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Faculty Biographies

Alan L. Dye

Alan L. Dye is a partner with Hogan & Hartson L.L.P., a Washington, DC law firm, where he specializes in securities matters. Mr. Dye represents both public and private companies in SEC and New York Stock Exchange compliance matters, with an emphasis on corporate governance, insider trading compliance programs, and equity compensation arrangements.

Before joining Hogan & Hartson, Mr. Dye spent two years in the SEC's division of corporation finance and served for two years as special counsel to the SEC chairman. Prior to that, Mr. Dye served as a law clerk for the Honorable Ellsworth A. Van Graafeiland of the U.S. Court of Appeals for the Second Circuit.

Mr. Dye is an active member of the ABA, serving as chairman of the securities, commodities and exchanges committee of its administrative law section and as a member of the committee on federal regulation of securities of its business law section. He also is a member of the federal securities law committee of the Society Of Corporate Secretaries And Corporate Governance Professionals. He has written extensively on various issues under the federal securities laws (particularly Section 16 and Rule 10b5-1), including his co-authorship of the Section 16 Treatise and Reporting Guide (Executive Press 2004), the Section 16 Forms and Filings Handbook (Executive Press 2003), the Comprehensive Section 16 Outline (Executive Press 2004) and The SEC's New Insider Trading Rules, 34 Rev. Sec. & Commodities Reg. 1 (2001). He is a frequent lecturer at professional seminars and was an adjunct professor at the Georgetown University Law Center.

David Lynn

David Lynn is chief counsel of the Securities and Exchange Commission's division of corporation finance in Washington, DC. The office of the chief counsel in the division of corporation finance is principally responsible for responding to interpretive questions and requests for no-action positions, as well as supporting the review of filings by the division's disclosure operations function.

Mr. Lynn rejoined the division's staff as chief counsel and had previously served as an attorney and special counsel in the division of corporation finance. Before that, Mr. Lynn was in private practice at the law firm of Wilmer, Cutler & Pickering, where he advised public and private companies in SEC matters, securities transactions, and corporate governance.

Mr. Lynn received B.A. and a M.S. from Loyola College in Maryland and his J.D. from the University of Maryland School of Law.

Sean McKessy
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Altria Group, Inc.

Broc Romanek

Broc Romanek is general counsel of Executive Press in Arlington, Virginia. He is also editor of TheCorporateCounsel.net, CompensationStandards.com, DealLawyers.com, GreatGovernance.com, and AccountingDisclosure.com and co-editor of ShareholderProposals.com.

Before these positions, Mr. Romanek was founder and editor of RealCorporateLawyer.com. In addition, he has served as assistant general counsel at a Fortune 50 company, was in the Office of Chief Counsel of the SEC's Division of Corporation Finance, acted as counselor to former SEC Commissioner Unger, and was in private practice.

Mr. Romanek is immediate past president of the Mid-Atlantic Chapter of the American Society of Corporate Secretaries (ASCS) and serves as a member of the ASCS board of directors. He also is the immediate past chair of ACC's Corporate and Securities Law Committee. He also teaches a class in corporate governance for the George Mason University Executive MBA program and is on the advisory council for the SEC Historical Society. He frequently writes and speaks about corporate and securities law and is editor of the *Corporate Governance Advisor* and managing editor for the *M&A Lawyer.*

He has a B.B.A. from the University of Michigan and a J.D. from the University of Maryland.

SEC update

SEC Adopts Major Securities Act Reforms

August 5, 2005

On July 19, the SEC announced numerous changes to the rules and forms under the Securities Act of 1933 designed to modernize important features of the securities offering process. The revisions, which are described in a 468 page release (No. 33-8591), are primarily intended to eliminate outmoded restrictions on public offerings registered under the Securities Act. In a separate release (No. 33-8587), the SEC announced other rule changes under the Act designed to deter fraud and abuse involving shell companies. The registration reforms will become effective on December 1, 2005, and the shell company changes, with one exception noted later, will become effective on August 22, 2005.

Registration Reforms

The revisions to the registration requirements are deregulatory in nature, adopted in recognition of technological and other developments that have rendered impractical several longstanding restrictions on registered offerings. The SEC's actions do not constitute a fundamental overhaul, but instead represent incremental changes affecting selected segments of the registration process. Even though the revisions are voluminous, their basic framework is little changed from that proposed in November 2004 for public comment. The widespread public support for the approach taken in the proposals allowed the SEC simply to fine-tune them to address valid concerns raised by the 130 commenters.

The registration changes are intended primarily to reduce burdens on issuers and other participants in the offering process and increase the timeliness of information provided to prospective investors. Generally, the registration reforms will:

- Liberalize communications relating to registered securities offerings;
- Improve shelf registration and other offering procedures;
- Revamp the approach to prospectus delivery requirements; and
- Clarify the liability framework for information disseminated in registered securities offerings.

1. Communications Changes

The communications reforms generally will eliminate "gun-jumping" as a concern for certain established issuers, permit more written communications in the offering process, and exclude from the restrictions of the Securities Act communications that do not appear to have a significant potential to condition the market. Gun-jumping is the practice of engaging in publicity-generating activities that condition the market favorably to an offering and thereby undermine the statutory prospectus that historically has been the sole selling document for the offering. Although the SEC continues to deplore gun-jumping, it believes that technological advances in the dissemination of information and other factors have reduced the need for many of the gun-jumping restrictions. Consequently, the reforms will reduce these restrictions and provide qualifying issuers and their agents with the flexibility to issue within prescribed guidelines written and oral communications beyond the statutory prospectus during the offering period.

New Classification System. The SEC's new approach rests to a significant extent on a classification system for issuers under which the world of registrants will be divided into five categories. These categories will establish the extent to which an issuer will be eligible to take advantage of the liberalized communications provisions. An issuer's eligibility will be greatest at the top level (which comprises approximately 30% of listed issuers) and decline with each succeeding level:

- ***Well known seasoned issuers*** - An issuer eligible to use Form S-3 or F-3 that has either $700 million of worldwide public common equity float or has issued in the immediately preceding three years $1 billion of non-convertible securities, other than common equity, in registered offerings for cash;
- ***Seasoned issuers*** – An issuer eligible to use Form S-3 or F-3 to register a primary offering of securities by virtue of having a public float of at least $75 million and meeting the other requirements of the applicable form;
- ***Unseasoned issuers*** – An issuer that is required to file reports pursuant to Sections 13 or 15(d) of the Securities Exchange Act of 1934, but is not eligible to register a primary offering on Form S-3 or F-3;
- ***Non-reporting issuers*** – An issuer that is not required to file reports pursuant to Sections 13 or 15(d) of the Exchange Act (such as a company engaging in an IPO or an issuer that is voluntarily filing reports under the Exchange Act);
- ***Ineligible issuers*** – An issuer that possesses specified characteristics that disqualify it from any form of communications flexibility (such as blank check companies, penny stock issuers, and shell companies), or is excluded because it (i) is not current in filing required Exchange Act reports, (ii) has been the subject of certain legal or enforcement proceedings, or (iii) is subject to a separate regulatory approach (i.e., registered investment companies and business development companies).

Ongoing Business Communications. The SEC has adopted two safe harbor rules for ongoing business communications that will result in most of these communications not being viewed as an offer of securities. One safe harbor will apply to reporting issuers (i.e., issuers in the first three categories mentioned above, all of which file reports under the Exchange Act). It will codify the SEC's longstanding position that an issuer which files Exchange Act reports may continue to publish or disseminate regularly released factual business or forward-looking information at any time, including the time of a registered offering. The second safe harbor will permit non-reporting issuers (the fourth category above) to publish or disseminate factual business information (but not forward-looking information) of a type that is regularly released and intended for use by persons other than in their capacity as investors or potential investors.

Offers During Pre-Filing Period. The current regulatory scheme does not permit an issuer to offer securities before it files a registration statement for the offering. The new system will depart from this approach by permitting well known seasoned issuers to make unrestricted oral and written offers of securities during the pre-filing period. Other issuers (except ineligible issuers) will be allowed to issue communications that make no reference to a securities offering up to 30 days before the filing of a registration statement, so long as the issuer takes reasonable steps to prevent further distribution of the information during the 30-day period before the filing date. As in the case of offers by well known seasoned issuers, these communications will be subject to the antifraud provisions of the securities laws.

Rule 134 Notices. Rule 134 under the Securities Act provides a safe harbor for public notices containing limited information about an offering that are disseminated after the issuer files a registration statement for the offering. The SEC's revisions will broaden the scope of these notices by allowing the notices to include additional information regarding the issuer, its business, the terms of the securities being offered, the mechanics of the offering process, and other matters. The expanded Rule 134 notice, however, will not be permitted to include a detailed term sheet for the securities being offered, although such a term sheet could be delivered as a free writing prospectus, as discussed below.

