 20-F.

- Section 302 of SOX requires the relevant officers to certify that the annual report does not contain any untrue statement of a material fact; that the financial statements and other financial information fairly present in all material respects the financial condition, results of operations and cash flows of the company; and certain aspects of the design, evaluation and effectiveness of the company's disclosure controls and procedures and internal control over financial reporting.
- Section 906 of SOX requires the relevant officers to certify that the annual report fully complies with the Exchange Act and the information in the report fairly presents in all material respects the financial condition and operations of the company.

Financial Restrictions Applicable to Company Insiders

No Personal Loans to Executives. Subject to certain exceptions, SOX prohibits foreign private issuers from extending or maintaining credit, arranging for the extension of credit, or renewing an extension of credit in the form of a personal loan to or for any director, executive officer, or any person holding an equivalent position.

Regulation BTR – Blackout Trading Restriction. Regulation BTR prohibits a foreign private issuer's directors and executive officers from purchasing, selling or otherwise acquiring or transferring any of the company's equity securities (other than exempted securities) during any "blackout period" with respect to the securities if the person acquired the securities in connection with his or her service or employment with the company. A blackout period is any period of more than three consecutive business days during which the ability to purchase or sell an interest in the company's securities held in an "individual account plan," such as 401(k) or other defined contribution plan, is temporarily suspended with respect to not less than 50% of the participants or beneficiaries, the plan is located in the United States, and those participants or beneficiaries number at least 50,000 or in excess of 15% of the total number of employees of the company and its consolidated subsidiaries.

For each blackout period, the company must notify in a timely manner each director or officer and the SEC and provide additional information, such as the reason for the blackout period. U.S. domestic companies are required to notify the SEC promptly by filing a report on Form 8-K. In contrast, foreign private issuers, although encouraged to notify the SEC of the blackout period by filing a report on Form 6-K, are only required to file the notice as an exhibit to their annual report on Form 20-F.

Persons who trade a foreign private issuer's securities in violation of Regulation BTR are liable to the company for any profits received through those trades. In addition, if a shareholder of the foreign private issuer requests the company to commence an action to recover profits made in violation of Regulation BTR and the company fails to do so within 60 days of the request, the shareholder may initiate a derivative action to recover the profit on the company's behalf.

Practice Tip: The blackout trading restrictions of Regulation BTR do not apply to an individual account plan maintained outside of the United States primarily for the benefit of nonresident aliens, or to a plan which has been approved by a foreign taxing authority or is eligible for preferential treatment under the tax laws of a foreign jurisdiction because the plan provides for broad-based employee participation.

Repayment of Certain Bonuses. If a foreign private issuer is required to prepare an accounting restatement due to the company's material noncompliance, as a result of misconduct, with any financial reporting requirement under the securities laws, SOX requires the company's principal financial officer and principal executive officer to reimburse the company for any bonus or other incentive-based or equity-based compensation received from the company during the 12-month period following the first public issuance or filing with the SEC (whichever is first) of the financial document being restated, and any profits received from the sale of the company's securities during that period. See also the section of this chapter entitled "Dodd-Frank Act Obligations—Corporate Governance" below regarding potential additional clawback requirements that may apply to foreign private issuers following the enactment of the Dodd-Frank Act.

> **Practice Tip:** Neither SOX nor the SEC's implementing rules clarify what constitutes "misconduct," but U.S. federal courts have held that a CEO or CFO must reimburse the company for any covered compensation or profits regardless of whether or not the person knew of or engaged in the misconduct which led to the restatement. It is unclear how these rules would be enforced in the event the repayment obligation would violate the employee's rights under home country law.

