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Mintz Levin Cohn Ferris Glovsky and Popeo PC

Securities Law Advisory: Preparation for 2007 Fiscal Year SEC Filings and 2008 Annual Shareholder Meetings

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As our clients and friends know, each year Mintz Levin provides a summary of the regulatory developments that impact public companies as they prepare for their fiscal year-end filings and annual shareholder meetings. This Advisory discusses key considerations to keep in mind as you embark upon the year-end reporting process in 2008.[1]

Compensation Disclosures. Companies' efforts to respond to the SEC's revised executive compensation disclosure requirements will remain a primary focus area this reporting season. The revised requirements took effect for annual reports and proxy statements covering fiscal years ending on or after December 15, 2006.[2] These requirements, including in particular the Compensation Discussion and Analysis section ("CD&A"), have shifted the timeframe for preparation of executive compensation disclosures to earlier in the year-end reporting process than ever before, due in part to the increasing number of individuals within and outside of companies whose input is required to draft the required disclosures. Following its review of companies' first efforts at preparing CD&A disclosure, the SEC has issued two valuable sources of guidance on the CD&A section, which we recommend all companies refer to prior to drafting the CD&A to cover 2007 compensation actions and decisions, as discussed in more detail below.

Internal Control over Financial Reporting. Companies continue to cope with the rigorous disclosure requirements that accompany internal control reporting obligations under Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). During 2007, the SEC issued interpretive guidance on internal control reporting for smaller companies, including an approach that will permit a more "scalable and flexible" approach to internal control reviews.[3] As noted by the SEC in its press release regarding the interpretive guidance, "smaller public companies often have less complex internal control systems than larger public companies, [and] this proposed approach would enable smaller public companies in particular to scale and tailor their evaluation methods and procedures to fit their own facts and circumstances."[4]

Smaller Reporting Companies. The SEC has also recently adopted rules creating a new class of reporting issuer: the "smaller reporting company." A smaller reporting company is an issuer that has less than $75 million in public equity float as of the last day of its second fiscal quarter. Issuers in that category will be able to take advantage of disclosure requirements that are in some cases less demanding than those that are required for larger issuers, as described in more detail below.

E-Proxy. The 2008 proxy season also marks the first year that many companies will be able to take advantage of the SEC's new electronic proxy delivery rules (referred to as the "e-proxy" rules) in distributing proxy materials. In order to do so, companies must comply with certain new procedural and notice requirements, which will necessitate adjustments to companies' time and responsibility schedules for the annual meeting process. These changes are summarized below.

Rule 144. Finally, as part of its ongoing efforts to ease capital-raising activities for companies, the SEC has shortened the holding periods for restricted securities under Rule 144.

We look forward to working with you to make this year's annual reporting process as smooth as possible.

Compensation Disclosures, Year 2—
More Detail, More Scrutiny

2008 represents the second year that companies are required to comply with the SEC's revised and expanded compensation-related disclosure requirements, including the CD&A. As we noted last year, in response to widespread demand from institutional and retail stockholder groups, on August 29, 2006 the SEC adopted rules that require extensive additional and revised detail on issuers' compensation practices and require that this disclosure be presented in "plain English."[5] After reviewing and evaluating issuers' first attempts to comply with the rules, the SEC has issued a series of comment letters and interpretive guidance setting forth ways in which companies must improve their disclosures, as described in more detail below.

Compensation Discussion and Analysis

The rules require most companies to provide a CD&A in their proxy statements or Form 10-Ks, discussing a company's philosophy on executive compensation for their named executive officers (NEOs).[6] Comparable to the Management's Discussion and Analysis of financial disclosure, or MD&A, the CD&A is viewed as the centerpiece of the principles-based reporting approach to executive compensation.

The CD&A must discuss the six explicit items set forth below, and must also discuss and analyze other information which the directors considered in determining the amounts and types of compensation paid to the NEOs during the most recently completed fiscal year.

- What are the objectives of the company's compensation programs?
- What is the compensation program designed to reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount (and, where applicable, the formula) for each element?
- How do each element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements?

As noted above, as you prepare the CD&A to analyze compensation decisions made during 2007, we encourage you to read the following documents made available on the SEC's Web site: *Staff Observations in the Review of Compensation Disclosure*, by the Division of Corporation Finance, and a speech by John W. White, Director of the SEC's Division of Corporation Finance, in which he discussed the Staff's observations and expounded upon his own thoughts and reactions to the first year of the new CD&A disclosure regime.[7]

In the *Staff Observations*, the Staff summarized and analyzed the principal comments it had provided to issuers, based on a review of the executive compensation and other related disclosure of 350 public companies. That review had been conducted by the Staff in order to evaluate compliance with the revised rules and provide guidance on how companies could improve their executive compensation disclosure. In its discussion, the Staff emphasized two main concepts: CD&A disclosure needs to be focused on *how* and *why* a company arrives at specific compensation decisions and policies; and the manner of presentation matters.