Free Writing Prospectuses. Perhaps the most remarkable change adopted by the SEC is the concept of a "free writing prospectus." Since the inception of the Securities Act over seven decades ago, the statutory prospectus has stood alone as the sole selling document through which a registered securities offering is to be made. While the revised system will continue to place primary emphasis of the statutory prospectus, it will permit issuers and other offering participants (such as underwriters, brokers and dealers) to disseminate other communications considered to be an offer of securities if certain prescribed conditions are met. The principal conditions will be that these other communications (i.e., free writing prospectuses) (1) not be materially misleading, (2) be consistent with the statutory prospectus, (3) contain a legend regarding the statutory prospectus, (4) be retained for at least three years, and (5) be filed with the SEC in most instances.

The SEC adopted this expansive approach because it believes that the current regulatory scheme places unnecessary restrictions on written communications during the offering process. The term "written communication" is defined to mean any communication that is written or printed, a radio or television broadcast, or a graphic communication. The definition of "graphic communication" is broad enough to encompass electronic road shows, but excludes these and other forms of communication that are carried live and in real-time to a live audience, regardless of the means of transmission.

Free writing prospectuses deemed to be written offers under the new system will be permitted to include information that goes beyond the information included in the statutory prospectus, so long as the additional information does not conflict with the statutory prospectus. Well known seasoned issuers will be allowed to make these offers at any time. Other issuers (except certain ineligible issuers) will be able to use free writing prospectuses only after a registration statement has been filed. Non-reporting issuers and unseasoned issuers also will be required in some instances to accompany or precede the free writing prospectus with the most recent statutory prospectus. A free writing prospectus will not be subject to the restraints of Regulation FD, so long as it relates directly to a registered securities offering.

All issuers will have to include a legend in the free writing prospectus that directs investors to the statutory prospectus and contains certain other information, and both issuers and offering participants will have to retain for three years copies of the free writing prospectuses used by them. An unintentional or immaterial failure to comply with these requirements will be curable where a good faith and reasonable effort to comply was made. Issuers will be required to file their free writing prospectuses with the SEC, as well as free writing prospectuses prepared or used by other offering participants (such as underwriters) that contain material information about the issuer or its securities not previously filed. Issuers also will be

required to file any free writing prospectus that describes the final terms of the offering. Offering participants generally will not have to file free writing prospectuses used or referred to by them, except where the prospectus is distributed by or on behalf of the participant in a manner reasonably designed to lead to its broad unrestricted dissemination.

Issuers will be liable under the antifraud provisions not only for free writing prospectuses issued by them that fail to conform to applicable requirements, but also for any issuer information contained in any other offering participant's free writing prospectus, as well as any free writing prospectus they prepare, use or refer to. Other offering participants will not be liable for a defective free writing prospectus where they do not use, refer to, or participate in the planning and use of the free writing prospectus by another offering participant who uses it.

Media Publications or Broadcasts. The SEC traditionally has been concerned about press interviews by company executives and other uses of the media by offering participants that may condition the market for an offering. Under the new system, these uses of the media generally will be permissible so long as the requirements for free writing prospectuses are satisfied. Additional requirements, however, will apply to any issuer or other offering participant who either prepares or pays for a media publication or broadcast (as in the case of an "infomercial" or written advertisement). Non-reporting issuers and unseasoned issuers will have to furnish a statutory prospectus no later than the time of the publication or broadcast. In practice, this may not be possible, so it seems unlikely that media offers will be made by non-reporting and unseasoned issuers. Seasoned issuers that prepare or pay for a media publication or broadcast will be required to have their most recent statutory prospectus on file with the SEC. Prior or simultaneous delivery of the statutory prospectus will not be required where the interview or other media event that constitutes a free writing prospectus is prepared by an unaffiliated media person and is not paid for by the issuer or other offering participant. The free writing prospectus, however, will have to be filed with the SEC by the issuer or offering participant.

Electronic Road Shows. The new system will eliminate many of the conditions presently imposed on electronic road shows by SEC no-action letters. The SEC recognizes that road shows, which are a primary means by which issuers market an offering, often are conducted or retransmitted over the Internet or other electronic media. As indicated above, an electronic road show will be considered a written communication, except where it is transmitted live and in real-time to a live audience. Where the exclusion for live shows does not apply, the road show will be deemed a free writing prospectus. An electronic road show or its script typically will not have to be filed with the SEC. Filing, however, will be necessary for an electronic road show relating to an initial public offer of common equity or convertible equity securities where the road show is not bona fide or not readily available to an unrestricted audience.

Issuer Web Sites. The new system will make clear that an offer of an issuer's securities, either on the issuer's web site or on a third-party web site hyperlinked to the issuer's web site, is a written communication that, unless exempt, will be a free writing prospectus of the issuer. The same view will apply to information contained on, or hyperlinked to, an offering participant's web site. Historical issuer information that can be accessed by visitors to the web site ordinarily will not be considered a free writing prospectus if the information does not constitute an offer, as in the case of ongoing business communications that fall within one of the safe harbors discussed above. If, however, the historical information is updated or otherwise modified, or used or referred to (by hyperlink or otherwise) in connection with the offering, the information will be deemed a free writing prospectus.

Research Reports. Research reports issued by broker-dealers and others relating to an issuer that is in registration currently are subject to limitations imposed by Rules 137, 138 and 139 under the Securities Act. The new system will expand the situations in which offering and non-offering participants may disseminate research reports during a registered offering.

2. Shelf Registration and Other Procedural Improvements

Current SEC rules allow issuers to register debt and equity securities to be "taken off the shelf" and offered to the public on a delayed or continuous basis during the two years following registration. Shelf offering documents generally consist of a "base prospectus" that contains information relevant to all offerings under the shelf registration statement and prospectus supplements that provide specific information regarding securities taken down from the shelf from time to time for offering to the public. The new system will include a number of procedural changes intended to improve the operation of the shelf registration process.

Automatic Shelf Registration by Well Known Seasoned Issuers. The new shelf registration procedures will make available to well known seasoned issuers an expedited method of shelf registration. Under this method, these issuers will be able to register unspecified amounts of different specified types of securities for takedown from the shelf at any time without indicating, at the time of registration, the plan of distribution, the names of any selling security holders, or whether the securities are being registered for a primary or secondary offering. The new approach effectively will reduce the information required to be included in the base prospectus, and shift the omitted information to prospectus supplements . Further, a well known seasoned issuer will not encounter any delays in making a shelf offering because the registration statement for the offering will become effective automatically upon filing, without review by the SEC staff. These issuers also will be able to (1) add immediately, at any time after effectiveness, not only classes of securities to those initially registered, but also majority-owned subsidiaries as registrants, and (2) pay registration fees either in advance or on a "pay-as-you-go" basis as securities are taken down from the shelf.

Relaxation of Restrictions. The new system will modify or eliminate a number of other restrictions on the shelf registration process. These changes will be accomplished by:

- Codifying in a single rule the information that may be omitted from a base prospectus in a shelf registration statement at effectiveness and included later in a prospectus supplement;
- Replacing the requirement that issuers register only securities they intend to offer within two years with a requirement that the issuer update the registration statement with a new registration statement that is filed every three years (and which will be immediately effective);
- Eliminating restrictions on "at-the-market" equity offerings by seasoned issuers with a $75 million public float;
- Revising for seasoned issuers with a $75 million float the requirement to identify selling security holders by permitting these holders to be identified in prospectus supplements (rather than post-effective amendments) where the securities to be sold (or securities convertible into such securities) are outstanding when the registration statement is filed;
- Permitting immediate takedowns of securities off shelf registration statements; and
- Allowing issuers to use prospectus supplements (rather than post-effective amendments) to make material changes to the plan of distribution described in the base prospectus.

Broadened Incorporation by Reference. The availability of incorporation by reference to meet disclosure requirements for prospectuses will be expanded by permitting issuers using Form S-3 or F-3 to incorporate by reference from their Exchange Act reports all information about themselves and their securities required by these forms. Further, issuers that must use either Form S-1 or F-1 to register a securities offering will be able to incorporate by reference into their registration statements information from their own reports and documents filed under the Exchange Act if, among other requirements, they (1)

have filed at least one annual report under the Exchange Act, (2) are current in their reporting obligations under that Act, and (3) make their Exchange Act reports that are incorporated by reference into their Form S-1 or F-1 readily accessible on their web sites. As part of these revisions to Forms S-1 and F-1, however, the SEC will not permit "forward" incorporation by reference of future Exchange Act reports filed by the issuer after its registration statement becomes effective. An issuer filing on Form S-1 or F-1 will have to include in the registration statement at effectiveness a list of all reports and documents incorporated by reference. After effectiveness, the registration statement will have to include material changes in or updates to the incorporated information.

Expanded Availability of Forms S-3 and F-3. The revisions will expand the availability of Forms S-3 and F-3 to permit use of these forms to register offerings of guarantees by majority-owned subsidiaries of non-convertible securities of other majority-owned subsidiaries or of the parent. Availability of the forms in these circumstances will depend on the ability of the entities to meet the qualification requirements applicable to well known seasoned issuers.

