



THE CORPORATE  
**communicator**

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## contacts

If you have any questions regarding the matters discussed in this issue please contact the authors, or your regular Snell & Wilmer contact:

**Jeffrey Beck**  
602.382.6316  
jbeck@swlaw.com

### Authors

**Jeff Scudder**  
602.382.6556  
jscudder@swlaw.com

**Travis Leach**  
602.382.6530  
tleach@swlaw.com

**Jeffrey Beck**  
602.382.6316  
jbeck@swlaw.com

**Melissa Sallee**  
602.382.6302  
msallee@swlaw.com

## The 2010 Annual Meeting Season

Dear Clients and Friends,

As always this time of year, we present you this issue of Snell & Wilmer's *Corporate Communicator* to help you prepare for the upcoming annual report and proxy season. This issue highlights some of the considerations your company should focus on this annual meeting season.

In this issue, we are including our customary articles on recent SEC and NYSE/NASDAQ developments. We are also including more in-depth articles on the elimination of broker discretionary voting in director elections and recent developments in the enforcement arena. In our view, the big items for the 2010 annual meeting season are the elimination of broker voting in director elections and the trends and considerations related to executive compensation.

Although it is official that proxy access will not be implemented in time for this year's annual meetings, the SEC has indicated that its goal is to implement proxy access in 2010. Of course, we will provide you an update if and when the rules are implemented.

During 2010, members of our Business & Finance Group will continue to publish the *Corporate Communicator*, host business roundtables, participate in seminars that address key issues of concern to our clients, and sponsor conferences and other events. First on the calendar is our annual Public Company Roundtable, which will be held in our Phoenix office on January 12, 2010. A copy of the invitation is included at the end of this publication and we hope you will be able to join us.

Finally, we are including in this issue our 2009 tombstone, which highlights selected deals that Snell & Wilmer's Business & Finance Group helped our clients close during the year. As always, we appreciate your relationship with Snell & Wilmer, and we look forward to helping you make 2010 a successful year.


Very truly yours,

Snell & Wilmer L.L.P.  
Business & Finance Group

# Snell & Wilmer

## RECENT BUSINESS & FINANCE TRANSACTIONS

### Debt Offerings and Credit Agreements

 <b>DriveTime™</b> <b>\$500 million</b> <i>Asset Based Financing Facility</i>	 <b>DriveTime™</b> <b>\$196 million</b> <i>2009-1 Securitization</i>	 <b>DriveTime™</b> <b>\$60 million</b> <i>Inventory Facility</i>	 <b>\$500 million</b> <i>8.75% Senior Notes Due 2019</i>	 <b>\$166 million</b> <i>Pollution Control Revenue Refunding Bonds Cholla Project 2009 Series A-E</i>	 <b>\$12.8 million</b> <i>Pollution Control Revenue Refunding Bonds Navajo Project 2009 Series A</i>	 <b>\$163.9 million</b> <i>Pollution Control Revenue Refunding Bonds Palo Verde Project 2009 Series A-E</i>
 <b>\$26.7 million</b> <i>Pollution Control Revenue Refunding Bonds Navajo Project 2009 Series B</i>	 <b>\$53 Million</b> <i>Three Secured Revolving Letter of Credit Facilities</i>	 <b>\$35 million</b> <i>Senior Term Loan</i>	 <b>\$25 million</b> <i>Senior Revolving Facility</i>	 <i>Subordinated Notes Offering</i>		

### Mergers and Acquisitions

 <b>\$45 million</b> <i>Sale of Genetic Seed Business to Monsanto Breeding Company</i>	 <b>\$26.6 million</b> <i>Acquisition of Assets of Fleetwood Enterprises, Inc.</i>	 <b>\$17 million</b> <i>Acquisition of PulseCore Holdings (Cayman), Inc.</i>	<b>Nutri-Health, LLC</b> <b>\$23.9 million</b> <i>Sale of Nutri-Health Supplements, LLC to Atrium Biotech Investments, Inc.</i>	 <i>Sale of Illinois Plant and Contract Manufacturing Agreement</i>	<b>Helm Software, Inc.</b> <i>Sale to Answer Systems, Inc.</i>	 <b>\$4.8 million</b> <i>Sale to TOLMAR Holding, Inc.</i>
 <i>Acquisition of Profit Keeper</i>	 <i>Acquisition of Unity Business Networks, LLC</i>	<b>ID Arizona</b> <b>\$176 million</b> <i>Acquisition of Search Media</i>	<b>Fast Medical, Inc.</b> <i>Sale of Assets</i>			

### Venture Capital and Equity Transactions

 <b>\$33 million</b> <i>Sale of Series B-1 Preferred Stock and Promissory Notes</i>	 <b>\$16.5 million</b> <i>Sale of Series B-1 Preferred Stock</i>	 <i>Investment in Series B Convertible Preferred Stock in SDC Materials, Inc.</i>	 <i>Series A Financing</i>	 <i>Investment in Convertible Promissory Notes and Warrants in Cancer Prevention Pharmaceuticals</i>	 <i>Investment in Series A Preferred Stock of Salutaris, Inc.</i>	 <i>Investment in Series A Preferred Stock of SynDev Rx, Inc.</i>
 <b>\$2.5 million</b> <i>Convertible Note</i>	 <b>\$2.5 million</b> <i>Secured Note Offering</i>	 <i>Series B Financing</i>	<b>Entrepreneur Opportunity Fund I, L.P.</b> <i>Formation of Private Equity Fund</i>			

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# SEC Developments and Other Issues Affecting Your 2009 Annual Report and the Upcoming Proxy Season

By Jeff Scudder

Much has happened in the world since our last annual meeting edition of the *Corporate Communicator*. Persistent themes such as corporate accountability, transparency, risk management, and increased shareholder access have remained prevalent and, when combined with market turmoil and government intervention, likely accelerated reform initiatives in the corporate governance arena. This article discusses certain reforms (both adopted and proposed) and other developments that will be particularly relevant for public companies as the 2010 annual meeting season approaches.