With regard to the "how and why" of executive compensation, the Staff explained that in many of the CD&As it reviewed, companies provided a great deal of detail regarding their compensation policies and decisions, but did not analyze sufficiently or at all the material factors underlying those policies and decisions. The Staff emphasized that under the principles-based disclosure regime, companies need to enhance their disclosure to explain, for example, the following:

- *how* they determined the amounts of specific compensation elements;
- *how* they arrived at the particular levels and forms of compensation that they chose to award to their NEOs;
- *why* they pay that compensation; and
- *how* and *why* the determinations they made with regard to one compensation element for a particular NEO may or may not have influenced decisions they made with respect to other compensation elements they contemplated or awarded to that NEO;

rather than simply listing numbers and stating policies.

The Staff emphasized it is not seeking longer CD&As; in fact "shorter, crisper, and clearer" disclosure was preferable. It advised companies to focus their CD&A discussions sharply on the motivations behind policies and decisions and cut back on lengthy descriptions of the mechanics of the policies and decisions. The Staff gave specific examples of the areas in which companies need to improve the most, with regard to presenting the "how and why." Prominent among these were the following:

In articulating compensation philosophies and decision mechanics, companies need to focus more on explaining how their analysis of relevant information resulted in the decisions they made and move away from lengthy discussions of the processes themselves.

In situations where individual NEOs received different compensation packages, companies need both to articulate the material differences among the packages and provide separate discussion of each package.

Where a company determines that it used corporate and individual performance targets as material factors in setting and awarding compensation, that company should discuss clearly *how* it analyzed individual performance and *whether or how* they focused on specific individual performance goals as part of that analysis. In such a discussion, the company should state the specific targets and clearly lay out the way that qualitative inputs regarding an NEO's performance were ultimately translated into objective pay determinations.

Where a company uses benchmarks, it should provide a more detailed explanation of *how* it used comparative compensation information and how that comparison affected compensation decisions, including identifying the companies to which it compared itself as well as the compensation components it used in that comparison; rather than just stating that it relied on benchmarking. Also, where a company uses a compensation consultant, it should identify the consultant and explain the scope of the consultant's involvement in compensation policy making.

In discussing their change-in-control and termination arrangements with NEOs, companies should disclose *why* they structured the material terms and payment provisions in these arrangements as they did and discuss *how* potential payments and benefits under these arrangements may have influenced their decisions regarding other compensation elements. Companies also should provide a total figure for the amounts payable upon each potential event triggering a payment under these arrangements.

The Staff also pointed out that in many cases, especially in the case of discussions of performance targets, companies may need to discuss trends in analysis and compensation over several years, in order to make the discussion of the current year's compensation meaningful.

With regard to manner of presentation, the Staff made several key points:

Companies should revise the structure of their disclosure so that it features material information more prominently and de-emphasizes and shortens discussions of compensation program mechanics.

In the CD&As that the Staff reviewed, many companies used charts, tables and graphs that were not specifically required by the rules to present detailed information in a comprehensive and succinct manner. The Staff encouraged this and, more generally, encouraged companies to use methods of presentation that are tailored to their particular circumstances.

Companies should follow plain English principles to provide clear, concise disclosure and avoid use of boilerplate language and should avoid copying language directly from employment agreements.

In Mr. White's speech, he gave his reaction to the first year of disclosures under the revised compensation disclosure requirements. The title of his speech, "Where's the Analysis?" sums up his basic response to many companies' attempts and echoes the messages conveyed in the *Staff Observations*. Themes Mr. White emphasized in his speech include the following:

The CD&A is a principles-based disclosure requirement. This means that companies are not required to address every example set forth in the disclosure in the CD&A—only those that are material to the company.

Meaningful analysis of compensation decisions is required. Mr. White observed that too frequently a detailed discussion of the components of a compensation package took the place of a discussion of *how* and *why* a company's compensation philosophies resulted in the compensation that was paid.

Mr. White echoed the Staff Observations in pointing out that specific areas in which companies frequently fell short in their analyses were benchmarking, differences in compensation among executive officers, change-in-control arrangements and, in particular, performance targets.

Mr. White also addressed manner of presentation, stressing that companies should follow plain English principles while presenting their CD&A disclosure as a succinct and effective discussion. He advised that companies could achieve this in part by avoiding certain pitfalls:

replacing boilerplate discussions of the individual performances of NEOs with specific analysis of how they considered and used individual performance to determine each individual's compensation;

avoiding mere repetition in the CD&A of information presented in the required compensation tables and instead providing a clear and concise analysis of that information; and

redrafting disclosure regarding compensation plans or employment agreements where the current disclosure repeats technical jargon of the plans or agreements themselves, to present a clearer, more concise and understandable discussion of those plans and agreements.

Overall, the heart of the message from the Staff and from Mr. White is that companies should devote sufficient time in preparing the CD&A to the actual analysis of *how* their compensation policies and practices translated into specific compensation decisions and *why* they opted for certain forms of compensation over others or for a particular balance of forms of compensation, such that when it comes to articulating the actual disclosure they can present that analysis in a clear and concise manner.

Summary Compensation Table

As a means of continuing to transition into the new disclosures, for the 2007 fiscal year, compensation data in the tables is only required for two years. Beginning with the 2008 fiscal year and beyond, compensation data will be required for three fiscal years, as was required under the former executive compensation rules.

As we go into the second year of reporting under the new rules, please contact the Mintz Levin attorney with whom you work if you have any questions on how to treat elements of compensation under these disclosure requirements.