Enhanced Disclosure Requirements

Annual Report on Form 20-F. In its annual report on Form 20-F, a foreign private issuer must include the following additional disclosures:

- any "material correcting adjustments" to the company's financial statements which have been identified by the company's independent auditors;
- any off-balance sheet arrangements;
- certain contractual obligations in specified tabular form;
- certain additional information in connection with the use of non-GAAP financial measures, such as EBITDA, including appropriate quantitative reconciliations;
- whether the company's audit committee has at least one member who is an "audit committee financial expert" under SEC rules and whether that member is independent;
- if the company does not have an audit committee financial expert, an explanation of why not;

- if the company is relying on any exemptions from the independence requirements for audit committees available under Rule 10A-3 of the Exchange Act, a statement to that effect, including whether the reliance will have a material adverse effect on the audit committee's ability to act independently and satisfy the other requirements of Rule 10A-3;
- the amount of professional fees paid to the company's auditor for audit and non-audit services and the company's pre-approval policies with respect to the provision of non-audit services;
- whether the company has adopted a code of ethics for senior financial officers, and if not, why not;
- whether the company has amended its code of ethics or granted any waivers under it during the past year; and
- the text of the company's code of ethics, either as an exhibit to the annual report or on the company's website.

Regulation G. Regulation G, which governs the use of non-GAAP financial measures contained in a company's financial statements, press releases and other public information, requires a company that presents such measures to do so in a manner that is not misleading, include the most directly comparable financial measure calculated and presented in accordance with GAAP, and include a quantitative reconciliation to that measure. Although Regulation G applies generally to foreign and domestic companies, a foreign private issuer is exempted if:

- its securities are listed or quoted on an non-U.S. exchange;
- the non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with U.S. GAAP; and
- the disclosure is made or included in a communication outside the United States prior to or contemporaneously with the release in the United States and the release is not otherwise targeted at persons located in the United States.

Dodd-Frank Act Obligations

Although its principal impact is on the financial services sector, the Dodd-Frank Act also includes significant corporate governance and securities law reforms affecting public companies, including foreign private issuers whose securities are listed in the United States. At present, the full extent of the Dodd-Frank Act's impact on foreign private issuers remains unclear, as many of the Act's provisions await implementation by SEC regulations and stock exchange listing requirements. A general overview of the key corporate governance and securities law provisions of the Dodd-Frank Act appears in the section of this handbook entitled "The Dodd-Frank Wall Street Reform and Consumer Protection Act." We discuss below certain Dodd-Frank Act provisions that are likely to be of interest to foreign private issuers.

Corporate Governance

Many of the corporate governance reforms contained in the Dodd-Frank Act relate to the U.S. proxy rules and proxy statement disclosure requirements, which do not generally apply to foreign private issuers. These reforms include the Dodd-Frank act provisions concerning "say-on-pay," proxy access, disclosure of executive compensation and golden parachute arrangements, pay vs. performance, employee and director hedging policies, and board leadership structures. Nevertheless, subject to any exemptions that the SEC may provide in its implementing rules, the following Dodd-Frank Act corporate governance provisions could apply to foreign private issuers:

Compensation Committee Independence. Section 952 of the Dodd-Frank Act directs the SEC to issue rules requiring U.S. stock exchanges to prohibit the listing of any company unless all members of its compensation committee are independent, taking into account relevant factors to be established by the SEC, such as the source of the member's compensation, including any consulting, advisory or other fees, and the affiliations of the member with the company and its subsidiaries and affiliates. These independence requirements do not apply to foreign private issuers that annually disclose to their shareholders the reasons why they do not have an independent compensation committee.

Compensation Consultants and Advisors. Section 952 of the Dodd-Frank Act also requires that public company compensation committees have the authority to retain their own compensation consultants, independent legal counsel and other advisors, and that such committees be directly responsible for the compensation and oversight of such advisors. A compensation committee is not, however, required to

implement any advice received from an advisor so retained. Public companies must provide appropriate funding to the compensation committee to retain such advisors. In addition, Section 952 directs the SEC to issue rules requiring U.S. stock exchanges to prohibit the listing of any company whose compensation committee engages a consultant, legal counsel or other advisor without taking into consideration factors identified by the SEC as affecting the independence of such advisors.