Elimination of Forms S-2 and F-2. The SEC will eliminate these forms on the ground they are outdated, due to technological advances in the dissemination of information, as evidenced by their infrequent use by issuers.

3. Prospectus Delivery Reforms

The Securities Act requires that a final prospectus accompany or precede the confirmation of sale sent to the purchaser. The SEC believes that the current requirement for physical delivery of a final prospectus has become outmoded in light of the technological advances that have provided investors with greater access to information. Accordingly, the SEC has adopted rule revisions that will allow other methods to be used to satisfy the prospectus delivery obligation.

Access Equals Delivery. The new rules will utilize an "access equals delivery" model for final prospectuses. This model presumes that investors have access to the Internet and therefore the issuer or offering participant can satisfy the delivery obligation through the availability of the offering documents or filings on a readily accessible web site. As a consequence, offering participants will not have to print or physically deliver final prospectuses if they file a final prospectus with the SEC by the due date specified in Rule 424 under the Securities Act and comply with certain other conditions. An inadvertent failure to file will be curable if certain conditions are satisfied. Consistent with this approach, the SEC's revisions will eliminate the requirement for broker-dealers to deliver a prospectus physically in aftermarket transactions where information regarding the issuer is broadly disseminated, including through the SEC's EDGAR web site.

Confirmation of Sale. Each underwriter, broker or dealer participating in a registered offering (or the issuer, if the offering is being made directly by it) will be able to satisfy the requirement that a confirmation of sale be sent to each purchaser by sending to each purchaser, within two business days after completion of the sale, a notice indicating that the sale was made pursuant to a registration statement or a final prospectus. Underwriters and broker-dealers participating in a registered offering still will be required to send notices after effectiveness of the registration statement, by e-mail or other form of written communication, to customers and members of the selling group indicating their allocation of securities in the offering. These notices, however, will not have to be accompanied or preceded by a final prospectus.

4. Liability Clarifications

Timing of Liability. Several rule changes will clarify the application of the liability provisions of the Securities Act. For purposes of the registration provisions of the Act, free writing prospectuses will not be considered part of the registration statement to which they relate. These prospectuses, however, will be subject to liability under the antifraud provisions if they contain material misstatements or omissions. Another change of perhaps greater significance is a rule indicating that the determination whether liability exists under the antifraud provisions with respect to statements by a seller to an investor will be measured as of the date the investor enters into a contract to buy the securities, rather than the later date on which the final prospectus is filed. This approach is likely to foster the adoption by issuers of procedures designed to provide a record that investors were not permitted to finalize their investment decisions until they were provided access to all of the information required to be disclosed under the Securities Act. The new approach could result in more frequent instances of recirculation of the final prospectus filed with the SEC containing last minute changes, even where the need for recirculation is not clear-cut. Although issuers and underwriters traditionally have been loathe to recirculate in such situations because of the chilling effect it can have on the offering , the new "access equals delivery" method of delivering prospectuses should eliminate the delays in completing the offering that traditionally have made last minute recirculation undesirable.

Liability for Shelf Registration Disclosures. Under the new rules, prospectus supplements used in connection with shelf takedowns and other situations will be deemed to be part of the registration statement to which they relate. This change will clarify the liability status of information in prospectus supplements by providing that the information is fully subject to the liability provisions of the Securities Act. Other new rules will provide that each takedown from a shelf registration statement establishes a new effective date under the registration provisions of Section 11 for issuers and underwriters, but not for experts, directors and signing officers. Experts, however, would have a new effective date if they provide a new report or opinion, for which a consent is required, in an Exchange Act report or in connection with the takedown.

Additional Exchange Act Disclosures

Because many of the revisions that will relax requirements under the Securities Act rest on the premise that Exchange Act filings provide adequate information about the issuer to investors, the SEC has strengthened the disclosure requirements for those filings. Under the new rules:

- Risk factor disclosures will be required in annual reports on Form 10-K and registration statements on Form 10, and will have to be updated as needed each quarter to reflect any material changes from previously disclosed risks;
- All issuers required to file Exchange Act reports on an accelerated basis (including well known seasoned issuers) will have to disclose in their annual report on Form 10-K or 20-F written comments from the SEC staff issued more than 180 days before the end of the fiscal year covered by the report that are material and remain unresolved at the time the report is filed; and
- Issuers that are filing reports voluntarily under the Exchange Act will have to disclose their voluntary filing status by checking a box on the cover page of their annual reports.

Shell Company Deterrence Measures

The SEC has long been concerned about fraud and abuse in the securities markets that occur through the use of shell companies. Although the SEC recognizes that shell companies should not be penalized where they are used in connection with transactions, such as restructurings, that have a legitimate purpose, it believes a number of measures are necessary to deter abusive practices involving these companies. Accordingly, the SEC adopted rules that will:

- Define what constitutes a "shell company" (i.e., a registrant with nominal operations and little or no assets other than cash or cash equivalents), and refine the definition of "succession" to encompass "back door" Exchange Act registrations that effectively take a private company public through a shell company;
- Prohibit the use of Form S-8 by shell companies, based on the SEC's experience that the form has been used to circumvent Securities Act requirements by these companies;
- Add to Form 8-K a new Item 5.06 requiring disclosure when a company ceases to be a shell company;
- Revise existing Form 8-K disclosure requirements relating to the acquisition or disposition of assets and changes in control to require companies that cease to be shell companies to disclose information comparable to the information they would be required to provide if they were filing an Exchange Act registration statement;
- Require shell companies that are foreign private issuers to provide disclosures on Form 20-F comparable to the new Form 8-K disclosures when they cease being shell companies; and
- Require issuers to indicate on the cover page of their Exchange Act reports whether they fall within the definition of "shell company."

The shell company changes will take effect on August 22, 2005, except for the new Form 8-K Item 5.06, which will become effective on November 7, 2005.

Commentary

The wide-ranging changes adopted by the SEC represent the second effort by the agency in the past seven years to modernize the registration process. The previous effort in 1998 was an ambitious one whose far-reaching scope earned it informal recognition as the "aircraft carrier." Although that effort did not result in significant reforms, it provided the conceptual basis for a number of the changes recently adopted by the SEC. In general, these revisions are thoughtfully constructed and will do much to ease outmoded restrictions. While it is too soon to say whether they will meet all of the objectives that prompted their adoption, they clearly represent substantial improvements that should result in registered offerings proceeding in a more timely and efficient fashion.

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Wednesday, June 8, 2005

Scenarios

Director turnover is at an all-time high and officers are coming and going in droves too. Heightened investor interest in corporate governance and a new disclosure regime also changes the dynamics of director and officer turnover. This webcast will provide practical guidance regarding how to handle timing and sensitive disclosure issues, recruitment and retention in a new environment, and much more. Join these experts:

- **Sharon Hendricks**, Shareholder, Heller Ehrman LLP
- **Karl Barnickol**, Partner, Blackwell Sanders Peper Martin LLP
- **James Ukropina**, Of Counsel, O'Melveny & Myers LLP and Director of Lockheed Martin, Central Natural Resources and Indymac Bancorp
- **Carol Ward**, Corporate Secretary, Cigna Corporation
- **Jim Rowe**, Executive Vice President, James Mintz Group

- Departing and Arriving Officers
- Disclosure Requirements
- Acquiring New Directors
- Complex Terminations
- Internal Controls for Appointments and Departures of Insiders
- CEO Succession

BROC ROMANEK, Editor, TheCorporateCounsel.net. Hi, this is Broc Romanek, Editor of TheCorporateCounsel.net. Welcome to today's webcast, "Managing D&O Departures and Arrivals." I'm real excited about this webcast. The panel has done an incredible job preparing for it and it could be an all-day event, but we're going to try to squeeze this into roughly an hour-and-a-quarter.

The first thing I'm going to ask you to do is to click on the link on the webcast's page called "Scenarios." And if you could go to that page and print off the three scenarios that are there, they will be sliced and diced during the webcast. The second and third scenario we actually might not have sufficient time to go through them, but we have included them in case there is enough time.

Let me introduce today's panel. Sharon Hendricks is a Shareholder of Heller Ehrman. She gave me the idea for this webcast a few months ago and Sharon has done a great amount of work on this. We have two former chairs of the American Society of Corporate Secretaries on this panel. Karl Barnickol is now a Partner of Blackwell Sanders, who used to be in-house, and Carol Ward is Corporate Secretary of Cigna Corporation. We have Jim Rowe who is an Executive VP at Mintz Group and who specializes in background checks for directors and CEOs. And of course, Jim Ukropina, who is Of Counsel at O'Melveny & Meyers and is a Director at Lockheed Martin, Central Natural Resources and IndyMac

Bancorp and author of a book called "The Board." Jim is going to speak about CEO succession, which is going to be a hot topic as the new Disney lawsuit proceeds to trial in August.

Without further adieu, let me turn it over to Sharon to go over the scenarios. Sharon.