Internal Control over Financial Reporting

Companies that qualify as large accelerated filers and accelerated filers have now experienced two years of compliance with the requirements of Section 404 of Sarbanes-Oxley concerning internal control over financial reporting ("ICFR"). As a reminder, those filers are required to include in their annual reports:

an evaluation by management of the effectiveness of the company's ICFR, and

an attestation report from the company's independent accountants with respect to the effectiveness of the company's ICFR.[8]

Management must also evaluate any change in a company's ICFR that occurs during a fiscal quarter and that has materially affected, or is reasonably likely to materially affect, the company's ICFR.

Starting with fiscal years ending on or after December 15, 2007, non-accelerated filers are now also required to include an evaluation by management of the effectiveness of ICFR. Non-accelerated filers are not, however, required to include the attestation report from their auditors on ICFR until their annual reports for fiscal years ending on or after December 15, 2008.[9]

For companies that are newly public, the SEC has granted a transition period allowing those companies not to include ICFR reports in the first annual report that they file after becoming subject to the reporting requirements of the Exchange Act. This is a significant benefit for newly public companies that otherwise would have been required to prepare for Section 404 reporting immediately after going public. Newly public companies that are relying on this provision must include a statement in the first annual report that they file to the effect that the report does not include management's assessment report or the auditor's attestation report on internal controls. For our clients that are planning to go public in 2008, this revision will allow them to wait to include required ICFR disclosures until their second annual report filed post-IPO.

Please note that if a company goes public early in a year (before February 15th for domestic issuers; before April 30th for foreign private issuers) using nine-month interim financial statements, that company's first annual report, in which the Section 404 reports will not be required, will be the one that is filed shortly after going public. The company would then become subject to Section 404 reporting in the next annual report, due the following year.

Management's annual report on ICFR and the attestation report provided by your auditors, which are required pursuant to Item 308 of Regulation S-K, should appear either in close proximity to the Management's Discussion and Analysis section of the Form 10-K or immediately preceding the company's financial statements. In addition, the SEC has indicated that companies should include both management's report on ICFR and the auditors' report on ICFR in the annual report to shareholders when audited financial statements are included in that report. The SEC has also noted that, if management states in the report that the company's internal controls are ineffective, or the auditors' report includes anything other than an unqualified opinion, and those reports are *not* included in the annual report to shareholders, the company would have to consider whether the failure to include those reports constitutes an omission of a material fact, rendering the annual report misleading.

If you receive any indication from your accountants that a qualified report will be issued, or that there are material weaknesses or significant deficiencies in your internal controls, you should consult with your counsel as soon as possible to determine any disclosure ramifications.

New Scaled Disclosure Requirements for Smaller Reporting Companies

Effective February 4, 2008, the SEC has adopted amendments to its disclosure and reporting requirements under both the Securities Act and the Exchange Act to expand the number of companies that qualify for its scaled disclosure requirements for smaller reporting companies. Specifically, the SEC has eliminated the definition of a "small business issuer" and created a new definition of a "smaller reporting company" that will encompass more companies than currently fall under the definition of a small business issuer. In addition, the amendments will integrate Regulation S-B, with its scaled disclosure requirements for small business issuers, into Regulation S-K and, with regard to preparation of financial statements, into Regulation S-X. Finally, the Forms SB-1 and SB-2 will be eliminated immediately, and the Forms 10-QSB and 10-KSB will be phased out by October 31, 2008 and March 15, 2009, respectively.

Under the new definition, companies that have less than $75 million in public equity float will be considered "smaller reporting companies" and will qualify for the scaled disclosure requirements. The definition of smaller reporting company parallels the definition of accelerated filer as to the process of determining that status: a company that, as of the last business day of its second fiscal quarter, has less than $75 million in public equity float may opt for the scaled disclosure requirements beginning with the Form 10-Q covering the second fiscal quarter corresponding to the measurement date establishing its eligibility as a smaller reporting company. Where a company is unable to calculate public float, the SEC has adopted an alternative standard, under which a company will be determined to be a smaller reporting company if it had less than $50 million in revenue in its last fiscal year. A smaller reporting company will be required to exit the scaled disclosure system after its public float rises above $75 million as of the last business day of its second fiscal quarter and will not be eligible to reenter the scaled disclosure system unless its public float falls below $50 million as of the last business day of its second fiscal quarter in a subsequent year. All companies that qualify as smaller reporting companies will be required to check a box on all of their filings, noting that they qualify as such, regardless of whether or not a particular company chooses to rely on the scaled disclosure requirements.

In addition to introducing the new category of a smaller reporting company, the amendments to the reporting requirements accomplish two main things: they eliminate Regulation S-B and its corresponding forms and integrate the item requirements of Regulation S-B that provided for scaled disclosure for smaller companies into either Regulation S-K or Regulation S-X.[10] The amendments for the most part do not make substantive changes to the disclosure requirements under Regulation S-B; they simply incorporate them into Regulation S-K, as alternative disclosure requirements for smaller reporting companies.[11] The only substantive change to the reporting requirements is to the financial statement rules, now under Article 8 of Regulation S-X: smaller reporting companies will be required to include two years of comparative audited balance-sheet data; whereas under the prior regime, small business issuers had only been required to include one year. The SEC opted for this increased disclosure because it felt that the comparative presentation would provide more meaningful information to investors.

