

Spring 2006

## What's New for the 2006 Proxy Season

by Andrew J. Merken

The 2006 proxy season is well underway, with December 31 fiscal year-end companies already having filed their 10-K's with the SEC and most having mailed their proxy statements in anticipation of Spring 2006 annual meetings. After one or two relatively quiet years in terms of disclosure changes mandated by the SEC and corporate governance changes encouraged by activist shareholders and their proxy advisory services (following the onslaught in the first few years immediately following the 2002 signing of the Sarbanes-Oxley Act), 2006 has seen an uptick in changes across several fronts. These changes impact not just public reporting companies themselves but anyone who invests in public companies either directly or through mutual funds, hedge funds and other investment vehicles.

From an SEC disclosure standpoint, three changes stand out. To start, for the first time in their 2005 10-K's, companies were required to disclose Risk Factors "where appropriate." While investors are used to seeing "Risk Factors" in prospectuses for initial and follow-on public offerings, companies more than several years removed from their IPOs or which have not completed public securities offerings in recent years had to, for the first time in a while, carefully consider the risks involved with their companies and their industries. This exercise was a good one for companies to go through, and has been even more helpful to their investors or potential investors when deciding whether to invest or remain invested. Next, larger companies were also required for the first time in their 2005 10-K's to disclose the existence and substance of unresolved SEC Staff comments that were first raised by the SEC Staff mid-2005 and earlier. The SEC Staff is now required post-Sarbanes Oxley to review the 10-K's and 10-Q's

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of every public company at least once every three years (the reviews typically focus on accounting and financial statement-related issues) and often the comment letter and response process can last for more than a year. Now, to the extent that there are material SEC Staff comments that companies have not been able to resolve with the SEC Staff for some time, the investing public must be made aware of them, which provides greater and earlier visibility to existing and potential investors of issues of which the SEC Staff is concerned.

Lastly, and a matter which has received a significant amount of press, the SEC recently published proposed new executive compensation disclosure rules. While these rules are open for public comment through Spring 2006 and will not be in place for the 2006 proxy season, a number of companies have in their 2006 proxy statements voluntarily complied with the proposed rules or otherwise begun to change the tone of their executive compensation disclosure according to what the SEC will ultimately require. A discussion of the proposed rules is well beyond the scope of this article. However, the two primary changes are expected to be the following: First, executive compensation disclosure would now begin with a Compensation Discussion and Analysis (CD&A). This narrative would provide a general overview similar to the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). Among other things, this new CD&A overview would explain

the material elements of a compensation scheme and answer the following questions: (1) What are the objectives of the compensation programs? (2) What are the programs designed to reward? (3) What is each compensation element and why does the company pay it? (4) How does the company determine the amount of each element? (5) How do elements fit into overall compensation objectives?

The second element of the proposed new executive compensation disclosure would be more detailed existing items and new disclosure items. Some of the more extensive disclosure would focus on the issues that have caught the attention of the financial press lately, including deferred compensation and pensions, special perks, severance or change in control compensation, and equity-related compensation.

From the corporate governance perspective, this year's biggest hot issue has been "majority voting" for directors. A number of activist stockholders have recently proposed that the typical plurality vote for the election of directors be changed to a majority vote. Currently, the corporate law of most states (including Delaware, where many public companies are incorporated) provides that (i) a plurality vote is the default standard in the election of the board of directors, and (ii) stockholders cannot vote against a particular director; they can merely withhold their support of a particular director. This

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## CLIENT FOCUS:

# A Business Field of Dreams

Michael Savit had a great job – the kind you don't leave. He spent 17 years at International Management Group – the world's largest sports and entertainment agency – where he became a Senior Vice President in charge of sporting events management. But as he approached age 40, his father's advice was ringing in his ears, "Nothing will make you happier than doing your own thing."

So after his father passed away, Savit asked himself, "If not now, when?" He approached his brother Jeffrey (a lawyer with a J.D. from Boston College) and said, "Let's do something together." That led to the creation of HWS Group (named after father Herbert W. Savit) and a venture into purchasing and managing minor league baseball teams.

"I really got the idea when I was asked to speak at the 1996 Winter Baseball Meetings," he recalls, noting that convention participants were buzzing about the growing public interest in minor league teams.

Since then, Westwood, Massachusetts-based HWS has purchased four major league affiliated teams: the Augusta Greenjackets; the Michigan Battle Cats; the Mobile Bay Bears; and the Modesto Nuts. The Savits also run a team in the Coastal Plain League of the Carolinas, a kind of Cape Cod League with stadiums and concessions, and they keep their eyes out for other available teams a little closer to home.

HWS has already sold two of the clubs – Michigan and Augusta – and turned a profit for their investors. The Augusta club – now run by the famous Ripken brothers – also retained Savit as a management consultant. Savit says it is not just "good management" that makes this business profitable, but the appreciation in franchises derived from growing public interest. Clubs that

sold for little more than \$100,000 in 1990 can sell for millions of dollars now.