SHARON HENDRICKS, Shareholder, Heller Ehrman LLP. Thanks Broc. We have a lot of material to cover today, so I'm going to jump into that. We're focusing on appointments and departures of executive officers and directors, which are one of the most sensitive corporate events that people at companies and those advising them face. They have a much more personal element than most other corporate events and they are occurring in an increasingly complex web of legal and regulatory rules that require the events that are happening to be made public and made public pretty quickly.

We've structured the presentation to be useful to both public company officers and directors themselves, to highlight the issues and considerations that they will face, and we're also focusing it for in-house and outside advisors involved in the process. And my sense is that those advisors who are not directly involved but are assisting in the process are feeling a bit more and more like air traffic controllers where they're directing several planes onto the landing strip at once because there are a lot of different moving pieces.

Departing and Arriving Officers

HENDRICKS: We did come up with some scenarios and we had a lot of fun doing that. We probably could have put together another half dozen scenarios and maybe Broc will encourage us to do that at some point. But the first one that we want to talk about - let me just follow that through - the Board of Directors of a public company at a board meeting in its private session determines that the CEO should leave, so they discuss this issue in a private session at the board meeting and then they continue discussing it after the board meeting and the few days that follow. And then after that a couple of the directors meet with the CEO and convey the board's sentiments.

The CEO then immediately grabs his employment agreement to see what rights he has. And the board goes off in its own direction to engage a head hunter to identify CEO candidates and eventually they meet with a promising candidate suggested by one of the board members. And then after that the background reference and conflict check process begins.

KARL BARNICKOL, Partner, Blackwell Sander Peper Martin LLP: This is Karl Barnickol and I'm going to jump into Sharon's scenario periodically, and I wanted to particularly point out the last point that Sharon made because there's a potential conflict and a potential problem here.

The Board says it's going to engage a head hunter, but then it proceeds right away to follow up with a crony of one of the directors. In my experience, directors are often more comfortable with somebody that another director knows and perhaps calling him a 'crony' is unduly pejorative but, whatever you think of the relative merits of the two selection methods, the absence of a search firm is going to have an impact on this conflict check and disclosure process and that's a theme we're going to keep coming back to through this presentation.

HENDRICKS: And we're going to hear a bit more about the CEO's succession process later in the panel, which would have impacted how this scenario plays out.

So by this point in the process, some members of the company's executive and administrative personnel are being asked to do different tasks relating to the incoming and outgoing CEOs. HR has probably been asked questions about a proposed package for the new CEO and the finance department is being asked to provide information about the accounting consequences that will come up on these different comp packages, in particular probably the outgoing CEO's severance package and what accounting consequences and comp charges will be incurred if those are triggered.

By this point, one of the directors has probably sat down with the general counsel to bring her up to speed with the developments. And it's at that point that the general counsel probably feels like the air traffic controller trying to understand and identify what the responsibilities are for everyone.

The director and the general counsel would probably discuss the timing of different board and comp committee meetings, finalizing agreements and public announcements of the expected developments, as well as the background work that would have to go on to make all this come together. The directors then determine to make some changes to the severance arrangements and the CEO's actual employment agreement because they're outdated or somehow they felt that they needed to be changed, so there are probably informal discussions among the comp committee members to approve this package before there's actual final approval of the package.

BARNICKOL: Now one thing that you have to keep in mind here is that this doesn't all happen on a single day. Time is passing. It wouldn't be surprising for a couple of weeks to have gone by by the time we get to this point in Sharon's scenario. Obviously, there's a major disclosure issue. When do you get to the point where there's a duty to disclose? I think most people would say "not yet." But the scenario as Sharon has read it out so far is a fairly clean scenario.

HENDRICKS: That's right. And at this point in the process now the board's looking a little bit more broadly at what impact this will have and they've become concerned that one or two of the other members of the executive team maybe at risk or the company may be at risk of losing them because of the change in CEOs, so they then consider whether they need to make some additional comp arrangements or put new employment agreements in place for some other officers to make sure that they're retaining them.

At this point the general counsel or whoever is sort of the central air traffic controller is probably calling time out and saying this is too much to put together all at once but things like this do happen.

Then one of the most important things that inevitably comes up in these situations - the finance department looks at what's happening, now has more information to know what the final terms will be, and determines that the financial statement charges associated with the comp packages, probably in particular the separation package, but possibly also the new CEO comp package and maybe if there are other awards or employment agreements being put in place for other officers, they may determine that there's some significant accounting effect. It may be material in amount. There may be a material comp charge that may have its own disclosure requirements. It may delay final sign off on an audit or other things going on that the auditors are involved in. It may raise questions to the auditors about the company's internal controls.

And so those issues have to be worked through and as a result of this, they decide that it's appropriate to call an audit committee meeting to make sure that the comp package and the decisions going on with the comp package are okay in terms of the left hand knowing what the right hand's doing. And then a full board meeting is called to discuss everything and make sure the board is signed off on it and then after that the comp committee meets to approve the compensation packages and then the officers accept their packages and the agreements are signed.

BARNICKOL: Now we are certainly at the time when there's a need to disclose. As Sharon said, there's a lot of moving pieces here. It's critical to have a good set of controls over this process. Do we know that all of the people who have tasks to do in connection with all of these actions are up to speed? Are they ready to execute? It's not just the legal group, the accounting group and HR. Are the people who need to deal with the business implications ready to go? Somebody has to be the overall air traffic controller, as Sharon says, and be sure that we've got everybody who needs to act.

HENDRICKS: So then at that point the company issues a press release and files an 8 K announcing the departure of the old CEO and the hiring of the new one. Probably the appointment of the new CEO to the board, a description of the separate comp packages for each of them and if there were other officers involved who are getting different or new comp arrangements which might need to be disclosed as well. Form 4s are probably filed at this time with respect to any equity grants. So as Karl said, this is a fairly clean and orderly process. There are a lot of complications that could come up and we'll get into some of those situations later in the presentation.

What Karl and I want to cover in the next bit of the program are the disclosure issues and we're going to look at the 8-K rules as well as the Section 16 rules. The compensation issues also drive this process quite a bit, in that they can be complex and can impact the overall conclusions. We're then going to talk about director appointments and get into some of the complex termination situations that arise and then conclude with internal controls and best practices.

Disclosure Requirements

HENDRICKS: On the disclosure requirements, I'm not going to recite the 8-K disclosure rules. We're not going to have time for that in this panel, but I do want to mention a few highlights of them in that the 8-K disclosure rules, as amended last August by the SEC, have really significantly changed the disclosure that's going on with officer and director appointments and the comp arrangements, as well as departures.

The SEC issued an FAQ on the 8-K rules last November which has been very helpful. And basically what we're looking at with respect to insider events is the hiring, promotion, appointing, electing of officers and directors. There are some exceptions: electing a director by means of a shareholder vote at a shareholder meeting called for that purpose would be excluded, but basically any time an executive officer or a director is coming on board, the analysis has to be done as to what must be disclosed.

Same with outgoing - terminating, retiring, demoting, directors refusing to stand or resigning. There are special rules if there's a disagreement when the director goes off, special rules also if the company is removing a director for cause. And then in addition, the entering into, material amending of, or terminating the compensation arrangements with the named executive officers and directors and probably certain other executive officers need to be considered in light of the disclosure requirement.

Basically all comp arrangements with NEOs and directors are material and require disclosure and they need to be filed with the company's 1934 filings as well, including any arrangements that otherwise wouldn't be written down. The SEC has been real clear that those need to be disclosed and at least a summary of those need to be filed. There are some exceptions to that - awards under already disclosed plans. But what we're seeing out there in terms of what's being filed is pretty conservative disclosure.

The 8-K rules - it's a four business day requirement - but as we sort of drew out in the scenario and as Karl mentioned, it's sometimes difficult to know when the actual event has occurred, particularly in these sensitive situations.

FAQ 24 is helpful on this. It articulates that in the event a principal officer or director retires, resigns, terminates, is removed, refuses to stand, et cetera, that that disclosure is triggered with notice. And I think that probably means notice by either party of a decision. The FAQ makes it clear that discussions or consideration of a resignation, retirement or refusal to stand doesn't trigger disclosure. The SEC is applying a facts, and circumstances test there that makes the advisors and, in particular, the lawyers have to evaluate what's going on and make sure that there hasn't in fact been a notice. The FAQ speaks only to retirement, resignation and refusal to stand for directors, but I think it probably is being applied more broadly than that in all the termination situations.

But it raises a bunch of questions. Does the board communicating to the incumbent officer that it has started to look for his or her replacement constitute notice of termination? Does starting to negotiate a severance package with the incumbent officer constitute notice? If the incumbent officer is taking action, has hired a lawyer or if he or she is starting to negotiate with other companies and the company or the board knows that, does that constitute notice? So it is different from situation to situation and it's going to depend on the nature and tone of the discussions and how preliminary they are, but this can be tough terrain.

Some companies have procedures and requirements as to how they terminate executive officers. I think bylaws often talk about that. And that may be an extra step that has to be gone through to confirm that in fact you have a termination.