Smaller reporting companies can opt to comply with the scaled disclosure requirements on an "*a la carte*" basis with regard to each filing, to the extent that their disclosure remains consistent and permits investors to make period-to-period comparisons, and to the extent that they include all disclosure necessary to make statements in the documents not misleading. Also, smaller reporting companies must comply with smaller reporting company requirements where those requirements are more stringent than the requirements for larger companies.[12] The SEC noted in the final rules release pertaining to these amendments that it expects that its Staff will evaluate item-by-item compliance by smaller reporting companies with only the Regulation S-K requirements applicable to smaller reporting companies, and not with the requirements applicable to larger companies, even if a particular smaller reporting company has chosen to provide disclosure compliant with the requirements for larger companies.

In addition to Article 8 of Regulation S-X, the specific items of Regulation S-K that were amended to allow scaled disclosure include the following:

Item 101, Description of Business: Smaller reporting companies may opt to meet the disclosure requirements of new paragraph (h), which, among other scaled requirements, only requires disclosure of business development activities for three years, rather than five.

Item 201, Market Price of and Dividends on Registrant's Common Equity and Related Stockholder Matters: The SEC has revised Instruction 6 to paragraph (e) to specify that smaller reporting companies do not need to provide a performance graph.

Item 301, Selected Financial Data; Item 302, Supplementary Financial Information: The SEC has added a paragraph (c) to each of these items to provide that smaller reporting companies are not required to present the information required by these items.

Item 303, Management's Discussion and Analysis of Financial Condition and Results of Operations: Smaller reporting companies may opt to meet the disclosure requirements of new paragraph (d), which specify that they are only required to provide two years of analysis, assuming they have opted to provide only two years of balance sheet data, and they are not required to provide tabular disclosure of contractual obligations.

Item 305, Quantitative and Qualitative Disclosures about Market Risk: The SEC has added paragraph (e) to this item, to specify that smaller reporting companies are not required to provide the disclosure required by this item.

Item 402, Executive Compensation: Smaller reporting issuers may opt to meet the disclosure requirements of new paragraphs (l) through (r) of this item. These scaled disclosure requirements include:

- providing disclosure for only three NEOs;
- providing Summary Compensation Disclosure for only two years;
- no requirement to provide a CD&A;
- providing only three of the seven tables required of larger companies[13];
- providing alternative narrative disclosures; and
- no requirement to include footnote disclosure of the grant date fair value of equity awards in the Director Compensation Table.

Item 404, Transactions with Related Persons, Promoters and Certain Control Persons: The SEC has revised the introductory text of paragraph (c)(1) and added paragraph (d) to change the calculation of total assets for smaller reporting companies to 1% of the average of their total assets for the last two fiscal years. Also pursuant to paragraph (d), smaller reporting companies will:

- not be required to disclose policies and procedures for reviewing related person transactions;
- be required to provide disclosure regarding transactions where the amount involved exceeds 1% of the company's total assets or $120,000;
- be required to provide additional specific information about underwriting discounts and commissions; and
- be required to provide disclosure regarding promoters and certain control persons.

Item 407. Corporate Governance: Smaller reporting companies may opt to meet the scaled disclosure requirements of new paragraph (g), and will not be required to provide Compensation Committee Interlock and Insider Participation disclosure or a Compensation Committee Report and will not be required to provide an Audit Committee Report until the first annual report after their initial registration statement is filed and becomes effective.

Item 503, Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges: The SEC has added paragraph (e) to this item, which specifies that smaller reporting companies need not provide information regarding the ratio of earnings to fixed charges when they issue debt or the ratio of combined fixed charges and preference dividends to earnings when they issue preference equity securities. In addition, under the scaled reporting requirements of this item, smaller reporting companies need not include risk factors disclosure in Exchange Act Forms 10, 10-K and 10-Q.

Under the amended regulations, all foreign companies will be permitted to qualify as smaller reporting companies if they otherwise qualify, based on the public float standard, and if they choose to make their filings on domestic company forms and provide financial statements prepared in accordance with U.S. GAAP.

The SEC has established a transition period for small business issuers, giving them the option to file their next annual report for the year ending on or after December 15, 2007 on either Form 10-KSB or Form 10-K. A small business issuer may continue to file its periodic reports using Regulation S-B and the "SB" forms until its next annual report is filed. After a small business issuer files its next annual report, it must file subsequent periodic reports on the standard forms, prepared using Regulation S-K and Regulation S-X, but it may elect to use the scaled disclosure requiremets as summarized above. In this initial transitional period, all small business issuers will be deemed to qualify as smaller reporting companies and will not need to make the calculation of their public float as of the last business day of the previous second fiscal quarter to establish their status. Companies that recently became reporting companies before the effective date of the amendments, but have not yet had a completed second fiscal quarter, will base eligibility on the public float calculated after the initial public offering. Companies determining their eligibility in connection with filing their initial registration statement will be required to choose a date within 30 days of filing to make the calculation to determine eligibility. In all cases, companies that qualify for smaller reporting company status will continue to have this status until they make their annual determination at the end of their next second fiscal quarter.