## Proxy and Other Disclosure Enhancements

On December 16, 2009, the Securities and Exchange Commission (the “SEC”) adopted amendments to its executive compensation and corporate governance disclosure rules. The amendments become effective on February 28, 2010, so they will be in effect for most companies during the 2010 proxy season (although companies with fiscal years ending before December 20, 2009 will not be required to comply until next year). The enhanced disclosure requirements are summarized below:

Subject of Disclosure	Old Rules	New Rules
Value of Stock and Option Awards to Directors and Named Executive Officers	Dollar amount recognized for the applicable fiscal year for financial statement reporting purposes (SFAS No. 123R) reflected as compensation in Summary Compensation Table and Director Compensation Table	<p>Aggregate grant date fair value of awards per SFAS No. 123R will be reflected as compensation in Summary Compensation Table and Director Compensation Table</p> <p>For performance awards, value will be based on probable outcome of applicable performance condition(s), consistent with recognition criteria in accounting literature (as opposed to being based on the potential maximum value)</p> <p>Companies must include re-computed amounts (including for total compensation) for each preceding fiscal year included in applicable table</p>

Subject of Disclosure	Old Rules	New Rules
Compensation Program and Risk Management	N/A	If risks arising from a company's compensation policies and practices for its employees (including non-executive officers) are reasonably likely to have a material adverse effect on the company, the proxy statement must include discussion of such compensation policies and practices as they relate to risk management practices and/or risk-taking incentives – purpose is to provide investors with information concerning how the company compensates and incentivizes its employees that may create risk
Background and Qualifications of Directors and Nominees	General qualifications and business experience – and information about certain legal proceedings – disclosed for past 5 years; board qualifications discussed in general	Disclosure must discuss <i>specific</i> experience, attributes, qualifications or skills (including beyond the 5-year requirement) that qualify the person to serve as a director; any directorships held during the past 5 years at public companies; certain legal proceedings occurring within the past 10 years; and whether (and if so, how) diversity is considered in identifying director nominees
Board Leadership Structure	N/A	Disclosure must be provided with respect to board's leadership structure and why the company believes it is the best structure as of the date of the filing – also must include discussion of whether and why company has chosen to combine or separate the board chair and CEO positions; whether and why company has a lead independent director; and the board's role in the oversight of risk (including any effect such role has on the leadership structure of the board)

Subject of Disclosure	Old Rules	New Rules
<p>Compensation Consultants and Conflicts of Interest</p>	<p>Disclosures required with respect to role of compensation consultants in determining or recommending the amount or form of executive and director compensation, whether consultants are engaged directly by the Compensation Committee or any other person, and nature and scope of assignment</p>	<p>If Compensation Committee consultant(s) provide(s) additional services (i.e., beyond consulting on executive and director compensation) in excess of \$120,000 during the fiscal year, disclosure must be provided with respect to all fees paid to the consultant(s), and whether company management was involved in the decision to engage the consultant(s)</p> <p>If Compensation Committee does not have a consultant but management uses its own consultant, similar disclosures are required if fees for the additional services exceed \$120,000 during the fiscal year</p> <p>Limited exceptions for situations in which Compensation Committee and company have different consultants or consultants only provide advice with respect to broad-based compensation plans</p>
<p>Shareholder Meeting Voting Results</p>	<p>Disclosure required in the periodic report (typically Form 10-Q) relating to fiscal quarter during which meeting occurred</p>	<p>Disclosure moved to Form 8-K and results must be provided within 4 business days after date of meeting (if director election is contested and definitive results are not immediately available, preliminary results must be filed within 4 business days and an amended Form 8-K must be filed within 4 business days after receipt of definitive results)</p>

The enhancements described above will require public companies to once again revisit various disclosures in their proxy statements – including those relating to corporate governance issues and the compensation of directors and named executive officers.

## Executive Compensation Disclosure – Expectations for 2010

Since the SEC's expansive overhaul of its executive compensation disclosure rules in 2006, we have regularly updated our clients on the latest trends and SEC guidance in what has become a constantly evolving subject of disclosure. In our January 2008 *Corporate Communicator*, we wrote about John White's (then the Director of the SEC's Division of Corporation Finance) October 2007 address to the Second Annual Proxy Disclosure Conference, in which he exclaimed "Where's the analysis?!" in reference to the SEC's review of the first round of proxy statements filed under the new, principles-based executive compensation disclosure regime. In the SEC's report, it called on public companies to provide more robust analysis, specific disclosures of performance targets, and improve their presentation generally (for example, by using tabular disclosures and plain English).

The story continues as we look ahead to the 2010 proxy season. On November 9, 2009, Shelley Parratt, Deputy Director of the SEC's Division of Corporation Finance, addressed the Fourth Annual Proxy Disclosure Conference and provided the following updates:

- Ms. Parratt reiterated that the SEC's role is not to regulate *how* companies compensate their executives, but rather to see that investors have the critical disclosure they need to make informed investment and voting decisions.
- Based on a 2009 review of its previous comments and the state of current filings, the SEC noticed that many public companies have been reluctant to enhance their disclosures until they receive specific comments from the SEC.
- According to Ms. Parratt, the SEC is encouraging companies to focus on two topics in 2010:
  - Analysis. As Ms. Parratt observed, "while many companies have improved their

discussions of how and why they made the decisions they did, far too many companies continue to describe – in exhaustive detail – the framework in which they made the compensation decision, rather than the decision itself." Along those lines, the SEC continues to encourage companies to shorten their disclosure by deleting unnecessary background and process-oriented information.