One helpful thing in the 8-K rules is that in appointing a new principal officer, if you intend to make a public announcement of the appointment, you can delay the 8-K until the date of the public announcement - not four days later but the date of the public announcement. And also delay the disclosing the terms of the employment arrangement or the appointment to the board. But this isn't available with respect to the termination of the outgoing officer, so we end up with a little bit of disjointedness there in terms of when the disclosure requirements on each end of the situation apply.

We're dealing with several different sets of people covered by these rules - principal officers, named executive officers, and executive officers - as well as different rules that apply with respect to what you have to disclose at the time of appointment or at the time of entering into the employment agreements.

I'm not going to get into those rules because they can be pretty time consuming. But one thing I'll mention is that with the comp packages, there may be circumstances and Broc mentioned he's having a confidential treatment request webcast in the upcoming weeks and some of the comp arrangements are at least raising questions about whether confidential treatment should be obtained. I don't think we're seeing a lot yet, but it's at least being discussed.

So, at this point you can understand that there a lot of parties involved - the decision makers themselves and the affected insiders, the company personnel, the outside advisors - and multiple filings and disclosures going on - we talked about the 8-K and there may be 10-Qs or 10-Ks being filed. There may be a proxy about to be filed or you may be in the period where the proxy is pending, you're in the period leading up to the shareholder meeting where various other considerations are going to have be made.

One of the things that gets tripped up sometimes with the appointment of new officers and directors is the need to have EDGAR codes and making sure that those are obtained in a way that the company can assist the insider in getting on file the Section 16 forms reflecting new grants on hire in a timely manner. And some thought needs to be given, particularly if you're appointing somebody and delaying the announcement until full public announcement, as to when the Form 4 will go on file and how that will interact with the public disclosure. And as people are going out, any continuing (post-termination) Section 16 reporting obligations or potential liability have to considered as well.

The compensation issues that come up in these situations are pretty involved and they involve a bunch of different parties. And this is probably where one of the biggest coordination issues has to come about. The board and board committee, sometimes multiple committees, need to be involved in these decisions. So some of the issues that have to be focused on are time to consider the different matters being discussed, scheduling issues - there's a always a director who's on his boat in the South Pacific and can't be on a call for a week .

Procedures have to be adhered to. There are still governance and fiduciary obligations at play here with the decisions being made and so some time needs to be allowed. We're seeing more and more informal, sort of 'non-meeting' board and committee interactions, where comp committee or board members are discussing things amongst themselves at a time when formal action isn't required and we think this is a good thing in terms of the board members being involved and on top of the issues.

You need to be coordinating amongst the different committees and the scenario we talked about, the audit committee and the comp committee, and the need for them to know what each other is doing. I think that's probably the most important issue there.

We're seeing more annual comp decisions where companies are making all the comp decisions for executive officers at a single time during the year and this simplifies the disclosure. And so the effect of making decisions for new officers or outgoing officers at other times can throw that schedule off or reopen the comp process.

One suggestion that Karl had that I think is an excellent one and we're seeing it more and more is making the comp committee take a look at what the 8-K disclosure will be and also the proxy statement disclosure, including the comp committee report, in terms of how those documents will disclose the comp decisions being made.

Contract issues - it's very important to review all the contracts of the departing officers and inform the board and, in particular, the comp committee about the rights and the expenses associated with separation packages, in particular. Although the comp committee should have already been aware of that and made aware of that in connection with preparing the comp committee report and reviewing tally sheets of the executive officer compensation.

These decisions can have a ripple effect, so they can affect other officers' agreements. We sometimes run into 'good reason' definitions for one officer that get triggered when another officer leaves, so it's important to look at the whole picture. If you're dealing with performance awards or we are occasionally seeing loans that might come up in the promotion context at this point but, there are some additional complexities there.

We highlighted in the scenario the accounting issues and I'm not going to spend a lot more time on that, other than to say that one of the difficulties that everyone's dealing with right now is that the comp committee and the audit committee, in looking at these decisions, need to have information both about the accounting consequences under the current accounting rules, if the company hasn't yet adopted FAS 123R, as well as what the consequence will be once those new rules apply to the company.

There are stock plan issues that need to be looked at. Does the plan allow the committee to do what it wants in either structuring the separation package or the new comp package? Does the plan have the right type of awards? How many shares are in the 162(m) limit, so how many shares can be granted during a single year, even to a new hire? Are there enough shares in the shareholder approved plan?

If there are not enough shares, it may be necessary to grant an award outside of shareholder approved plan under the special exception under the Exchange rules to do that for new hire officers. And that involves its own set of complexities - press releases and other disclosure requirements, additional listing applications and registration of those shares.

And there should also be consideration to any stock ownership guidelines that apply in structuring a new comp package for a new officer coming on.

There are a bunch of tax issues and these issues are complex and they seem to just be getting more complex. There will be corporate tax issues, including the 162(m) considerations. This could have a material effect, particularly for smaller companies. There may be golden parachute issues.

New Section 409A, the new deferred comp tax law that we're all struggling right now to understand and awaiting IRS interpretation and guidance later this year, can have a big impact on these arrangements. And you have to think about the impact under 409A for agreements that have been in place for a while, so existing agreements have to be taken into account as well as structuring new agreements and the issues we're dealing with there, particularly in the severance context - really severance payments that extend into years after the year of termination, so salary continuance for a couple of years, that's raising questions under this new law.

Modifications of options at a time when those options are in-the-money other than - I think most people think other than just vesting acceleration. Those are being looked at pretty carefully.

Certain 'constructive termination' or 'good reason for quitting' definitions are raising some concerns. And you have to look at if there are any actually deferred comp arrangements that exist, in particular all of the executive officers involved would be key employee and this new 409A requires that actual deferred comp arrangements to those employees that are paid on separation from service be delayed until six months after separation from service. So there are a bunch of analytical issues that are coming up there.

I think Karl is now going to talk about some of the director issues.

BARNICKOL: Right, Sharon. We're going to shift from a focus in scenario one on a departing CEO and an arriving new CEO to the process of acquiring new directors. And we're going to start with Carol Ward to talk about the process of finding and then nominating new directors.

Acquiring New Directors

CAROL WARD, Corporate Secretary, Cigna Corporation. I wanted to start by just saying that the director recruitment process has changed a lot in the last few years and I think it's going to continue to evolve. In general, the process is far more complex and takes longer.

I'm going walk through a timeline for director recruitment. It starts with the nominating committee adopting New York Stock Exchange or other exchange-mandated director responsibilities and qualifications. Then, beyond that, it's helpful to the committee if they can develop specific skills or skills matrix or assessment, what skills and experience are currently represented on the board, and then, looking ahead, what skills and experience are going to be needed in the future? Again, committees can find this exercise really helpful in focusing their recruitment effort. Are they looking for somebody with a lot of financial experience or people management experience? This matrix can be very helpful to that end.

Once the committee has thought about what it is looking for, because of the importance of director recruitment these days, many governance committees are retaining director search consultants to help with the process. How do you find one? Well, most of the large executive search firms have a director recruitment product and there are also smaller firms that do director recruitment as well.

And I have observed, and my counterparts I think would support this, that using a good firm helps ensure that the governance committee sees the best available and fully-vetted prospects. And the firm can also help with preliminary contacts and interest level assessment. You're going to reach out to a lot of people who just say no.

It is important that the firm have a clear understanding of what the search's goal is and to ensure that understanding, it can be helpful if the firm talks with the chairman of the governance committee or the chairman of the board, whoever is best able to explain that to the firm.

If the firm is not familiar with your company, the corporate secretary or someone is going to need to spend time educating the firm. The firm is going to do a better job for your company if they have a really good understanding of your business and culture.

Search firms can also help sort out mundane things like potential date conflicts. If your board regularly meets on the first Tuesday of the month, you can't be looking to recruit prospects who have standing commitments on the first Tuesday.

When you've identified some serious prospects, you can anticipate that the prospects will want to do their own due diligence. You may find that this process is in many ways kind of a mini-orientation.

Let me just give you two resources that can help you prepare for this phase of recruitment – the American Bar Association's Corporate Directors Guidebook includes a section entitled, "Deciding to Join a Board" and there's also a recent article that (Joe Hinsey) wrote in the May issue of Directorship. You can just anticipate that many subjects mentioned in these and similar pieces are going to be asked of you by the prospects, and it's best to get the answers ready and in a forum easily shared with the prospects. For example, it shouldn't come as a surprise to anyone that prospects are likely to ask about D&O insurance and it's really helpful to have that information in a package that's readily shareable and digestible by any prospect.

I'd also say, and this goes to Karl's earlier points about trying to gather information, your director questionnaire needs to be up to date and ready to be sent because you're going to want to get this into the hands of your prospects when you're reaching the serious stage of discussion because you're going to need more data than you ever have in the past in order to help the governance committee sort through the prospect's independence, financial literacy, qualifications as an audit committee financial expert and, again to Karl's point, potential conflicts. The information that you gather at this stage is often in addition to what can be provided by the search firm.