The major league club supplies all players and coaches, paying their contracts as well, so the key to making money is maximizing revenue from use of the stadium, according to Savit. His franchises do much more than just selling tickets, concessions, souvenirs and advertising (ads appear in programs, broadcasts and on outfield walls).

"When you have a stadium, you can [theoretically] do 365 events a year, and most of your extra revenue comes from extra events," he asserts. "For us, each night is a chance to do a promotion," Savit adds, noting that the current crowd favorite is a "Snow Magic" night for fans in Mobile, Alabama. On those nights, a New Hampshire company makes enough snow for families living in a Gulf-coast town to go sledding or snowboarding, throw snowballs and ride mini-chairlifts across the park.

The HWS managing partner says it helps to create a "hospitality area" for weddings, bar mitzvahs, special occasions and corporate events. "You have to remember – in a place like Mobile – where there are no major league teams anywhere close to them, this [franchise] is a really big deal," he observes.

From a legal point of view, Savit says "there is a lot more than meets the eye" to buying, operating and selling teams. "Copyrights, trademarks, equipment [and assets] and even concession agreements are important," he explains. Savit's relationship with Burns & Levinson evolved from a single environmental matter affecting his father's textile business over a

## Featured Client



MICHAEL SAVIT  
HWS Group

decade ago. "Now there is a level of trust where I can pick up the phone and just say, 'Do it,' when we have [all kinds of things] and that's great," he asserts.

That allows Savit to focus on the real mission of his business – "doing well and having fun." He says a lot of the fun in his business derives from the major league affiliations. "We go to spring training each year, and . . . get to see a lot of kids who will be stars but none of them are spoiled yet," he exclaims.

The former sports editor for the Harvard Crimson points, for example, to his Modesto Nuts (an A-league affiliate of the Colorado Rockies) and his old Augusta team (now an A-league affiliate of the San Francisco Giants, but formerly a Red Sox farm club) which have produced a number of rising stars, such as Lew Ford (now playing outfield for the Minnesota Twins) and Justin Duchscherer (now pitching for the Oakland Athletics). Savit has also seen talented kids playing for his Mobile Bay Bears, the AA affiliate of the San Diego Padres. The Bears have sent infielders Josh Barfield and Khalil Greene to the parent club, along with star pitcher Jake Peavy, who led the National League in earned run average in 2004.

There is another psychic benefit for Savit – the idea of bringing "affordable family entertainment" to people in small towns that rarely get to see professional athletic events. "I just knew we could do this," says Savit. "What I didn't know is that I would love it so much." ■

*This article was contributed by John Cunningham, freelance writer/editor.*

**Josef Volman, and several other attorneys at Burns & Levinson LLP, have experience in sports-oriented legal work. Mr. Volman has represented Mr. Savit and HWS Group in buying and selling several minor league teams and related agreements.**

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means that in an uncontested election, in order to be elected or reelected, a nominee for director must only receive

one affirmative vote, even if all other stockholders vote to withhold their support. Changing to a majority

of votes cast standard would make the election of directors equivalent to most *continued on page 3*

# Changes in Medicaid Rules

by Dianne L. Fraide

On February 8, 2006, President Bush signed The Deficit Reduction Act of 2005. The Act makes significant changes to the Medicaid rules. Although the Act gives states a grace period to enact legislation to come into compliance with federal law, Massachusetts is already in the process of promulgating emergency regulations to implement the new rules. It is not yet clear whether Massachusetts will make the new regulations retroactively effective to February 8, or whether the effective date will be a date on which the new regulations are implemented. In any case, it is now even more important to undertake asset-protection planning sooner rather than later.

Notably, the changes apply to any transaction made after the effective date of the new regulations. The old rules will apply to planning that you may have done before that date.

Asset-protection planning for Medicaid purposes typically involves making transfers of assets. This kind of planning allows you to protect your assets from recovery by Medicaid upon

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your death if during your lifetime you received benefits. However, certain actions that an individual undertakes in which he or she transfers resources that would have otherwise been available to pay for his or her own care trigger a penalty period in which the individual would be ineligible for benefits for a period of time.

Under the old rules, the penalty period would begin at the time the transfer was made. The individual would wait for the penalty period to end before applying for benefits, during which time the individual would spend down the individual's remaining assets to pay for covered expenses until reaching the applicable asset limit. The limit for singles is \$2,000, and for married couples it varies, but in no event (this year) can it exceed \$99,540.

Under the new rules, the penalty period **no longer** begins to run at

the time the transfer is made. Now, the start of the penalty period would essentially be delayed until an individual reaches his/her applicable asset limit and then applies for benefits. The individual's application would be denied because of the transfer made, and the penalty period would begin to run upon issuance of the denial, leaving the individual struggling to find a way to pay for otherwise covered expenses such as nursing home fees, after having spent all other resources.

There is still a safe harbor that exists in the transfer rules, albeit made more narrow by the changes. Under the old rules, transfers made to a Trust before five years, and transfers made to an individual before three years, of applying for benefits need not be disclosed. Assuming that the individual did not apply for benefits during the applicable "look-back" period, the transfers would not trigger a penalty period. Under the new rules, the "look-back" period for **all** transfers is five years.