- Performance Targets. The SEC has issued more comments on performance targets than any other executive compensation disclosure item. If corporate-level or individual performance targets are material to a company's compensation policies and decisions, the SEC's position is that they must be disclosed *with specificity* (including quantitative metrics if applicable). To the extent that a company believes specific disclosure would result in competitive harm, it must engage in the same analysis as is required in connection with a confidential treatment request. If specific disclosure is omitted following a robust competitive harm analysis, the company must disclose with *meaningful specificity* how difficult or likely it would be for the company or the individual to achieve the target. According to Ms. Parratt, it is insufficient to simply describe the target as "challenging" to achieve.

The SEC has indicated that it will also focus in its 2010 reviews on new disclosure requirements, including those relating to the connection between a company's compensation programs and risk management. Finally, Ms. Parratt addressed the SEC review process in general, noting that the SEC's expectations for quality disclosure will be higher as the "new" executive compensation disclosure regime begins its fourth year. As she stated:

“What does that mean for you? It means that after three years of ‘futures’ comments, we expect companies and their advisors to understand our rules and apply them thoroughly. So, any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules.”

In light of this guidance, it will be as important as ever for companies to take a fresh look at – and proactively improve – their executive compensation disclosures.

### Proxy Access Proposal

On June 10, 2009, the SEC proposed a variety of rules relating to proxy access in an attempt to “remove impediments to the exercise of shareholders’ rights to nominate and elect directors.” Generally, the proposed rules would require a public company to include in its proxy materials a shareholder’s (or shareholder group’s) director nominee(s). The rules might also make it easier for shareholders to force the company to include in its proxy materials shareholder proposals seeking to amend the company’s director nomination procedures.

The SEC has received a significant volume of comments with respect to its proxy access proposal, and on December 14, 2009, it extended the comment period until January 19, 2010 to allow interested persons to comment on additional data and related analyses already submitted in the comment process. Thus, the rules will not be effective for the 2010 annual meeting season. Given the controversies associated with and far-reaching implications of increased shareholder access to company proxy materials, we are including a summary of the SEC’s proposed rules, even though we anticipate that the final rules may be very different than the current proposal. Below is an overview of the primary requirements (of the proposed rules) that would need to be satisfied for a shareholder to include their nominee in the company’s proxy materials:

- Compliance with state law and governing documents – companies would not be required to include shareholder nominees in the proxy materials if state law or the company’s governing documents prohibited such nominations (although shareholders would be able to seek an amendment to the governing documents).<sup>1</sup>
- Nominee eligibility – to be included in the proxy materials, the nominee’s candidacy could not violate federal or state law, the company’s governing documents, or applicable exchange rules (except those relating to subjective independence determinations; the nominee would be required to meet basic independence requirements but not those pertaining to audit or compensation committee members).
- Shareholder eligibility – a shareholder or a shareholder group would have to meet the following beneficial ownership tests (based on a holding period of at least 1 year at the time of the nomination filing) and represent that they had no intent to effect a change of control with respect to the company:
  - Large accelerated filers (public float of at least \$700 million) – 1%
  - Accelerated filers (public float of between \$75 million and \$700 million) – 3%
  - Non-accelerated filers (public float of less than \$75 million) – 5%
- Schedule 14N filing – the shareholder or shareholder group would have to file a report containing certain information about the nomination with the SEC and the applicable exchange. Any false or misleading statements

<sup>1</sup> Public companies should be aware, however, that there are several pieces of legislation currently pending in Congress that attempt to preempt such state laws.

or omissions in such report could subject the filing person(s) to anti-fraud liability.

- Number of Permitted Nominees – a company would only be required to include in its proxy materials the greater of (i) 1 shareholder nominee or (ii) the number of shareholder nominees that would represent 25% of the company’s board of directors. Any incumbent director(s) previously elected pursuant to the proposed rules would count towards that quota. In other words, if one incumbent director on a 5-person board of directors would continue in office following the election, the company would not be required to include any shareholder nominees even if the other requirements of the proposed rules were satisfied.

Most observers agree that proxy access is coming and that the only remaining questions surround “when” and “how”. Regardless of the specific rules ultimately adopted by the SEC, these future developments should prompt public companies to carefully examine the rules alongside their governing documents and applicable state law to ensure that an orderly process of nominating and electing directors is maintained.

### Amendments to e-Proxy Rules

Last year, we described the two methods that public companies can adopt to comply with the SEC’s mandatory e-proxy rules – “notice-only” and “full set delivery.” Under the notice-only method, a company can send a Notice of Internet Availability of Proxy Materials meeting certain requirements to its shareholders and post its proxy materials on the Internet. The Notice of Internet Availability of Proxy Materials must be sent to shareholders at least 40 calendar days prior to the meeting date. Under the full set delivery method, a company can send its shareholders a traditional proxy mailing provided that the materials are also posted on the Internet and certain notice information is sent with (or incorporated in) the proxy statement.