Jim Rowe, in just a minute, is going to talk about further background checks. Some companies contact firms directly. Some contract those checks through their search firm. I have found those checks to be helpful in simply confirming information, but also they have occasionally identified issues requiring further research. And it's just a great comfort to the nominating committee to know that the work has been done.

Looking at how you're going to staff your governance committee and your board before they make any decision, the corporate secretary needs to be sure that all of the relevant information is provided to the governance committee throughout the recruitment process and then to the full board when the committee is ready to make recommendations. You all know which mechanisms work best at your companies, but both the committee and the board need to be apprised of the committee's progress as it proceeds.

In addition to the selection process and regulatory requirements that are prompted by director election, this also helps to consider how your company wants to handle the announcement. There was an article in a recent issue of "Directors and Boards" regarding announcing a new board member. And it really encourages people to think creatively about this event. If you work with your IR folks, your PR folks and even your employee communication folks, the announcement of the new director can be positioned as very exciting news for your company.

Needless to say, the prospect is going to want to see the announcement. And if that prospect is associated with a corporation or other significant institution, that organization is also likely to want to see the press release, so build that into your timeline.

Once the board has appointed a new director, you start a formal orientation process. A very unscientific poll of my counterparts suggests that the orientation processes are becoming more structured and more thorough, often with sessions before the new director's first meeting and then additional sessions as committee assignments are made.

So I've laid out a number of steps in the process, than briefly, but to reinforce my original point, the process is just more complex than it used to be, a lot more information needs to get assembled, digested and analyzed. And that just takes longer, so it's really important for folks to use that time wisely to get through that workload.

And I'd like to turn now to Jim for a little bit more detailed discussion on the kind of background checks that he does on directors and executives.

JIM ROWE, Executive Vice President, Mintz Group. Thanks Carol. This is Jim Rowe with the James Mintz Group and we get involved towards the end of the process, obviously prior to the appointment of the director or the hiring of the senior executive.

We are finding more and more often that search committees at companies as well as the execute search firms are reaching out to outside consultants to do more thorough background checks or due diligence on the candidates.

Traditionally, due diligence was something that was done in a deal capacity or a lending capacity and now I think it's fair to say that the industry norm is to work with the search committee or the search consultants with the external consultants doing the due diligence in a way that supplements the third-party interviewing that the search firms traditionally have done.

What we do is we look at the individual who's under consideration first and foremost from a prior public record standpoint. And we really drill down on what we would describe as criminal and civil litigation, regulatory matters, licensing issues, prior employment. We try to verify that rigorously. We often go all the way back to the candidate's first job and one thing that we do find fairly often are jobs that fall off resumes or jobs that have durations that don't quite coincide with the actual tenure that the person had.

We also look at financial matters and we do a rigorous news search. We know publications that are not online as well as esoteric trade newsletters you usually have to have a subscription to. So we work hand in glove with either the internal search committee at the company or the external executive search firm.

In senior executive appointments where you're hiring the individual, you have to comply with the Fair Credit Reporting Act, so we often find ourselves writing reports that are going to be handed over to the individual who may be running the company at the end of the day.

With a director appointment that is not deemed to be subject to the Fair Credit Reporting Act and while it's helpful to get a consent to do certain things, frequently on director searches we will not go through the Fair Credit Reporting Act drill and we will not have a report that would end up with the director.

We work very carefully with the search liaison people. They'll have resumes and I think the points that were made by the prior speakers about fashioning a questionnaire, from our standpoint, what we would like to do is work with the client and having probing questionnaires about possible prior controversies in their past. Most of our executive searches and directors have people who have been in a handful of companies at the very top levels and while we might have a jaundiced eye about a class action case, we are going to rigorously look into regulatory or Department of Justice action thereafter.

We do try to do this rapidly. As Carol noted, we tend to get involved at the end. Oftentimes there is a lot of time sensitivity and we will try to do this within a week's time, but obviously if there's a red flag, we call that in immediately.

The price is really contingent on how far back in time you want to go. The controversy over Sunbeam and Chainsaw Al Dunlap, the questions in his past went back over 20 years. And frequently we work out a scope of activities that the search team wants us to do, whether it's really first day after college or the last decade or so.

And with that, I'll turn it back to Carol, if she has anything to add.

WARD: No. I think Jim, you've covered it. Again I just reinforce that the background work that Jim does is generally found to be very helpful by the committees and others working on the search process.

ROMANEK: Jim, have you seen a big growth in your practice since Sarbanes-Oxley?

ROWE: I think that firms like ours are probably doing as much in what we would call pre-employment, pre-appointment for CEO or board vetting as we were doing in deals and prefinancing due diligence. If it's not industry norm, it's becoming more and more commonly expected and the candidates that a couple of years ago might have been bewildered by the Fair Credit Reporting Act and the consent form process are no longer so.

ROMANEK: I have a number of articles from the Mintz Group up in the CEO Succession Practice Area as well as the Director Recruitment Practice Area. One of the articles that Carol mentioned is up there. Why don't we go ahead and switch it back over to Karl to continue on with his discussion about directors.

BARNICKOL: Sometimes you're in the situation where you don't have the benefit of a search firm and may not have the benefit of a firm that can do the kind of background checking that Jim's firm can do. Typically, that's the situation where the nominating committee already thinks they know somebody who would be a good candidate to be an outside director and don't see a need to hire a search firm.

And then it falls pretty much to the company staff and counsel to try to figure out the necessary information to determine whether this person is going to qualify to meet the standards that the board think it's meeting in naming this person. How will a committee know about the affiliations of the nominee?

There is a provision in the Clayton Act, Section 8, which is sometimes forgotten that bans persons from being directors of competing companies. There's a very small de minimis exception.

Perhaps a more common problem is to find the relationships which could trigger potentially embarrassing disclosure in the proxy statement in response to the related party transaction disclosure required under Regulation S-K Section 404.

How can the committee achieve assurance that the director will qualify as independent? What you would like to do is, as Carol said, do a director and officer questionnaire with a candidate at a fairly early stage. Sometimes that's possible. Sometimes it's not for various reasons.

Occasionally, I have been able to get permission to talk to the general counsel of the candidate director's principal company. That can be very helpful. You can learn a lot of information and clear up a lot of potential problems if you can get permission to do that.

The situation is a little better than it was a few years ago, at least in my experience, because the director candidates are more active in doing due diligence on the company. Serious director candidates want to meet and quiz several of the senior officers, the other directors. They really do look at this information that Carol has described that you need to provide and those kind of contacts open the door for the company to gain information about the candidate. But if you don't have a search firm and you don't have a background firm, there's a little bit of risk here.

Compensation issues in nominating a new director - a new director obviously doesn't necessarily mean that compensation of the outside directors changes, but it does tend to cause the other directors to want to bring up issues about compensation and talk about it. That may necessitate preparing summaries of the compensation or dealing with changes and that needs to be managed in terms of, first, who approves board compensation. Practice on that varies. Some places it's the compensation committee. Some places it's the full board. Some places it's the nominating committee. What filings or disclosure do those changes trigger? And are there any changes in compensation that are going to require shareholder approval?

Probably worth noting in terms of disclosure of director compensation is one of the FAQs that Sharon referred to, number 5, that talks about summary sheets that are distributed to directors with their compensation and when that might in itself trigger an 8-K.

Sharon and I are going to turn now to complex termination situations, issues that arise from other corporate events that are going on while you're trying to handle this process of naming a new officer or director or terminating an old officer.

Complex Terminations

HENDRICKS: Yes and I think the point to be made here is that these changes and these decisions don't happen in a vacuum. There's typically a lot going on at the company at the time that these decisions are being made. And it's critical to have the big picture in terms of all of the corporate events going on.

There may be other sorts of disclosure events that are occurring at the time of the change and most of these are more complicated with terminations, so we're really focusing on officer terminations here.

The company may be about to file a 10-K or a 10-Q and there may be certification issues if it's the CEO or CFO. There may be a need to appoint an interim CEO or CFO if one of those officers leaves abruptly and financial statements are about to be filed.

There are accounting issues. We have hit on that before in terms of the ripple effect that can go with that and the potential need to have the auditors involved to make sure that the changes being made or the way its being handled doesn't have any impact on the financial statements. Some of those accounting issues could be outside of the compensation area altogether and it might be in the comp area where you're looking at comp charges. But there might be other things going on outside of the comp area altogether that affect accounting issues.

There are other corporate announcements that are routinely going on about the company's news and products and litigation and regulatory matters and so it's good to understand what's going on in that respect and when those are happening. If you're making management changes after filing the proxy but before the shareholder meeting, you're going to be facing questions about whether to update the proxy materials or how to handle that.

There may be industry conferences, so the CEO or CFO or another officer that is about to leave - and particularly if it's abrupt there - it may be that the company doesn't involve the IR person or the sales person in the decision until very late in the process and that person will raise the issue - but this person is leaving two days before they're supposed to appear at an industry conference and speak for the company.