Pay Equity. Section 953 of the Dodd-Frank Act directs the SEC to amend Item 402 of Regulation S-K to require that public companies disclose the median of the total annual compensation of all employees other than the CEO, the total annual compensation of the CEO, and a ratio comparing the two amounts. The calculations must be determined in accordance with the rules for named executive officer compensation. Although this "pay equity" provision is akin to the "pay vs. performance" and other proxy statement disclosure requirements which are generally inapplicable to foreign private issuers, the provision applies to any filings described in Item 10(a) of Regulation S-K (which includes "annual or other reports under sections 13 and 15(d) . . . and any other documents required to be filed under the Exchange Act"). Accordingly, it is unclear whether this provision will be applied to foreign private issuers.

Incentive Compensation Clawback Policy. Section 954 of the Dodd-Frank Act provides that the SEC must issue rules requiring U.S. securities exchanges to prohibit the listing of any company that does not adopt and implement clawback policies which enable the company to recover incentive-based compensation from current or former executive officers in the event the company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws. The clawback would apply to any incentive-based compensation (including stock options) received in excess of what would have been paid under the restatement, would have a 3-year look-back period running from the date on which the company is required to prepare the restatement, and would apply irrespective of whether any fraud or misconduct was involved.

Whistleblower Protections

The Dodd-Frank Act enhances the protections and rewards available to corporate whistleblowers who provide original information about violations of U.S. securities laws. Under Section 922 of the Dodd-Frank Act, whistleblowers may be awarded between 10% and 30% of any successful enforcement action resulting in monetary

sanctions in excess of $1 million. These whistleblower protections and rewards apply equally to non-U.S. persons in actions brought against foreign private issuers. Section 922 also includes new legal protections for employee whistleblowers who are retaliated against by their employers for providing information or assistance to the SEC. These protections include the creation of a new private right of action that may be brought in U.S. federal court, and remedies including reinstatement, two times back pay plus interest, and legal costs and reasonable attorney's fees. In addition, subject to certain exceptions, the SEC is prohibited from disclosing any information which could reasonably be expected to reveal the identity of the whistleblower.

The Dodd-Frank Act also expands the existing whistleblower protections of SOX by (i) extending whistleblower protections to cover employees of a public company's consolidated subsidiaries and affiliates, (ii) extending the statute of limitations for SOX whistleblower retaliation claims from 90 to 180 days after the employee became aware of the retaliatory conduct, (iii) prohibiting the waiver of whistleblower protections by any agreement, policy or condition, including a pre-dispute arbitration agreement, and (iv) clarifying a whistleblower claimant's right to a jury trial.

Extractive Industries, Conflict Minerals and Mine Safety Disclosures

Title XV of the Dodd-Frank Act contains three "Miscellaneous Provisions" that impose new disclosure obligations on public companies that operate in certain extractive industries or use specified conflict minerals in their products or production methods. Title XV does not expressly exempt foreign private issuers from its provisions, and as of this handbook's publication it is unclear whether these disclosure requirements will apply to foreign private issuers.

Use of Conflict Minerals. Section 1502 of the Dodd-Frank Act requires the SEC to enact rules by April 15, 2011 requiring certain public companies to disclose whether their products or production methods use conflict minerals that originated in the Democratic Republic of Congo or its adjoining countries. Conflict minerals are defined as columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, and any other minerals or derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