On October 14, 2009, the SEC proposed amendments to its e-proxy rules, which would give companies additional flexibility under and otherwise improve the notice and access model for furnishing proxy materials to shareholders. The SEC’s proposal is designed to address concerns that the “notice-only” method has resulted in lower shareholder response rates to proxy solicitations, presumably because of investor confusion about the process. In response, the SEC has proposed the following amendments:

- Companies using the “notice-only” method would be given more flexibility with respect to the format of and language used in the Notice of Internet Availability of Proxy Materials. Under the existing rules, companies must include a specific legend in the notice, which some shareholders may have mistaken for boilerplate language. This important information (which includes details about how a shareholder can access proxy materials online, request a paper copy of such materials, vote his or her shares, etc.) would still be required in the notice under the new rules, but companies would be free to format it in a more tailored, understandable manner.
- The rules would also be relaxed to allow companies to send informational materials about the notice and access model with the Notice of Internet Availability of Proxy Materials. Under the existing rules, only a pre-addressed, postage-paid reply card for requesting a copy of the proxy materials and a copy of any shareholder notice required under state law may accompany the Notice of Internet Availability of Proxy Materials. The exception proposed by the SEC, which would be limited to materials explaining the process of receiving or reviewing the proxy materials and voting (i.e., persuasive or solicitation materials would still be prohibited), is intended to allow companies to better educate shareholders about the notice

and access model and increase investor participation in the process.

## Odds & Ends

### Powers of Attorney in New York

Effective as of September 1, 2009, the State of New York amended the statutory requirements for powers of attorney executed by individuals within that state. The amendments require that all powers of attorney:

- include certain “caution to the principal” and “important information for the agent” legends that are prescribed by statute;
- be legibly printed or typed in a font size of no less than 12-point; and
- be signed and notarized by *both* the principal *and* the agent (with the power of attorney becoming effective only after being signed by the agent).

The amendments do not apply to powers of attorney executed by entities (like corporations, limited liability companies and trusts) or outside of the State of New York (even if the principal is a New York resident). They do, however, apply to powers of attorney executed within the State of New York by individuals in connection with SEC filings (including Form 10-K filings). Accordingly, public companies should be careful to take note of where any powers of attorney used in their SEC filings are signed. If any powers of attorney will be executed in New York, a separate form that complies with the New York statute should be used in lieu of the standard power of attorney language included on the signature page, and that form should be filed as an exhibit to the applicable SEC filing.

### 404(b) Attestation Reports for Non-Accelerated Filers

On October 13, 2009, the SEC amended its temporary rules that required non-accelerated filers (typically, companies with a public float of less than \$75

million) to include in their annual reports an attestation report of their independent auditor on internal control over financial reporting for fiscal years ending on or after December 15, 2009. Under the new rule, a non-accelerated filer will not be required to include such an attestation report until such filer’s annual report for its fiscal year ending on or after June 15, 2010. Accelerated filers have been required to include auditor attestation reports with respect to their internal control over financial reporting, which are required pursuant to rules adopted by the SEC pursuant to Section 404(b) of the Sarbanes-Oxley Act of 2002, since June 15, 2004.

The SEC stated that it does not anticipate further extensions of the compliance deadline for non-accelerated filers, although this is the third extension of these requirements.

### SEC Filing Fee Updates

On December 16, 2009, President Barack Obama signed the appropriations bill that provides funding for the SEC. Accordingly, effective December 21, 2009, the fee rate applicable to the registration of securities increased 28%, from \$55.80 per million dollars to \$71.30 per million dollars. Effective January 15, 2010, the fee rate applicable to securities transactions on national securities exchanges (e.g., NYSE and NASDAQ) and the over-the-counter markets will decrease 51%, from \$25.70 per million dollars to \$12.70 per million dollars.

# NYSE & NASDAQ Developments

By Travis Leach and Jeffrey Beck

## Elimination Of Broker Discretionary Voting In The Election Of Directors

### Background

On July 1, 2009, the SEC approved a New York Stock Exchange (“NYSE”) proposal that prohibits discretionary voting by brokers of shares held by their customers in “street name” in *uncontested* director elections (the “Amendment”). NYSE rules already prohibited discretionary broker voting in *contested* director elections.<sup>2</sup> The Amendment will apply to all shareholder meetings held after January 1, 2010. The Amendment will impact most companies listed on a U.S. securities exchange including those on NASDAQ, as it applies to the voting of shares held through brokers that are NYSE member organizations and most brokers that hold shares of public companies are either NYSE members or comply with NYSE rules.

### Considerations

As a result of the Amendment, there are a number of issues public companies should consider:

<sup>2</sup> NYSE Rule 452 and Listed Company Manual Section 402.08 permit brokers to vote as they wish on “routine” matters on behalf of their beneficial owner customers, provided the customer has not given specific voting instructions to the broker at least 10 days before a scheduled meeting. Prior to the Amendment, brokers often voted uninstructed shares of their customers in uncontested elections in favor of management nominees. The Amendment treats uncontested elections of directors as part of the list of enumerated matters that are considered “non-routine” and therefore, matters on which a broker cannot vote a customer’s shares without specific instructions from the customer.

### 1. Increased Cost to Achieve a Quorum

Often taken for granted, establishing a quorum is an important procedural aspect of any meeting of shareholders. As a result of the Amendment, the number of shares voted by proxy could be reduced, which could make it more difficult and/or costly to establish a quorum.

The corporation laws of most states, including Delaware, provide that a quorum, once established for a meeting, is valid for all matters voted on at that meeting. As a result, the allowance of broker discretionary votes for routine matters could, depending on state law and charter provisions, provide a mechanism for the establishment of a quorum that is valid for the entire meeting, including non-routine matters. The elimination of uncontested elections as a routine matter leaves the ratification of auditors as the most common routine matter for shareholder voting. Companies should consider leaving auditor ratification on their agendas (or adding it) particularly if it will help establish a quorum for their annual meeting.