Electronic Delivery of Proxy Materials

The Securities and Exchange Commission has finalized its so-called "e-proxy" rules, which will ultimately require all issuers to post their annual meeting materials on a publicly available Internet site (which must be different from the SEC's Web site).[14] While all proxy materials must be *available* electronically, issuers will have a choice as to the means of *delivery* of those materials. As the SEC notes in its release adopting these rules, these changes "are intended to provide all shareholders with the ability to choose the means by which they access proxy materials, to expand use of the Internet potentially to lower the costs of proxy solicitations, and to improve the efficiency of the proxy process and shareholder communications." Issuers will still be required to have a supply of proxy materials available in paper copies for those shareholders who request them.

Under the e-proxy rules, issuers can either elect the "notice only" option, under which the issuer will send a notice to its shareholders that the annual meeting materials are available on the Internet, and not deliver paper copies of those materials unless requested to do so by shareholders, or the "full set delivery" option, under which the issuer will continue to deliver paper copies of all proxy materials to shareholders, but must still post those same materials on an Internet site and tell shareholders how they can access the materials on the Internet. Issuers do not need to choose only one of the options for all of their shareholders and may choose different delivery options for different groups of shareholders.

Notice Only Option

An issuer that chooses the "notice only" delivery model will be required to send a Notice of Internet Availability of Proxy Materials (a "Notice") to all shareholders *at least 40 calendar days* before the meeting date or, if no proxies are being solicited, before the date on which votes will be used to take a corporate action. This timing requirement will mean, for most issuers choosing to rely on this option, that they will need to prepare and distribute the Notice well in advance of 40 days prior to the meeting date, because the rules also provide that issuers must provide *intermediaries* (such as brokers who hold securities on behalf of their clients) with information necessary for the intermediary to prepare and distribute its own notice at least 40 calendar days before the meeting date (or shareholder action date). The notice only delivery option may not be used for proxies related to business combination transactions.

The Notice must be written in plain English and must contain the following information:

- a prominent legend in bold-face type that states:

  Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].

  This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.

  The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].

  If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery;

- the date, time, and location of the meeting or the earliest date on which the corporate action may be effected;
- a "clear and impartial" identification of each separate matter to be acted on, and any recommendations of the issuer regarding those matters (only if the issuer chooses to make a recommendation, which is not required), without any supporting statements;
- a list of the proxy materials that are being made available at the specified Web site;
- a toll-free telephone number; an e-mail address; and a Web site address where shareholders can request a copy of the proxy materials, both for all meetings of the issuer and for the particular meeting to which the Notice relates;
- any identification numbers that the shareholder needs to use to access his or her proxy card on the Web site;
- instructions on how to access the proxy card, which may not enable a shareholder to execute a proxy without having access to the proxy statement; and
- information about attending the shareholder meeting and voting in person.

The Notice must also be filed with the SEC no later than the first date that the issuer sends the Notice to its shareholders, and no other proxy materials may be sent along with the Notice. If a shareholder who receives the Notice requests delivery of a paper copy of the proxy materials before the meeting has occurred, the issuer must respond to the request by sending a copy of the materials by first-class mail within three business days of receipt of the request.[15] A shareholder's request for delivery of a paper copy shall continue with respect to subsequent proxy statements, unless it is revoked by the shareholder.

If the issuer is providing telephone voting as a means for executing a proxy, the Notice must not include the telephone number to use for voting since the shareholders will not, as of the time of receipt of the Notice, necessarily have reviewed the proxy materials themselves.

Issuers relying on the notice only option may follow up the delivery of a Notice with a paper or e-mail mailing of a proxy card, but must wait to do so until at least 10 calendar days from the mailing of the Notice, unless the proxy card is accompanied or preceded by a copy of the proxy materials.

Full Set Delivery Option

If the issuer elects to continue to deliver all proxy materials in paper form, it will nonetheless still be required to

- post its proxy materials on a publicly available Internet Web site (not including the SEC's Web site); and
- include information regarding access to the proxy materials that are posted on the Internet and other information regarding the meeting, either by preparing and sending a separate Notice of Internet Availability of Proxy Materials or by including the information in the proxy materials themselves.

Unlike the notice only option, issuers do not need to send the Notice out to shareholders at least 40 days before the meeting date, and the Notice may, although it is not required to, be accompanied by the proxy statement, annual report and proxy card.

The information that must be provided in a Notice under the full set delivery option includes the following information:

- a prominent legend in bold-face type that states:

  Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].

  The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address];

the date, time and location of the meeting or the earliest date on which the corporate action may be effected;

a "clear and impartial" identification of each separate matter to be acted on, and any recommendations of the issuer regarding those matters (only if the issuer chooses to make a recommendation, which is not required), without any supporting statements;

a list of the proxy materials that are being made available at the specified Web site;

any identification numbers that the shareholder needs to use to access his or her proxy card on the Web site; and

information about attending the shareholder meeting and voting in person.

Design of Internet Site at which Materials are Posted

Whether the issuer is using the notice only option or the full set delivery option, the Web site at which the proxy materials are posted must:

be in a format that is "convenient for both reading online and printing on paper";

remain available through the conclusion of the shareholder meeting; and

"not infringe on the anonymity" of the persons accessing the Web site. This means that issuers must refrain from using "cookies" or other features that could track the identity of those persons accessing the Web site to review the proxy materials, and may not disclose a shareholder's e-mail address. The SEC notes that this may "require segregating those pages [on which the proxy materials are posted] from the rest of the company's regular website or creating a new website."