Some terminations come about as a result of misconduct and that can significantly increase the complexity. There may be grounds for a cause termination. There may be issues that need to be looked at in terms of whether there has been a securities law violation or any sort of financial statement fraud, whether there's a need to notify the SEC about it. There may be whistleblower implications. Some of those situations do become quite contentious and they may lead to litigation, so that would up the ante as well. And by that I mean litigation between the officer and the company.

There's also misbehavior less than a for-cause termination and some sensitivity to how terminations are disclosed in terms of who made the decision. There may be a claw back of benefits in really extreme cases.

We mentioned before in this scenario, multiple officer involvement. It may be that there are multiple departures. The CEO is leaving but as a result of that, several other people will leave at the same time.

The company may be involved in litigation that the officers are involved in as well. There may be securities litigation that's ongoing or other product litigation that needs to be considered in the decision-making process.

BARNICKOL: A couple other items for the checklist on the departing officer situation. Does the departing officer have some critical relationships with regulators or with a customer or vendors or creditors which are going to require personal calls from another officer or possibly even from an outside director or other action to avoid damage to the business?

Serious consideration has to be given to how you're going to handle the internal communications. Any event like this, particularly a departing CEO, is very disruptive to the employees and anybody who has gone through this knows that what happens is the employees basically stop working and gather around the modern equivalent of the water cooler, which are their computers, and they start firing rapid emails back and forth to each other, speculating on why this officer is leaving.

You need someone to appear before the employees quickly, if it's not the CEO departing then it needs to be the CEO. If it is the CEO, it needs to be an outside director to speak to the employees, explain the change and provide, if possible, some assurance of continuity.

Some special considerations if the departure involves a director. This involves scenario two which Broc referred you to. I won't read it, but it's essentially the situation where a director resigns or refuses to stand for reelection because of the disagreement with the company or the rest of the directors that is known to an executive officer on any matter relating to the company's operations, policies or practices or if in the rather rare case that a director is removed for cause, then there is additional disclosure as to the circumstances, representing the disagreement that caused the resignation or refusal.

You have to file copies of the correspondence with the director, provide the director with the disclosure that you're going to make on an 8 K and allow him or her to provide a letter responding to the company's disclosure and file that. It's rare. It occasionally happens. It is a very difficult situation and one that needs to be handled as quickly as possible.

Internal Controls for Appointment and Departure of Insiders

BARNICKOL: Let's turn now to some possible internal controls that you can establish to help deal with these situations of appointment and departure of directors and officers and some best practices.

These events are typically surprises, but there is some advance planning possible. And it is certainly possible to have a checklist for situations where insiders would be departing and replacements arriving and some allocation of responsibility so that everybody knows who will do what and who needs to be consulted before final decisions are made.

Sharon points out that oftentimes the IR people know things that other people in finance or certainly the legal group don't know. Another basic step is simply to list who are the executive officers, who are the named executive officers, who are the principal officers and make sure that everybody who could be involved in the process recognizes that there are special considerations if there is a change contemplated with respect to them.

In particular, at least in my experience, the human resources people need to be reminded who are the people who are on the list of special officers because it is not top of mind for them. They are frequently the first people to know that a change is underway and you want them to be very sensitive to a change if it involves one of the named executive officers or one of the principal officers, under the new category, or one of the regular executive officers.

Obviously a best practice is that the board should have a succession plan in place and Jim Ukropina is going to talk about that further. But even if there's no succession plan, there are two things that ought to be done.

Number one, make sure that there's somebody among the directors who knows who at the company needs to be informed about a sensitive personnel issue. It could be the general counsel. It could be the head of human resources. But make sure that the lead director, if there is one, or the person most likely to be involved in leading this sort of a change at a high level knows who on the staff to contact.

Correspondingly, that company officer, whoever that is, needs to know which director to contact first in the event of an emergency affecting the CEO. Is it the lead director? Is it the chair of the nominating committee? You need to have a discussion with the directors as to who is going to be the point person in the event of a true crisis.

Also a good best practice is to make sure that the finance group is kept in the loop about significant compensation decisions so that they can provide the information to the compensation and the audit committee prior to action being taken.

As Sharon has mentioned earlier, part of preparation here is to recognize that there is a time factor. This is going to take time and indeed there needs to be some time provided, particularly for the directors and the board committees, so that they can satisfy their duties as fiduciaries and follow good governance practices, despite the time pressure.

Sharon mentioned earlier when you have a new director arriving, make sure that EDGAR codes are obtained early on. It is the sort of technical glitch that can make for a big problem if it's not done in time.

And finally, consider your cycle of awards, bonuses, equity awards - where are you in that cycle and is the announcement of a departing or arriving senior officer going to have an impact on the timing, or should it have an impact on the timing, of equity awards?

Finally in terms of best practices, it seems to me that we've been talking about the event where an officer or director is arriving or departing, but there's an ongoing maintenance component to this. We've already spoken about the need to make sure that conflicts of interest are found, are vetted prior to appointment. But conflicts of interest can arise after you have a director or an officer on board.

Now companies generally have corporate governance policies covering conflicts of interest by directors or officers, but particularly with respect to the outside directors, how will the company know if the director takes a new position or a new directorship which raises an actual or a potential conflict of interest? And this is not limited to the situation where the director becomes the director of a competitor, which would be a flat out violation of the Clayton Act.

It's more likely to apply to a situation where the director's new company is a vendor, a customer, a creditor, perhaps not on a big scale but nonetheless there's a relationship there that could trigger disclosure. And this is scenario three among the scenarios that Broc referred you to. A director takes up a new position, having left his or her old company or becomes a director of yet another company.

The staff really has to focus on this. The other directors typically won't know that this is going on unless the director in question tells them. In my experience, even when they're told, they're frequently reluctant to face up to it. The potential conflict of interest is not their day-to-day problem. It's probably the problem of the Vice President of Purchasing or somebody like that. And moreover, the other directors probably like the sitting director. They really don't want to face up to the problem of having to push this person off the board. It's probably going to be up to management and counsel to push the outside directors to face up to these problems.

Now we all have two standard tools to accomplish what I've called the maintenance aspect of conflicts of interest. And one is obviously the director conflict of interest policies, although there is the problem of knowing when the conflict arises. And the other way we do it is through the annual director and officer questionnaire.

How do you make sure the director and officer questionnaires are completed and that the responses are thought through and correct? We all know that it has been common practice over the years for D&O questionnaires to be given short shrift by directors and senior officers. They're often given to a secretary to fill in. The secretary is told to just look at last year's questionnaire – that it's probably all the same answers. - just go through it and put in the same answers as last year.

The enforcement action on compensation disclosure that the SEC recently brought against Tyson focused on the poor quality of the responses to the D&O questionnaire. That was a major factor in the Tyson problem.

I would offer one practical hint that has worked well for me with D&O questionnaires and that is, don't send the questionnaire in the same format as you did last year. Change the order of the questions and if the "right answer" to question 2 was 'yes' last year, change the language so that the right answer this year is 'no.' And change the format of the questions and the style of the questionnaire. It has a remarkably beneficial effect in terms of forcing higher quality answers.

CEO Succession

ROMANEK: Before I turn it over to Jim Ukropina to talk about CEO succession, I wanted to mention two things. One of which Jim will be too modest to talk about is his book, "The Board." It's a great book. When you read it, you'll see what sort of experience that Jim has from being in the board room because the way he's drafted the book it talks about what a board meeting is like, but not from an academic standpoint but as if you were in the board meeting or at a committee meeting. And I know it's being used in a lot of law schools and business schools as well as by practitioners. So I recommend everyone to that book, which I'm sure is available on Amazon.

The other thing I wanted to mention is what's happening in the Delaware Chancery Court where two days ago Chancellor Chandler ruled that a lawsuit can go ahead to trial - that will take place this August - in which Stanley Gold and Roy Disney filed suit against Disney after Robert Iger was announced as the successor to Eisner. What the dissidents claim is that they would have run a proxy slate against some of the directors during this past annual meeting, but they heard that a bona fide CEO succession process was going to take place and so they lowered the guns. And then after Iger was appointed as the successor, they are now claiming that it wasn't a bona fide search. It's really a disclosure case and it'll be pretty interesting.

But what's pretty clear to me is that even though it's a disclosure case, this is also the Delaware courts really looking more closely at the CEO succession process. Eisner did sit in on all the interviews that took place with external candidates.

I'm not sure that's a good governance practice when you have a sitting CEO sitting in on all the interviews. And also the fact that Disney refused the books and records request by Gold and Disney perhaps played a role as well. The process that companies go through during a CEO succession is often not publicly disclosed in any manner, but Disney was under a lot of pressure after Eisner got such a high level of withhold votes the prior year – and CEO succession is one of the primary areas that shareholders are very concerned about, so at some point companies are hard pressed to not tell us about CEO succession. But most of the time they don't, even though I think it is one of the board's primary responsibilities.

So it will be interesting to see if regulators will force companies to - or if companies are going to voluntarily – publicly disclose what their succession processes are. Jim, having been in the board room for many years and gone through a number of CEO successions, what is your idea of good succession practices?