### 2. Use of the Notice and Access Option Under the e-Proxy Rules may Decrease

The Amendment may discourage companies from utilizing the “notice and access” option for the electronic delivery of proxy materials. Generally, early surveys have indicated that when companies deliver their proxy materials electronically, shareholder participation has decreased. However, because the Amendment makes shareholder participation more important than ever, companies may be reluctant to rely solely on the electronic delivery of proxy materials.

### 3. Majority Voting Requirements

Majority voting requirements for director elections are becoming increasingly common. However, without the benefit of broker discretionary voting,

it may be more difficult for directors to accumulate the necessary votes to achieve majority support.

If loss of votes as a result of the Amendment is a concern in director elections, companies should consider the following:

- review and confirm that the proxy materials adequately explain to shareholders the importance of their vote (some shareholders with small positions may feel their votes are not important) and how to vote;
- post information on the investor relations website that explains the importance of shareholder votes;
- after the proxy materials are mailed, follow-up with reminders (more than one if necessary) that explain the importance of the vote, explain the voting process, and include a proxy card; and
- engage a proxy solicitor to contact shareholders directly.

#### ***4. Increased Influence of Third Parties***

The Amendment increases the influence of shareholders who cast votes, including institutional investors. These institutional investors may be more swayed by recommendations, including those from proxy advisory firms, holders of large blocs of shares, or the company itself.

#### **Recommendations**

Companies should begin to evaluate the likely impact of the Amendment on their director elections and plan accordingly, including by taking some or all of the following actions:

- perform a detailed review of the company's shareholder profile, its historical voting pat-

terns, and the impact of broker discretionary voting on past uncontested director elections;

- discuss with counsel the possibility (and pros and cons) of amending organizational documents to lower the threshold required for a quorum;
- to ensure that a quorum will be achieved, consider (i) adding the auditor ratification proposal (a "routine" proposal) to the 2010 annual meeting agenda and/or (ii) mailing proxy materials earlier than usual in advance of the meeting;
- if there are no routine proposals on the agenda, consider hiring a proxy solicitor; and
- consider impact and strategies in the event one or more directors do not obtain a majority vote.

#### **Other Developments**

Although the elimination of broker discretionary voting in director elections is clearly the biggest development in NYSE and NASDAQ arenas, there are other recently adopted changes that you should be aware of.

Effective last May, NYSE-listed companies are no longer required to file a separate press release to comply with NYSE's rules that require companies to immediately release any material news or information. Rather, companies may comply with the immediate release rule by disseminating the information by any Regulation FD-compliant method, including by filing a Current Report on Form 8-K, press release, or previously announced conference call or webcast. Despite the elimination of the technical requirement, however, NYSE still encourages companies to use press releases to disseminate material information. Conversely, the SEC approved in December 2009 a rule change to NASDAQ Rule 5250(b)(1) and IM-5250-1 so that

NASDAQ companies will be *required*, rather than merely urged, to notify NASDAQ at least 10 minutes prior to releasing material information.

In November 2009, NYSE adopted amendments to certain of its corporate governance rules. These rules are contained in Section 303A of NYSE's Listed Company Manual. The new rules do not generally alter the substantive provisions of Section 303A but rather are designed to more closely align NYSE's disclosure rules concerning director independence, board committees and corporate governance with the SEC's applicable disclosure rules for those areas (which are now contained in Regulation S-K, Item 407). The new rules:

- replace NYSE's disclosure requirements concerning categorical standards of independence, the compensation committee charter and the audit committee charter with the requirements set forth in Regulation S-K, Item 407;
- include several changes permitting more liberal use of a company's website (to more closely align with Regulation S-K, Item 407) for disclosures concerning charters for the audit, nominating and compensation committee charters, corporate governance guidelines and code of ethics;
- eliminate the requirement that companies make available hard copies of their applicable charters, corporate governance guidelines and code of ethics;
- permit companies to make certain required disclosures currently required in their proxy statement or annual report on or through their websites, including disclosure concerning: contributions to tax exempt organizations, lead or presiding directors, and communications with the independent directors;

- clarify that companies only need to hold regular sessions of *independent directors*, versus sessions of *non-management directors*;
- change the notification period for waivers of the code of ethics from two or three business days to four business days (to conform with the requirements of Form 8-K); and
- eliminate the current requirement that companies disclose in their annual report that they filed the CEO certifications required by NYSE and the SEC.

Finally, the new rules contain a potential sleeper change that companies should be mindful of. Previously, companies were only required to notify NYSE in writing if any executive officer became aware of an event of *material* non-compliance with NYSE's corporate governance rules (Section 303A of the Listed Company Manual). The new rules require written notification if an executive officer becomes aware of *any* non-compliance.

In closing and as a reminder, in April 2009, NASDAQ completely reorganized its Marketplace Rules, replacing the 4000 Series by restating the rules in the new 5000 Series (which was previously unused).

## A Review of SEC Enforcement in 2009

By Melissa Sallee

Not surprisingly given macro-economic conditions, SEC enforcement activity increased in 2009. The financial crisis, the new Obama Administration, new SEC leadership, increased funding and increased focus by Congress and the media have all contributed to this increase in enforcement activity by the SEC. In addition, high-profile events, such as the collapse of the subprime mortgage market

and the Madoff Ponzi Scheme, led to a loss of confidence in the SEC's ability to protect investors. As a result, there have been significant changes in the SEC and a number of significant enforcement actions by the SEC.

## Changes in the SEC

Almost immediately after taking office in January, the Obama Administration began pushing for a new regulatory and enforcement agenda for the SEC. On January 27, 2009, Mary Schapiro was sworn in as the new Chairman of the SEC. Shortly after becoming Chairman, Ms. Schapiro began implementing changes to increase enforcement by the SEC.