Compliance Dates

Large accelerated filers (not including registered investment companies) are required to comply with these rules for proxy solicitations beginning on or after January 1, 2008. All other filers (including registered investment companies) may voluntarily comply with these rules for proxy solicitations beginning on or after January 1, 2008, and are required to comply with these rules for proxy solicitations commencing on or after January 1, 2009.

Amendments to Rule 144

Effective February 15, 2008, the SEC has adopted revisions to Rule 144 under the Securities Act. The primary effect of the revisions is to shorten the holding periods required prior to sales of restricted securities both by affiliates and non-affiliates, as described below.

Non-affiliates of Reporting Companies

Amended Rule 144 now provides a 6-month holding period for sales of restricted securities by non-affiliates of reporting companies, subject to compliance with the current public reporting requirements in Rule 144(c). After a 12-month holding period, non-affiliates of reporting companies will be able to freely resell restricted securities without compliance with the current public reporting requirements. In addition, non-affiliates of issuers are no longer required to file reports of sales on Forms 144.

Affiliates of Reporting Companies

Revised Rule 144 also provides for a 6-month holding period for sales by affiliates of reporting companies, subject to revised manner of sale requirements for equity securities. The revised rule will also remove the manner of sale requirements for debt securities and ease the volume limitations on debt securities. Affiliates will also continue to be subject to the current public reporting requirement. In addition, fewer affiliates will be required to file Forms 144 for sales under the rule, as the thresholds to require those filings will be raised from 500 shares or $10,000 to 5,000 shares or $50,000.

Final (for Now) Phase-in of Accelerated Periodic Report Filing Deadlines

For companies that qualify as large accelerated filers, annual reports on Form 10-K are due 60 days after fiscal year-end (Friday, February 29, 2008 for December 31 year-end companies).[16] Form 10-K reports continue to be due 75 days following fiscal year-end for accelerated filers[17] (Monday, March 17, 2007 for December 31 year-end companies), and 90 days after fiscal year-end for non-accelerated filers (Monday, March 31, 2008 for December 31 year-end companies).

In addition, Form 10-Q reports filed by accelerated filers and large accelerated filers will continue to be due 40 days after the close of the fiscal quarter. The Form 10-Q due date for such filers will not be accelerated to 35 days as originally planned. The deadline for Form 10-Q reports for non-accelerated filers continues to be 45 days after the close of the fiscal quarter.

The existing proxy statement filing deadline of 120 days after fiscal year-end remains in effect for companies that choose to incorporate by reference from their definitive proxy statements the disclosure required by Part III of the Form 10-K.

The SEC has also made it significantly easier for companies that have had declines in the market value of their public float to exit accelerated filer status. An accelerated filer whose public float had dropped below $50 million as of the last business day of its second fiscal quarter may cease to report as an accelerated filer at the end of the fiscal year in which its public float fell below $50 million, and may therefore file its annual report for that year and subsequent periodic reports on a non-accelerated basis. The rules also contain similar requirements for exiting large accelerated filer status, permitting a large accelerated filer whose public float dropped below $500 million as of the last business day of its second fiscal quarter to cease reporting as a large accelerated filer as of the end of the fiscal year in which its public float fell below $500 million, and to file its annual report for that year and subsequent periodic reports as an accelerated filer, or a non-accelerated filer, as appropriate.

Impact of Section 409A of the Internal Revenue Code

As you are aware, the U.S. Congress enacted Section 409A of the Internal Revenue Code (the "Code") in October 2004 and directed the Internal Revenue Service (IRS) and the Treasury Department to draft regulations providing much of the detail under that section. In April 2007, the IRS issued final regulations regarding Section 409A. Section 409A broadly regulates "deferred compensation," which is defined to include stock options.[18] Among other things, Section 409A applies to stock options that are granted below fair market value and potentially also to any stock option that is later modified.

If an option, as initially granted or *as subsequently modified,* is deemed under Section 409A of the Code to be deferred compensation and the option does *not* meet the strict requirements of Section 409A, the optionee will initially be subject to income tax in the year of vesting rather than the date of exercise (or later). The tax will be based on the spread between the exercise price of the option and the fair market value of the underlying stock on the last day of the year in which the portion of the option vested, *plus an additional excise tax of 20% as a penalty for noncompliance with Section 409A* and, potentially, interest from the date compensation is deemed to have been deferred. Some of these taxes are required to be withheld by the employer and paid to the IRS in connection with regular withholding payments. The penalty tax must be paid by the employee. If the payments to the IRS are not made in a timely fashion, the company issuing the option could be subject to penalties for late withholding.