On December 15, 2010, the SEC issued proposed rules to implement Section 1502. Under the proposed rules, if conflict minerals are necessary to the

functionality or production of a product manufactured, or contracted to be manufactured, by a public company, the public company would be required to disclose whether its conflict minerals originated in the Democratic Republic of the Congo or an adjoining country. If the conflict minerals originated in the Democratic Republic of the Congo or an adjoining country (or if the company is not able to conclude that its conflict minerals did not originate in such countries), the company would be required to furnish a "Conflict Minerals Report" as an exhibit to its annual report that includes, among other matters, a description of the measures taken by the company to exercise due diligence on the source and chain of custody of its conflict minerals. These due diligence measures would include, but would not be limited to, an independent private sector audit of the company's report conducted in accordance with standards established by the Comptroller General of the United States. The Conflict Minerals Report would be required to include a description of the products manufactured or contracted to be manufactured that are not "DRC conflict free." "DRC conflict free" is defined in Section 1502 to mean products that do not contain minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Any company required to furnish a report would be required to certify that it obtained an independent private sector audit of its report and make its reports available to the public on its website.

Payments by Resource Extraction Issuers. Under Section 1504 of the Dodd-Frank Act, the SEC is required to enact rules by April 15, 2011 requiring public companies that engage in the commercial development of oil, natural gas or minerals ("resource extraction issuers") to disclose any payments they or their subsidiaries have made to the U.S. or foreign governments for the purpose of commercial development of those resources. The SEC issued proposed rules implementing Section 1504 on December 15, 2010.

Mine Safety. Pursuant to Section 1503 of the Dodd-Frank Act, public companies that operate coal or other mines must disclose in their periodic reports detailed information related to health and safety violations under the Federal Mine Safety and Health Act of 1977, as well as any pending legal actions before the Federal Mine Safety and Health Review Commission. The SEC issued proposed rules implementing Section 1503 on December 15, 2010.

KEY ACCOMMODATIONS FOR FOREIGN PRIVATE ISSUERS

In addition to the various exemptions and accommodations from SOX, the Dodd-Frank Act and their respective implementing SEC rules and stock exchange listing requirements described above, the U.S. federal securities laws and SEC rules provide foreign private issuers with the following key accommodations:

Exemption from Section 16 Reporting and Short-Swing Profit Rules. As discussed in the section of this handbook entitled "Ownership and Trading Reports by Management and Large Shareholders," under Section 16(a) of the Exchange Act and related SEC rules, any person who is an officer, director, or greater than 10% shareholder of a public company must file statements with the SEC reporting their beneficial ownership of the company's securities. These "Section 16 insiders" are also subject to the short-swing profit rules of Section 16(b), which require them to disgorge any profits resulting from the purchase and sale or the sale and purchase of the company's securities which occur within six months of each other. These insider reporting and short-swing profit rules do not apply to securities of a foreign private issuer.

Exemption from Proxy Rules. Foreign private issuers do not have to comply with U.S. federal securities laws which govern the procedures and documentation required for soliciting the votes of shareholders.

Exemption from Regulation FD. Foreign private issuers are exempted from compliance with Regulation FD, which requires companies to publicly disclose any material non-public information that has been selectively disclosed to the company's shareholders or certain enumerated persons, which generally include securities market professionals such as securities analysts, selected institutional investors or other holders of the company's securities who could reasonably be expected to trade on the basis of the information disclosed. Under Regulation FD, when a U.S. domestic company, or a person acting on its behalf, discloses material nonpublic information to these persons, it must disclose that information publicly. The timing of the required public disclosure depends on whether the selective disclosure was intentional or non-intentional. Intentional disclosures must be made public simultaneously; non-intentional disclosures must be made public promptly. Although a foreign private issuer is not subject to Regulation FD, it may be required to publicly disclose the information covered by Regulation FD under its home country rules, in which case it may file a report on Form 6-K with the SEC to satisfy its disclosure obligations in the United States.

Practice Tip: Many foreign private issuers elect to comply with Regulation FD as a best practice, in order to minimize their potential Exchange Act liability for insider trading based on selective disclosure.