Ms. Schapiro announced that formal orders would be approved either by a *seriatim* vote of Commissioners, without a meeting, or by a single Commissioner acting as the "duty officer." Formal orders of investigation give the SEC authority to subpoena documents and witnesses. In practical terms, this means that staff attorneys will now be able to issue subpoenas merely with approval from their senior supervisor.

Ms. Schapiro also ended a program that required the SEC staff to seek prior approval of the Commissioners before negotiating a civil money penalty against a public company for alleged securities fraud. This program was thought to cause significant delays in the process of bringing a corporate penalty case, discourage the SEC staff from arguing for a penalty and sometimes resulted in reductions in the size of penalties. Ms. Schapiro believes that eliminating this program will expedite the SEC's enforcement efforts.

Additionally, in August, Robert Khumazi, the newly appointed Director of the Division of Enforcement, announced several changes in that division and the enforcement process, including: (i) requiring approval of the Director for any tolling agreement; (ii) the creation of five specialized units that

will focus on Asset Management, Market Abuse, Structured and New Products, the Foreign Corrupt Practices Act, and Municipal Securities and Public Pensions; (iii) fostering cooperation by individuals: (A) by creating a "Seaboard Report" for individuals, (B) seeking expedited immunity requests to the Department of Justice, (C) providing witnesses in an investigation oral assurances that they will not be charged, and (D) recommending to the SEC the use of deferred prosecution agreements; and (iv) creating an Office of Market Intelligence to collect and analyze the tips and complaints received by the Division of Enforcement.

## Significant 2009 SEC Enforcement Actions

### Regulation G

On November 12, 2009, the SEC announced its first enforcement action for violations of Regulation G since its enactment in 2003. The SEC settled a civil injunctive action against SafeNet, Inc. ("**SafeNet**") and certain of its former officers and accountants in which the SEC alleged that, during the period from the fourth quarter of 2000 through May 2006, SafeNet engaged in earnings management that resulted in SafeNet reporting materially misleading GAAP and non-GAAP financial results. The SEC alleged that SafeNet violated Regulation G by reporting non-GAAP earnings that improperly excluded certain ordinary expenses as non-recurring charges.

Regulation G requires that if a company chooses to disclose a non-GAAP measure, it must reconcile the non-GAAP financial measure to the most directly comparable GAAP financial measure. Regulation G also prohibits disseminating false or misleading non-GAAP financial measures or presenting non-GAAP financial measures in such a manner that would mislead investors or obscure the company's GAAP results.

SafeNet, without admitting or denying the allegations, consented to the entry of a judgment and a

permanent injunction from violating the antifraud provisions of the federal securities laws and was ordered to pay a civil penalty of \$1 million. The former officers also consented to permanent injunctions, disgorgement and civil penalties.

This enforcement action is a signal that the SEC is willing to use all the enforcement tools at its disposal. It is important to note that Regulation G imposes requirements in connection with the public communication of non-GAAP financial measures that do not rely solely on the antifraud regime of Rule 10b-5. Regulation G independently prohibits material misstatements or omissions that would make the presentation of the material non-GAAP financial measure misleading. In SafeNet, the SEC alleged that the company and the officers violated both Regulation G and Rule 10b-5.

### Claw Back of Bonuses

#### *Jenkins Suit (CSK Auto)*

On July 22, 2009, the SEC filed a complaint against Maynard Jenkins, former Chief Executive Officer of CSK Auto Corporation (“**CSK**”), seeking to claw back bonuses and stock sale profits of more than \$4 million that Mr. Jenkins received during the time CSK filed financial statements containing material misstatements. CSK restated its financial results for the periods involved and the SEC charged CSK and other insiders with securities fraud. Notably, the SEC did not allege that Mr. Jenkins was responsible for the false or misleading statements or the misconduct relating to the material misstatements. Instead, the SEC alleged that Mr. Jenkins: (i) signed and certified public filings that ultimately turned out to contain material misstatements, (ii) received more than \$4 million in bonuses and profits from sales of CSK stock during the 12 months following publication of the misstated financials, and (iii) failed to reimburse CSK for the \$4 million.

The SEC brought the suit against Mr. Jenkins under Section 304 of the Sarbanes-Oxley Act (“**Section**

**304**”), which states that if a company restates its financials “as a result of misconduct,” the Chief Executive Officer and Chief Financial Officer shall reimburse the company for any bonuses, incentive-based and equity-based compensation and profits from sales of the company’s stock during the 12 months following the issuance of the public filing that is later restated. This is the first time the SEC has relied upon Section 304 to seek reimbursement from an officer not charged with any wrongdoing.

#### *McCarthy Suit (Beazer Homes)*

On November 17, 2009, the SEC also filed a claim against Ian McCarthy, the Chief Executive Officer of Beazer Homes. Similar to the Jenkins suit, the SEC brought the suit against Mr. McCarthy under Section 304, seeking to claw back bonuses and stock sale profits of more than \$38 million that Mr. McCarthy received during the time Beazer Homes filed misstated financial statements. The SEC is not alleging that Mr. McCarthy was responsible for fraud, but rather that the incentives and other compensation were earned based on misstated financial accounts. Beazer Homes is already in the process of restating the misstated financial statements for 2004-2007.

The Jenkins and McCarthy suits are test cases for a strict liability interpretation of Section 304 and should determine if Section 304 requires a showing of wrongful conduct by the bonus recipient, or instead merely misconduct by someone else at the company.