We only highlight two of the changes made to the Medicaid rules. However, these two changes illustrate the importance of doing asset-protection planning well in advance of potential nursing home placement. ■■

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all other matters upon which stockholders vote and, more importantly, would make it easier for stockholders to vote out (if not actually replace) directors with whom the stockholders have come to disagree. Under this scenario, a nominee for the board would not be elected if fewer votes were cast in favor of his or her election than were withheld from his or her election.

Finally, also in the corporate governance area, Institutional Shareholder Services (ISS, a leading proxy advisory firm) released its U.S. Corporate Governance Policy 2006 Updates, which has impacted how ISS recommends to its institutional clients that they vote their shares for particular company proxy proposals. ISS is continuing to increase its focus on corporate and director performance. recommend "Withhold" votes from a The ISS Policy Updates included the

following: (1) Performance Test for Directors: ISS will determine on a case-by-case basis whether to recommend "Withhold" votes from directors at a company where weighted one-, three- and five-year total shareholder return is at the low range within the company's industry peer group; (2) Overboarded Directors: ISS will continue to recommend "withhold" votes from a director who serves both as a CEO of a publicly-traded company and on more than three public company boards (including his or her own company's board). ISS will also continue to recommend "Withhold" votes from any director nominee who is not an active CEO and serves on more than six public company boards; and (3) Tally Sheets for CEOs: While not adopting a formal "Withhold" vote policy, ISS is "strongly encouraging" companies to disclose "tally sheet" or other total compensation information on the

CEO's compensation. The disclosure should itemize base salary, stock options, restricted stock, performance shares, deferred compensation, SERPs (supplemental executive retirement plans), perks, tax gross-ups, various forms of severance and any post-retirement pay package.

The 2006 proxy season is shaping up to be one of the busiest of the past few years in terms of SEC-required disclosure changes and institutional/activist shareholder encouraged reforms. While Sarbanes-Oxley mandated changes have for the most part been successfully incorporated into 10-K's and proxy statements as well as companies' corporate governance policies and financial operating procedures, the SEC and influential shareholders and their advisors continue to hammer away at the actual or perceived abuses of the late 1990s. Stay tuned. ■■

# Director Exculpation Under Massachusetts Law – Red Flags and Dereliction of Duty

by Theodore E. Dinsmoor

Twenty years ago in *Smith v. Van Gorkum* the Delaware Court shocked the corporate world by holding nine directors of blue-chip Trans Union Corporation personally liable to stockholders for failing to **carefully review** the terms of a cash out merger for their corporation. The thrust of the Delaware Court's opinion was that the directors could not avail themselves of the business judgment rule, because they did not make an **informed judgment**, e.g., they cast a casual glance, rather than a keen eye, at the transaction.

In response to *Van Gorkum*, Massachusetts and other states passed legislation permitting corporations to adopt bylaw provisions exculpating their directors from damages for negligence. See MA General Laws Ch. 156D, § 2.02(b)(4). However, the Massachusetts statute precludes exculpation if the director's negligence is accompanied by his disloyalty, bad faith and/or participation in a transaction that confers a personal benefit. The legal conundrum posed by such bylaw provisions is distinguishing between negligence and its transcendence into disloyalty and/or bad faith.

A director's duty of care includes the duty of oversight to insure that the corporation is protecting stockholder interests. A component of such oversight is making necessary inquiry and taking appropriate action, where suspicions arise that stockholder interests may be in jeopardy. Suspicious situations include: financial irregularities; insider transactions; generous or excessive executive compensation; criminal conduct; and, any activity that is unnecessary for pursuit of the corporation's legitimate business goals.

These suspicious situations create "red flags" that compel directors to

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make due inquiry and otherwise inform themselves sufficiently so that they can decide upon the appropriateness of remedial action. Sitting idly by or turning the proverbial blind eye to such "red flags" is not an option, because such passivity may be deemed a dereliction of duty in breach of loyalty or good faith, rather than negligent omission or inaction, thereby vitiating the application of exculpatory bylaw provisions.

## How do directors protect their pocketbooks?

First, directors must **watch out** for "red flag" situations.

Second, upon sighting "red flag" situations directors must **initiate due inquiry** and, if necessary, request **independent investigation** by counsel, auditors or other outside professionals.

Third, directors must **consider** the "red flag" situation by weighing its pros and cons; or, to put it bluntly, looking at "the good, the bad and the ugly" of the situation. Directors who consider only management's views are not acting in good faith, as there are few situations that are all one sided.

Fourth, directors must **make a judgment** as to whether remedial action is required and, if required, recommend appropriate action. It may be that remedial action is unnecessary, but to protect themselves against judicial second-guessing directors still need to go on the record to show that they investigated the situations, considered alternatives and exercised judgment in deciding that no remedial action was required.

If the foregoing steps are followed, directors should be able to avail themselves of exculpatory bylaw provisions to protect themselves against personal liability for damages. ■

# Focus

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