No Quarterly Reporting Requirement. The Exchange Act requires U.S. domestic companies to file quarterly reports on Form 10-Q which contain quarterly financial information (see the "Periodic and Current Reporting under the Exchange Act" section of this handbook for a discussion of the requirements of Form 10-Q). No such requirement applies to foreign private issuers. Nevertheless, where a foreign private issuer is required to publish quarterly information under its home country rules or the rules of the exchange on which its securities are listed or quoted, or where it has agreed to provide such information to its shareholders, it must furnish such information to the SEC on Form F-6.

No Form 8-K Filings. Unlike U.S. domestic companies, foreign private issuers are not required to file current reports with the SEC on Form 8-K. Instead, foreign private issuers must furnish the SEC under cover of Form 6-K a copy of any material information it makes or is required to make public in its home country or send to a stock exchange or its shareholders.

Financial Statement Preparation – IFRS, U.S. or local GAAP. Although the SEC has proposed allowing and eventually requiring U.S. domestic companies to report financial results in accordance with IFRS as issued by the IASB, currently U.S. domestic companies are required to prepare financial statements in accordance with U.S. GAAP. Foreign private issuers, however, may prepare their financial statements in U.S. GAAP, IFRS as issued by the IASB, or local home country GAAP. A foreign private issuer that prepares its financial statements according to non-IASB IFRS or local home country GAAP must include a reconciliation to U.S. GAAP.

Listing Requirements. U.S. stock exchanges such as NYSE and NASDAQ generally have alternate listing standards for foreign private issuers which allow them to follow their home country practices in many instances, while requiring disclosure of the significant ways in which home country practices differ from those followed by U.S. domestic companies listed on a U.S. exchange. The particular listing standards applicable to foreign private issuers listed on NYSE and NASDAQ are discussed more fully in the section of this handbook entitled "Stock Exchange Listing Requirements."

Foreign Private Issuer Deregistration

Despite the accommodations accorded to foreign private issuers, the extensive reporting and corporate governance obligations imposed by the Exchange Act and SOX have led many foreign private issuers to consider terminating their obligations under those laws by deregistering their securities.

Equity Securities

Under Rule 12h-6 of the Exchange Act, a foreign private issuer with a class of equity securities registered under Section 12 of the Exchange Act can deregister those securities and terminate its reporting obligations if it meets either of the following criteria:

- the U.S. average daily trading volume (ADTV) of the securities has been no greater than 5% of the worldwide ADTV of the securities during the most recent 12-month period; or
- the securities are held of record by fewer than 300 U.S. residents or 300 persons on a worldwide basis.

In determining the number of U.S. record holders, a foreign private issuer uses the same "look-through" principles described in "Ownership Test" above. A foreign private issuer that has delisted its securities from a U.S. stock exchange or terminated a sponsored ADR facility in those securities within the previous 12 months may not deregister those securities in reliance on the ADTV test unless it met the 5% ADTV benchmark at the time of delisting or termination. If at that time the foreign private issuer did not meet the 5% benchmark, it must wait an additional 12 months before it can deregister in reliance on the ADTV test.

In addition to meeting either the ADTV or record holder tests outlined above, to be eligible to deregister a foreign private issuer must meet the following additional conditions:

- it must have had Exchange Act reporting obligations for at least the 12 months preceding deregistration, have filed or furnished all reports required for that period, and have filed at least one annual report;
- subject to certain exceptions, it must not have offered its securities pursuant to a Securities Act registration statement during the 12 months preceding deregistration; and

- it must have maintained a listing of the subject securities for at least 12 months prior to deregistration on at least one non-U.S. exchange that constitutes its primary trading market.

> **Practice Tip:** A foreign private issuer that has sold securities in the United States during the past 12 months pursuant to an exemption from Securities Act registration, such as Rule 144A or Rule 802, may still be eligible to deregister under Rule 12h-6.

Under the rule, primary trading market means a market that accounted for at least 55% percent of the worldwide trading in the relevant securities, either alone or together with another non-U.S. market. If the foreign private issuer aggregates trading in two non-U.S. markets to reach the 55% worldwide trading threshold, then the trading in at least one of them must be greater than the trading in the United States.