### Bank of America Case

The SEC filed a complaint against Bank of America in connection with Bank of America’s acquisition of Merrill Lynch in late 2008. The SEC’s complaint alleged that Bank of America made false and misleading statements to its shareholders in its proxy statement that sought shareholder approval of the acquisition. The SEC alleged that Bank of America’s proxy claimed that Merrill had agreed not to pay year-end performance bonuses or other

discretionary incentive compensation to its executives prior to the closing of the merger without Bank of America's consent when in fact, Bank of America had already agreed that Merrill could pay up to \$5.8 billion – nearly 12 percent of the total consideration to be exchanged in the merger – in discretionary year-end and other bonuses to Merrill executives for 2008.

On August 3, 2009, the same day the SEC filed the complaint, Bank of America entered into a consent judgment with the SEC. The consent judgment provided that Bank of America agreed to an injunction prohibiting it from making future false statements in proxy solicitations and to pay a \$33 million fine to the SEC. On September 14, 2009, the United States District Court of the Southern District of New York issued an order sharply rejecting the consent judgment. The court held that the proposed consent judgment was “neither fair, nor reasonable, nor adequate.” The court stated that the proposed settlement was “absurd” because it caused “the victims of the violation [to] pay an additional penalty for their own victimization.” The court suggested that the SEC should have pursued the executives or lawyers for the alleged false statements. Because the court rejected the settlement, it ordered the parties to prepare to litigate the action and set a trial date of February 1, 2010.

The action by the SEC illustrates that the financial crisis has moved into a new phase of accountability as the SEC has ramped up efforts to punish professional advisors and executives that the SEC believes contributed to the financial crisis meltdown. The ruling by the United States District Court of the Southern District of New York was an unusual rejection of a consent judgment and reflects that potential settlements with the SEC may garner more scrutiny than has previously been commonplace.

## Insider Trading

### *Cuban Suit*

In November 2008, the SEC brought a civil suit against Mark Cuban, the Dallas Mavericks basketball team owner, alleging that he acted on nonpublic information when he sold his stake in Internet search engine company Mamma.com in advance of negative news. Mr. Cuban held shares in Mamma.com and, in June 2004, Mr. Cuban was invited by the company to participate in a private placement offering after he agreed to keep the information confidential. When Mr. Cuban found out the offering would dilute existing shareholders and be sold at a discount to the market price, he became “angry and upset,” the SEC said. Shortly after the call with Mamma.com's chief executive officer, Mr. Cuban told his broker to “sell what you can tonight and just get me out the next day.” During after-hours trading on June 28, 2004, Mr. Cuban sold 10,000 of his 600,000 shares and the following morning sold his remaining stake. After markets closed, Mamma.com announced its offering. When markets reopened the following day, the company's stock price decreased more than 9%.

On July 17, 2009, a federal judge in the Northern District of Texas dismissed the SEC's action against Mr. Cuban. Mr. Cuban argued that Rule 10b-5 liability requires a fiduciary or fiduciary-like relationship with the provider of the information and that a mere agreement cannot provide a basis for liability. The SEC argued that third parties who accept material nonpublic information from a company on a confidential basis are precluded from trading on the information. The court rejected both Mr. Cuban's and the SEC's argument. The court, however, held that, since Mr. Cuban's alleged oral agreement to maintain the confidentiality of the information did not go so far as to have him agree “not to trade on or otherwise use it,” there was no misappropriation because, “absent a duty not to use the information for personal benefit, there is no

deception in doing so.” In October, the SEC filed an appeal of the court’s decision.

#### *Galleon and Incremental Capital Suits*

In October 2009, the SEC brought criminal charges against the founder of Galleon Management L.P., a \$3 billion hedge fund (“**Galleon**”), Raj Rajaratnam, executives of Intel, executives of International Business Machines, and an employee of the consulting firm McKinsey & Co. In its complaint, the SEC alleges that Rajiv Goel, an executive in Intel’s treasury department, provided inside information to Mr. Rajaratnam about certain Intel quarterly earnings and a pending joint venture in which Intel had invested. The SEC alleges that Mr. Rajaratnam then used this information to trade on behalf of Galleon. The SEC also alleges that as payback for Mr. Goel’s tips, Mr. Rajaratnam, or someone acting on his behalf, executed trades in Mr. Goel’s personal brokerage account based on inside information concerning other companies, which resulted in nearly \$250,000 in illicit profits for Mr. Goel. The SEC alleges that the ring made off with \$25 million in illicit gains by trading on insider information.

Three weeks after the initial charges against Mr. Galleon, nine more people were arrested and fourteen more were charged. The most recent charges focus on a group of traders at the firm Incremental Capital. Zvi Goffer, the founder of that firm, who formerly worked at Galleon and Schottenfeld Group, allegedly organized a ring involving fellow Galleon and Schottenfeld trading colleagues. Mr. Goffer arranged to get tips on technology company deals through a lawyer at a major New York law firm. The SEC alleges that Mr. Goffer and the lawyers used difficult-to-trace pre-paid cell phones to communicate, and moved money in clandestine cash drops at various locations in Manhattan.

Several co-conspirators acted as informants for the government, some of them wearing wires, in conversations dating back two years. Authorities said they recorded calls in which the accused discussed companies they targeted.

In their investigation of both Galleon and Goffer, authorities used sophisticated data mining and electronic surveillance tactics that are normally reserved for the pursuit of gangsters and drug traffickers. The tactics used by the government illustrate that the government is under heavy political and investor pressure to more aggressively bring perpetrators of financial fraud and illegal profits to justice. These cases also illustrate that insider trading remains an area of intense focus by the SEC and other federal enforcement agencies.