Although it is customary for public companies to grant stock options at fair market value, it is important to be aware of the new regulations as Section 409A must be analyzed whenever options are modified or assumed in a merger transaction. In addition to stock options, Section 409A applies to any compensation to which the company has provided the recipient a legally binding right to be paid (even if such right is conditional) and the right to the compensation is "earned and vested." An amount is not "earned and vested" if it is subject to a substantial risk of forfeiture. In addition to traditional deferred compensation plans, Section 409A can apply to, among other things, bonus arrangements and severance payments if the time of payment does not comply with the new stringent requirements imposed by Section 409A. If you have not done so already, now is the time to analyze all of the arrangements that your company has in place, as much of the noncompliance can be rectified if modifications to these arrangements to comply with Section 409A are made prior to January 1, 2009.

Board of Director and Committee Membership

Each year as part of the year-end reporting process, we recommend that companies carefully examine the membership profiles of their board and board committees. Sarbanes-Oxley, the SEC rules issued under Sarbanes-Oxley, and changes to the listing requirements of Nasdaq, NYSE and AMEX relating to board and committee membership requirements have all made an impact on who may serve.[19] Mintz Levin has prepared a director independence and qualification checklist to assist with this analysis, and we encourage you to evaluate each director and director nominee to ensure continued compliance with these requirements.

Director Independence

Nasdaq's, NYSE's and AMEX's rules

- require each listed company to have a majority of independent directors serving on its board, and
- define who qualifies as an independent director.

Mintz Levin's form of *Director and Officer Questionnaire* includes questions designed to help companies determine whether a particular director will qualify as independent under the listing requirements. During 2007, Nasdaq, NYSE and AMEX amended their respective listing requirements to raise the dollar threshold for determining whether a transaction with a director will cause the director to fail to satisfy the independence requirements from $60,000 during any period of 12 consecutive months to $100,000 during such period.

In addition, Nasdaq, NYSE and AMEX require companies to disclose which directors have been affirmatively determined by the board of directors to have no relationship with the company that would interfere with the exercise of independent judgment in carrying out their responsibilities as a director.

Audit Committee Membership

In addition to the independence requirements imposed by Nasdaq, NYSE and AMEX for members of the board of directors, members of the audit committee are required to have greater knowledge of accounting matters and comply with even stricter independence standards. Rule 10A-3 under the Exchange Act provides that audit committee members may not be considered independent if they

- directly or indirectly accept *any* consulting, advisory or other compensatory fee from the issuer other than in their capacity as a member of the board or a committee thereof; or
- are affiliated persons of the issuer or any subsidiary.

In addition, no audit committee member may have participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years. Each audit committee member must be able to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement at the commencement of the audit committee member's term instead of within a reasonable time thereafter, as was previously permitted. In addition, any partner in a law firm that receives payments from the issuer is ineligible to serve on that issuer's audit committee.

In response to the directive of Rule 10A-3, Nasdaq, NYSE and AMEX prohibit the listing of any security of an issuer if each member of its audit committee is not independent under Rule 10A-3, subject to certain limited exceptions.

Compensation Committee Membership

Under Nasdaq, NYSE and AMEX corporate governance requirements, compensation of the CEO and all other executive officers must be determined, or recommended to the board for determination, either by a majority of the independent directors or by a compensation committee that is comprised solely of independent directors. In addition, the chief executive officer may not be present at the deliberations of, or voting by, the compensation committee with respect to his or her own compensation.

Additional considerations affect the composition of a public company's compensation committee in connection with other statutory and regulatory requirements. In order for a public company to derive a federal tax deduction for performance-related compensation expenses that result in more than $1 million of compensation being earned by an executive officer subject to Section 162(m) of the Code, including the recognized gain arising from stock option grants, the company's compensation committee that authorized the compensation must be comprised entirely of "outside directors," as defined in Section 162(m). In addition, Rule 16b-3 under the Exchange Act provides that one way of exempting stock option grants from the short-swing trading restrictions of Section 16(b) of the Exchange Act is to have stock option grants approved by a compensation committee that is comprised solely of at least two "non-employee directors," as defined in Rule 16b-3. We recommend that public companies make every effort to have all members of their compensation committees qualify as "outside directors" for purposes of Section 162(m) and "non-employee directors" for purposes of Rule 16b-3.

Nominating Committee Membership

The listing standards of Nasdaq, the NYSE and the AMEX provide that the nomination of directors must be determined either by a majority of independent directors or by a separately constituted committee. These listing standards do not require listed companies to consider shareholder nominees, although issuers must certify that they have adopted either a formal written charter or board resolutions addressing the nominations process. Nominating committees must also nominate the candidates for election at the company's annual meeting of shareholders, and those nominations must be accepted by the company's full board of directors.

Stockholder Approval of Equity Compensation Plans

Nasdaq, AMEX and NYSE all require shareholder approval for the adoption of equity compensation plans and arrangements for employees, directors and consultants and for any material modification of such plans and arrangements, including the addition of new shares to a plan. Exemptions from the stockholder approval requirement continue to be available for inducement grants to new employees if such grants were approved by a compensation committee or a majority of the company's independent directors and promptly following the grant a press release is issued specifying the material terms of the award, including the name of the recipient and the number of shares issued, and in certain situations relating to an acquisition or merger. An exemption from the stockholder approval requirement is also available for certain tax-qualified, nondiscriminatory employee benefit plans (such as plans that meet the requirements of Section 401(a) of the Code and employee stock purchase plans meeting the requirements of Section 423 of the Code), provided that such plans are approved by the issuer's compensation committee or a majority of the issuer's independent directors. Equity plans adopted prior to June 30, 2003 are unaffected under this rule, until a material modification is made to such a plan.