> **Practice Tip:** To calculate its ADTV, a foreign private issuer may use commercial service providers and publicly available sources it reasonably believes are reliable. The U.S. ADTV calculation must include all trading in the subject securities, whether on an exchange or over-the-counter. The worldwide ADTV may also include off-market transactions so long as the information is reasonably reliable and not duplicative.

Debt Securities

Under Rule 12h-6(c), a foreign private issuer may terminate its Exchange Act reporting obligations with respect to a class of registered debt securities if it meets the following conditions:

- it has filed or furnished all of its required Exchange Act reports, including at least one annual report, since it registered the debt securities; and
- the securities are held of record by fewer than 300 U.S. residents or 300 persons on a worldwide basis.

Rule 12g3-2(b) exemption

Rule 12g3-2(b) provides foreign private issuers with an exemption from Exchange Act registration and reporting in circumstances where the company's shares are not listed on a U.S. stock exchange, yet the number of its U.S. resident

shareholders could potentially trigger an obligation to register under Section 12(g) of the Exchange Act. Foreign private issuers that deregister under Rule 12h-6 are eligible to take advantage of the Rule 12g3-2(b) exemption immediately following deregistration. To qualify for the Rule 12g3-2(b) exemption, a foreign private issuer must satisfy the following conditions:

Publish Material Disclosure Documents in English

The foreign private issuer must publish electronically, such as through a posting on its website, certain material non-U.S. disclosure on an ongoing basis in English. In addition to these ongoing publication obligations, a company that is seeking the 12g3-2(b) exemption and which has not been subject to Exchange Act reporting obligations during its current fiscal year must publish all material non-U.S. disclosure documents it has released since the first day of its last fiscal year. The rule lists various types of disclosures which would be considered material for purposes of the exemption, including information relating to:

- the company's results of operations or financial condition;
- changes in its business;
- acquisitions or dispositions of assets;
- the issuance, redemption or acquisition of securities;
- changes in management or control;
- the granting of options or the payment of remuneration to directors or officers; and
- transactions with directors, officers or principal security holders.

At a minimum, a foreign private issuer should publish English translations of the following documents electronically:

- its annual report and annual financial statements;
- its interim reports that include financial statements;
- press releases; and

Practice Tip: A foreign private issuer may provide an English summary instead of a full English translation if a summary would be permitted for a document submitted under Form 6-K or Exchange Act Rule 12b-12(d)(3).

- all other communications and documents distributed directly to holders of the subject class of securities to which the exemption relates.

The electronic publication of material non-U.S. documents should be made promptly after the information has been publicly disclosed in the foreign private issuer's primary trading market. Promptness depends on the type of document and the time required to obtain a requisite English translation. In general, the company should publish any material press releases on or around the same business day as the original publication.

Maintain Foreign Listing

The foreign private issuer must maintain a listing of the relevant securities on at least one non-U.S. exchange that constitutes its primary trading market. A definition of primary trading market appears above under "Foreign Private Issuer Deregistration." The foreign private issuer is not required to have maintained the listing for a given period of time, so a company that has recently listed its securities on a foreign stock exchange is eligible to claim the exemption.

No Exchange Act Reporting Obligations

Lastly, in order to establish the Rule 12g3-2(b) exemption a foreign private issuer must not already be subject to reporting obligations under Sections 13(a) or 15(d) of the Exchange Act. A company will generally be able to meet this condition if its securities are not publicly offered or listed in the United States and it has not otherwise registered a class of its securities – including debt securities – under the Exchange Act.

A foreign private issuer that fails to comply with the provisions of Rule 12g3-2(b) must either re-establish compliance with the rule's conditions in a reasonably prompt manner, determine that it has fewer than 300 U.S. resident security holders and is eligible for the exemption under Rule 12g3-2(a), or register the relevant class of securities under the Exchange Act within 120 days of the company's fiscal year end.

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