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**Denver**

Roger Cohen ..... rcohen@swlaw.com ..... 303.634.2120  
 Brian Gaffney ..... bgaffney@swlaw.com ..... 303.634.2077  
 Richard Krumbein ..... rkrumbein@swlaw.com ..... 303.634.2088  
 Kristin Sprinkle ..... kmsprinkle@swlaw.com ..... 303.634.2112

**Las Vegas**

David Levine ..... dlevine@swlaw.com ..... 702.784.5224  
 Sam McMullen ..... smcmullen@swlaw.com ..... 702.784.5271

**Los Angeles**

Susan Grueneberg ..... sgrueneberg@swlaw.com ..... 213.929.2543  
 Marshall Horowitz ..... mhorowitz@swlaw.com ..... 213.929.2519  
 Rebekah Prince ..... rprince@swlaw.com ..... 213.929.2530  
 Peter Rho ..... prho@swlaw.com ..... 213.929.2535  
 Gregg Sultan ..... gsultan@swlaw.com ..... 213.929.2555

**Los Cabos**

Richard Krumbein ..... rkrumbein@swlaw.com +52624.173.9759

**Orange County**

Anthony Ippolito ..... tippolito@swlaw.com ..... 714.427.7409  
 Adam Miller ..... amiller@swlaw.com ..... 714.427.7474  
 Josette Mollica ..... jmollica@swlaw.com ..... 714.427.7032  
 Jim Scheinkman ..... jscheinkman@swlaw.com ..... 714.427.7037  
 Mark Ziebell ..... mziebell@swlaw.com ..... 714.427.7402

**Phoenix**

Charles Alm ..... calm@swlaw.com ..... 602.382.6349  
 Brandon Batt ..... bbatt@swlaw.com ..... 602.382.6546  
 Jeffrey Beck ..... jbeck@swlaw.com ..... 602.382.6316  
 Brian Burke ..... bburke@swlaw.com ..... 602.382.6379  
 Brian Burt ..... bburt@swlaw.com ..... 602.382.6317

Jon Cohen ..... jcohen@swlaw.com ..... 602.382.6247  
 Franc Del Fosse ..... fdelfosse@swlaw.com ..... 602.382.6588  
 Michael Donahey ..... mdonahey@swlaw.com ..... 602.382.6381  
 Matthew Feeney ..... mfeeney@swlaw.com ..... 602.382.6239  
 Cheryl Ikegami ..... cikegami@swlaw.com ..... 602.382.6395  
 Eric Kintner ..... ekintner@swlaw.com ..... 602.382.6552  
 Stefanie Layton ..... slayton@swlaw.com ..... 602.382.6567  
 Travis Leach ..... tleach@swlaw.com ..... 602.382.6530  
 Amy Lohman ..... alohman@swlaw.com ..... 602.382.6330  
 Daniel Mahoney ..... dmahoney@swlaw.com ..... 602.382.6206  
 Angela Perez ..... aperez@swlaw.com ..... 602.382.6354  
 Terry Roman ..... troman@swlaw.com ..... 602.382.6293  
 Melissa Sallee ..... msallee@swlaw.com ..... 602.382.6302  
 Jeffrey Scudder ..... jscudder@swlaw.com ..... 602.382.6556  
 Garth Stevens ..... gstevens@swlaw.com ..... 602.382.6313  
 Bianca Stoll ..... bstoll@swlaw.com ..... 602.382.6236

**Salt Lake City**

Ken Ashton ..... kashton@swlaw.com ..... 801.257.1528  
 Michael Black ..... mblack@swlaw.com ..... 801.257.1960  
 Brad Merrill ..... bmerrill@swlaw.com ..... 801.257.1541  
 John Weston ..... jweston@swlaw.com ..... 801.257.1931

**Tucson**

Richard Katz ..... rkatz@swlaw.com ..... 520.882.1270  
 Doug Ota ..... dota@swlaw.com ..... 520.882.1235  
 Lowell Thomas ..... lthomas@swlaw.com ..... 520.882.1221

**Denver, CO**

1200 Seventeenth Street | Suite 1900  
 Denver, Colorado 80202  
 (p) 303.634.2000 | (f) 303.634.2020

**Las Vegas, NV**

3883 Howard Hughes Pkwy | Suite 1100  
 Las Vegas, Nevada 89169  
 (p) 702.784.5200 | (f) 702.784.5252

**Los Angeles, CA**

350 South Grand Avenue | Suite 2600  
 Two California Plaza  
 Los Angeles, California | 90071  
 (p) 213.929.2500 | (f) 213.929.2525

**Orange County, CA**

600 Anton Blvd | Suit 1400  
 Costa Mesa, California 92626  
 (p) 714.427.7000 | (f) 877.253.4919

**Phoenix, AZ**

One Arizona Center | Suite 1900  
 Phoenix, Arizona 85004-2202  
 (p) 602.382.6000 | (f) 602.382.6070

**Salt Lake City, UT**

15 West South Temple | Suite 1200  
 Salt Lake City, Utah 84101  
 (p) 801.237.1900 | (f) 801.237.1950

**Tucson, AZ**

One South Church Avenue | Suite 1500  
 Tucson, Arizona 85701-1630  
 (p) 520.882.1200 | (f) 520.884.1294

**Los Cabos**

Snell & Wilmer de Mexico  
 S. de R.L. de C.V.  
 Plaza Las Velas, Suite 113  
 Paseo San Jose S/N entre Paseo del Estero  
 Zona Comercial Fonatur  
 San Jose del Cabo, B.C.S.  
 Mexico, C.P. 23400  
 +52 624.173.9737  
 Fax +52 624.173.9701

**Snell & Wilmer**  
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