Companies should review their existing equity compensation plans as part of their year-end reporting preparation in order to determine whether shareholder approval will need to be obtained for new plans, increases in the numbers of shares available under old plans, or other material plan amendments.

Another revised rule now affects votes taken at shareholder meetings with respect to equity compensation plans. Registered broker-dealers holding stock in "street name" may no longer use their discretionary voting power to vote on any stock plan proposals without explicit instructions from the beneficial owner. Prior to September 2003, any proposal to adopt a plan or plan amendment that reserved for issuance a number of shares less than 5% of an issuer's outstanding common stock was deemed routine, and broker-dealers could use their discretionary authority to vote shares for which they did not receive instructions. As a result of this rule change, companies can no longer rely on the "routine" nature of an equity compensation plan proposal to be sure that a vote on that proposal will pass. In addition, RiskMetrics (formerly known as Institutional Shareholder Services, or ISS) and some institutional shareholders have their own guidelines to determine whether to vote in favor of a stock plan proposal. Because of these changes, more companies are retaining proxy solicitation firms in order to increase their chances of receiving approval for their equity compensation plans.

Other Year-End Considerations

We also recommend that companies take the opportunity while planning their year-end reporting to consider what amendments may be necessary or desirable to their corporate documents over the coming year that may require stockholder approval. Some items to consider are:

- Does the company have enough shares authorized under its certificate of incorporation to achieve all of its objectives for the year, including acquisitions for which it may want to use its stock as currency?

Does the company have adequate shares available under its equity compensation plans to last throughout the year?

Are there other material changes that should be made to the company's equity compensation plans that would require shareholder approval?

Has the company reviewed its charter and bylaws to assess any anti-takeover measures in place?

To the extent that a company expects any proposal in its proxy statement to create controversy among its stockholder base, it may want to consider hiring a proxy solicitor to assist with the process of seeking the requisite stockholder vote.

Mintz Levin Web Site Publications

We would also like to call your attention to the many advisories and alerts regarding topics of current interest that are available to you on our Web site, http://www.mintz.com//. New alerts and advisories are posted periodically, and we hope that you will find the information to be useful.

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[1] We invite you to review our Advisory from last year which described regulatory changes that were new for fiscal year 2006 and is available at http://www.mintz.com/newsletter/2007/Securities-Advisory-Year-End-0301/SecuritiesYearEndMemo3.pdf.

[2] Our advisories regarding the executive compensation disclosure rules are available on our Web site at http://www.mintz.com/newsletter/2007/Securities-Alert-SEC-AmendExComp-01-07/index.htm and http://www.mintz.com/newsletter/2006/Securities-Advisory-Principles-11-06/index.htm.

[3] This guidance is available at http://www.sec.gov/rules/interp/2007/33-8810fr.pdf.

[4] The text of this press release is available at http://www.sec.gov/news/press/2006/2006-206.htm.

[5] The final rules are available at http://www.sec.gov/rules/final/2006/33-8732a.pdf, and the amendments to the final rules are available at http://www.sec.gov/rules/final/2006/33-8765.pdf.

[6] The CD&A is not required for smaller reporting companies and foreign private issuers.

[7] The *Staff Observations* are available at http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm, and the speech by Mr. White is available at http://www.sec.gov/news/speech/2007/spch100907jww.htm.

[8] Previously, the attestation report from a company's independent accountants was required to address both the accountants' views as to the company's ICFR and also the accountants' views as to the company's evaluation of its own ICFR. The SEC has revised this requirement to provide that the attestation need only cover one topic: the accountants' views as to the effectiveness of the company's ICFR. See http://www.sec.gov/rules/final/2007/33-8809.pdf.

[9] The requirement for non-accelerated filers to include an auditor attestation report on ICFR may be extended yet again from the December 15, 2008 date, but no definitive guidance has been issued on the potential extension as of the date of this Advisory.

[10] These requirements formerly appeared in Item 310 of Regulation S-B.

[11] The SEC is including an index of scaled disclosure requirements in the definition of a smaller reporting company at the beginning of Regulation S-K.

[12] The SEC noted one particular example where this is the case: under Item 404 of Regulation S-K, smaller reporting companies are required to report transactions with related persons that exceed the lesser of 1% of the average of the smaller reporting company's total assets *or* $120,000, which may impose a higher disclosure burden given some companies' total assets. See also the changes to Item 404 for additional examples.

[13] These are the Summary Compensation Table, the Outstanding Equity Awards at Fiscal Year End Table and the Director Compensation Table.

[14] *Shareholder Choice Regarding Proxy Materials*, Release No. 34-56135 (July 26, 2007). See also *Internet Availability of Proxy Materials*, Release No. 34-55146 (Jan. 22, 2007).

[15] If the request for copies is received after the conclusion of the meeting, the materials must still be sent, but they do not need to be sent by first class mail nor do they need to be sent within three business days.

[16] *Large accelerated filers* are domestic companies that meet the following requirements as of their fiscal year-end:

have a common equity public float of at least $700 million, measured as of the last business day of their most recently completed second fiscal quarter (*i.e.*, for calendar fiscal year-end com

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