



# CORPORATE NOTES

A PERIODIC REVIEW OF CURRENT LEGAL ISSUES

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## SEC to Propose Changes to Executive Compensation Disclosure

On January 17, 2005, the Securities and Exchange Commission voted to propose rules that would amend disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters and security ownership of officers as well as directors. Once issued, the proposed rules will be subject to a 60-day public comment period. Therefore, they will probably not become effective prior to the 2006 proxy season.

The proposed rules would refine the current tabular disclosure, combine it with improved narrative disclosure and cover the CEO, CFO, the three other highest paid executive officers and the directors. Among other things, the proposed rules would modify disclosure in the following ways:

- The new "Compensation Discussion and Analysis" section would address the objectives and implementation of executive compensation programs and would replace the compensation committee report.

- The executive compensation disclosure would be organized into three categories: (1) compensation over the last three years; (2) holdings of outstanding equity-related interests received as compensation that are the source of future gains; and (3) retirement plans and other post-employment payments and benefits.
- The summary compensation table would be reorganized and include a new column for total compensation and a dollar value for all stock-based awards measured at grant date fair value computed pursuant to FAS 123R. Additionally, a director compensation chart and narrative would also be required.
- The perquisite threshold would be reduced to \$10,000, and the proposing release will include interpretive guidance for determining what is a perquisite.
- Two supplemental tables would report grants of performance-based awards and grants of all other equity awards.

## Court Holds Company Liable for Employee's Illegal Downloading

A federal court in Illinois recently ruled that a company may sue a rival company under the Computer Fraud and Abuse Act when a former employee of the plaintiff company downloaded information from the plaintiff company's computer system and gave it to his new employer.

In *Charles Schwab & Co. v. Carter*, the court allowed Schwab to pursue a theory of "vicarious liability" against the defendant company to seek recovery for the illegal downloading activity of its new employee. Vicarious liability is the legal theory that allows plaintiffs to recover damages from an employer caused by the acts of an employee as long as those acts were taken within the course of the employee's duties. For an act to be considered within the course of employment, it must either be authorized or be so connected with an authorized act that it can be considered a method, although an improper one, of performing it. In this case, the court took note that employees of the defendant company

The proposed rules would also increase the threshold for reporting related party transactions to \$120,000, require certain disclosures regarding director independence and consolidate Form 8-K disclosure requirements regarding employment arrangements under a single item.

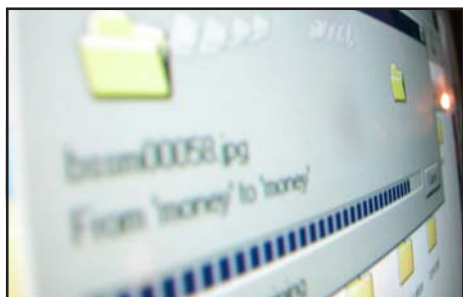
**Companies should monitor the status of the proposed rules because there may be some items, such as the determination of perquisites, that require compliance in the 2006 proxy season.**

may have urged the former Schwab employee to access Schwab's computer network and take proprietary information that would assist the defendant company.

**Employers can face a number of situations involving vicarious liability issues, including sexual harassment of one employee by another, discriminatory behavior by an employee against fellow employees or customers or any other action in which employees personally cause harm. Therefore, it is important that employers protect themselves from the acts of their employees by having careful guidelines and policies in place.**

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## Internet Delivery of Shareholders Meeting Materials Pondered by SEC and NYSE

One of the perennial costs incurred by public companies is the expense of printing and mailing proxy materials and annual reports to shareholders in connection with annual and special shareholders meetings. SEC Rule 14a-3 currently requires that a proxy statement, which must include specified disclosure, be delivered with or prior to any solicitation of a proxy for a public company's shareholder meeting. When a company solicits proxies, it also must deliver an annual report to shareholders, which must include additional specified disclosure. Under current SEC rules, the proxy statement and annual report must be delivered in paper form or, if the shareholder consents, by e-mail.

Recently, both the SEC and the NYSE proposed changes to their respective rules that may allow paperless delivery of these materials via the

Internet. At a meeting held on November 29, 2005, the SEC proposed amendments to its proxy rules that would allow companies to post proxy materials on an Internet Web site (other than EDGAR or one requiring multiple "clicks" from the company's homepage) rather than mailing paper copies to shareholders. A company using Internet delivery would be required to mail a brief notice to shareholders informing them where they can access the proxy materials and offering to provide a written copy of the material upon request. The notice of Internet availability must be delivered at least 30 days prior to the shareholders meeting, and, under the current proposal, a proxy card may be sent along with the notice. Third parties soliciting proxies for a shareholder meeting would also be allowed to use this new notice and access model.

The New York Stock Exchange has also filed proposed rule changes with the SEC that would allow listed companies to deliver annual reports to shareholders via the Internet. The NYSE's proposed rule will allow a listed company to satisfy its requirement to distribute annual financial statements by making its Form 10-K available on, or by a link through, its corporate Web site. The Web site must include a prominent undertaking to provide a paper copy free of charge upon shareholder request.

**The proposed rules could result in a substantial decrease in the expense incurred by public companies to comply with the proxy rules and would provide individuals other than the company with more cost-effective means to undertake their own proxy solicitations.**

## Mere Suspicion Does Not Justify Inspection of Executives' Pay Records

Recently, the Delaware Chancery Court ruled that a shareholder's mere suspicion of excess compensation paid to a corporation's executives does not justify a request to inspect the corporation's books and records.

In *Seinfeld v. Verizon Communications Inc.*, the plaintiff, a Verizon shareholder, sent a written demand pursuant to Section 220 of the Delaware Code, Title 7, seeking to inspect the corporation's books and records and board meeting minutes pertaining to the compensation paid to the corporation's top three executives. The shareholder alleged that he was concerned these executives were receiving compensation in excess of the minimum amounts to which they were entitled pursuant to their employment agreements and that the executives had been given excessive option grants. After Verizon rejected the demand, the shareholder filed a lawsuit.

The court found that, while an investigation into corporate mismanagement and waste is a proper purpose for seeking to inspect books and records pursuant to Section 220, a mere suspicion of such wrongdoing does not justify the request. The requesting shareholder bears the burden of establishing sufficient evidence from which the court can evaluate whether there are reasonable grounds to suspect such mismanagement or waste has occurred. A mere concern or curiosity is inadequate to satisfy this burden. In the absence of a showing of reasonable grounds to suspect mismanagement or waste, the corporation is entitled to deny the records inspection request.

**Shareholder requests to inspect books and records often present a difficult balance of shareholder rights and a company's legitimate need for confidentiality.**

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