JIM UKROPINA, Of Counsel, O'Melveny & Myers LLP and Director of Lockheed Martin, Central Natural Resources and Indymac Bancorp: Generally, I would certainly agree with you that it's highly unusual for an incumbent CEO to sit in on interviews with prospective external candidates in particular but there are a number of elements of good practice and I'll try to cover those in my remarks.

I would also say from a corporate secretary perspective that one of the interesting aspects of the case that Broc just outlined is that in the prayer for relief, Mr. Disney and Mr. Gold are seeking another annual election of the directors and to set aside the last annual meeting, which could certainly a formidable task.

In any event, thank you for the comments about the book Broc. I appreciate that and I do want to take some time on succession planning. Its the last topic here but I think, as a director, many of us consider it to be one of our first duties.

In fact, one of my fundamental principles as a director is that two of our most important roles are to select the company CEO with a lot of care and then to provide a sound succession plan so that the company doesn't experience a long-term vacancy in its leadership.

Some commentators like Marty Lipton believe that succession is the most important duty for a board and I share that thought. That position has been held for a long time. About 20 years ago I read a comment by Walter Wriston, who was then the CEO at Citicorp, and he said the same thing. But not withstanding that, in my view, many companies today, if not most of them, do a lousy job on succession planning.

Bringing it down to the present day, about every other week it seems we hear about a CEO either being discharged or stepping down and in many situation it appears that the board is not at all well positioned to find the successor.

Coca-Cola is regarded as one of many examples of poor planning, but McDonald's gets an A+ for a first rate planning effort.

And the deficiencies in this are pretty broad based. Recent surveys suggest that about half of the public companies do not have a meaningful succession plan according to surveys of their directors. And of those that do, only about 25% of board members are satisfied that the plans they have are good ones.

There's also a lot of anecdotal evidence that this topic is a lot more important than ever before. Up to a couple of years ago, the average tenure for a CEO of a large public company was about a decade. Now that's down to seven years and moving south pretty rapidly. One survey, a recent one, found that over 1/3 of the newly appointed CEOs are replaced before they even reach their two year anniversary.

We've been asked to try to cover how good CEO succession planning is conducted. And I also want to cover emergency succession. As Karl and others have pointed out, it's important that the committee that's going to handle this be designated. Often it's the comp committee. In some cases, it's the nominating and governance committee and now you also have to look at the potential role of either the presiding or lead director.

In many respects, the unexpected departure will place you right in the middle of what a lot of us call crisis management. So to try to lay out how that crisis will be effectively managed is pretty important.

In any event, the governance committee and the chairman need to be sure that that board committee is designated to handle what I think is a critical function. And let's face it, particularly with younger CEOs you're going to face often a lot of resistance to planning or conducting an orderly administration of the function. If that's the case, I think the board just has to step up and band together and get on with it. And in certain cases, I've seen instances where we've had to tie some of the CEO's performance bonus to effective succession planning.

In any event, as the succession planning progresses, the relevant committees has to review the performance of the CEO and senior management at least annually, take a look at the succession plan, and upgrade and downgrade various personnel who are in the plan.

In terms of what a good plan includes, it's a prioritized list of internal and, if needed, external candidates for all the senior management positions and often with an indication of the projected year each of the candidates are going to be ready for the senior leadership position, if not then ready.

It also obviously includes important criteria for each of the positions. And a typical set would include strong leadership, first rate management skills, more and more of an emphasis on a strategic vision for the company, and an important understanding of relevant industries. And certainly a big emphasis, particularly recently, on character, integrity, personal traits, relational skills, style and appearance – that is, someone who can walk on water, at least most of the time.

In terms of the format for the plan, you don't see many of them because they're really highly sensitive and confidential. But just by way of general description, to me they often look like a 3- deep depth chart for a professional basketball team showing the five starters, two substitutes for each position and, in certain cases, some notes about certain trades that might have to be made if the internal substitute doesn't work out. And often potential successors are listed under more than one position.

If you have to go to the outside and internal candidates aren't strong, it's going to be a much more difficult time-consuming and challenging process. And that's why good planning is important because without it, a comprehensive outside search can certainly run up to six months.

Another complication, which a lot of us have been through, is the top three headhunting executing recruiting firms actually control about 75% of the searches, so they can run into some real client conflicts in terms of accessing potential prospects.

It's also important to have a emergency succession plan in place. This plan is in response to a number of potential events - unexpected death, disability, unexpected departure or an operating or, these days, a financial reporting catastrophe. Certainly as noted earlier, emergency succession has become more of an issue in recent years. Large and historically good companies like Fannie Mae, AIG, Sony, Boeing, have all been forced to replace one or more CEOs in a hurry and, in a few cases, only an interim or an acting CEO has been available.

A relatively new challenge for us has been that some of the leading prospects for a succession have been eliminated on a concurrent or near concurrent basis with the outgoing CEO's termination. Why? Well, as we all know the CFO is often a candidate, but now the CEO and CFO both have to certify financial statements and when they go sour, often actions are brought against both of them. And as we know, the Attorney General of New York, among others, has made bad financial reporting not only a matter of civil liability but criminal liability.

So the succession challenges are quite formidable. They're exacerbated by the fact that many directors only need to find a new CEO about once or twice in their careers. And a lot of directors are rookies and you need veterans, so that setting makes it a lot tougher. And as Broc as mentioned, this new Disney case emphasizes another important issue. Under Delaware law, the duty of disclosure is an issue; as Broc has pointed out, the new case is a procedural decision - but the complaint, which I've taken a look at, alleges that the Disney board management assured a thorough, well-considered and objective search. It is alleged it was just a preordained search to name Mr. Iger as Mr. Eisner's successor.

So now if a company is going to talk about succession planning in its proxy statement, it ought to be very careful about subjective adjectives that are associated with the plan.

In conclusion, if it's not carried out properly, what you may find is that the corporate ship becomes rudderless, so to speak, and large financial losses can be incurred. We've all seen stock prices take a pounding as CEOs go out the door. And it also may cause serious reputational damage to the company, to the board, the board members.

At the same time, good planning can result in well deserved accolades for the board and others from shareholders, so what you want to is a seamless and effective transition.

That concludes my remarks.

ROMANEK: Let me ask you a few questions. With Sarbanes-Oxley demanding so much more time from directors, do you get a sense so far in the boardroom that the CEO succession has been - the time devoted to that planning - has been increased because directors are now more focused on their governance responsibilities, and business strategy as well? Or do you see that because there have so many other tasks and that this was not regulated at all by Sarbanes-Oxley, that the time devoted to this has decreased, at least for the time being?

UKROPINA: Broc, I see the time increasing but a little differently than one might think. I think the time requested for many directors has nearly doubled in the last five years. And so much of what we have to do is being pushed down to work at the board committee level - and I do see compensation committees spending a lot more time, again maybe double the time that we used to, on succession planning. In some cases, we have not only an inventory of good internal prospects but we even have to retain a search firm to help us take a look at the outside world in case the internal candidates don't work, so you can move quickly.

You look at Hewlett-Packard and Carly Fiorina's departure and there was a quick succession. So I do think a lot of boards have done more work on it, but I think much of it has to be done in committee because the board meeting agendas are so full these days.

ROMANEK: What time of the year during a company's fiscal year typically does an annual succession planning meeting take place?

UKROPINA: It's interesting. It used to be, you have informal succession planning once a year for about ten minutes and that was the time in February or March when you were setting the bonus awards for the prior year and you talked about the qualities of the CEO and the other officers.

Now it's a very different time of year, usually in the Fall. You're looking at what's going on that year and what the prospects are for the coming year. And it's often, in October and November. We ask the HR director to work with the CEO to give us a very full report every other year on the comprehensive nature of the plan. And then in the next year we have an update of the plan if times have changed or if people have changed. So we do a pretty fulsome job in the Fall on most boards that I'm on.

ROMANEK: And then in terms of the board getting to know senior officers during the course of the year, often senior officers are invited to board meetings, some of them on ad hoc basis if they're making a presentation. How much of value do you place on those interactions?

UKROPINA: Tremendous value. I think there are a number of opportunities to do that during the regular board meetings, and often at breakfasts or lunches before and after the board meeting. And importantly, you often have offsite retreats for two or three days when you're considering corporate strategy and I think there it's very helpful to have extended discussions, not only with the prospects for senior management, but also with their spouses, to meet her or him and to see how they might work into what is a kind of a corporate family environment. Unfortunately, in the past, directors have had to look at the top prospects without knowing much about them prior to making a decision.

ROMANEK: Yes, I would think that those strategic planning meetings are among the most important of the year.

UKROPINA: They are - and very often the business units are making presentations about their plan and that's a very good time to tackle it. But as I say, even the social hours offer a first rate time to get to know them better.

ROMANEK: I appreciate you time and the panel was tremendous, just an incredible amount of information packed into an hour-and-a-quarter. And again, this could have been an all-day event - the speakers were definitely more than able to do that. I want to thank the panelists for a job well done. Have a good evening. Thanks.