

2013 Public Company Update

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Webinar Presenters



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Overview – Scope of Webinar

- Proxy season trends and developments
- New disclosure obligations
- Rule 10b5-1 plans under siege
- Use of social media under Regulation FD
- ISS updates
- Delaware law/litigation developments
- Outlook on SEC rulemaking

Proxy Season Developments

- Looking back to 2012
 - 454 proposals at S&P1500 companies
 - Slight uptick from 2011
 - But still short of 2008-2010 levels
 - Key proponents remain the same
 - Labor-affiliated investors and pension funds
 - Ex: Amalgamated bank, AFL-CIO, AFSCME, NY pension funds
 - Individual shareholders
 - Most retail proposals are attributable to a small handful of well-known activists

Source: Georgeson, Inc.

Proxy Season Developments (cont'd)

- Key 2012 shareholder proposals within the S&P1500
 - Separate CEO/chair
 - 46 proposals averaging 36% support
 - Majority voting
 - 28 proposals averaging 61% support
 - Repeal classified board
 - 44 proposals averaging 81% support
 - Disclosure of political contributions
 - 70 proposals – average fluctuates based on type of proposal
 - Stock retention
 - 27 proposals averaging 24% support

Proxy Season Developments (cont'd)

- Say-on-Pay
 - Average 2012 support of 91%
 - Compare with 89% average support in 2011
 - ISS recommended in favor of 87% of proposals
 - But average support dropped to 65% upon a negative ISS recommendation
 - 53 companies failed to receive majority support last year
 - Compare with 40 in 2011

Proxy Season Developments (cont'd)

- Proxy Access
 - Last year was the first year in which proxy access proposals were permitted under Rule 14a-8
 - Of 24 proposals submitted in 2012, only 13 went to a vote last year
 - Many were excluded under SEC no-action letters
 - ISS recommended in favor of 6
 - Only 2 received majority support
 - Chesapeake Energy and Nabors Industries
- Note: At least two management proposals on proxy access will be considered this year
 - HP: 3% (up to 20 shareholders) for 3 years

Proxy Season Developments (cont'd)

- “Withhold/Against” Votes
 - Number of “withhold/against” votes of 15% or greater:
 - 526 directors at 263 companies within S&P 1500
 - This is lowest level in five years
 - » Compare to 1,027 directors at 378 companies in 2009
 - Only 28 directors failed to get majority support in 2012
 - Slight increase from 20 in 2011
- Proxy Contests
 - Wet Seal
 - Successful consent solicitation just 5 months after annual meeting
 - ISS recommendation remains important
 - At least partial success in 66.7% of contests where ISS recommends in favor of dissident nominees

Sources: Georeson, Inc. and Innisfree M&A Inc.

The 2013 Proxy Season

- Expect most of these trends to continue for 2013
 - Push for majority voting and dismantling of takeover defenses
 - Moving beyond the S&P500
 - Disclosure of political contributions remains a “hot topic”
 - Will “say on pay” become a larger referendum on management?
- Shareholder engagement
 - Not just for the proxy season
- Importance of disclosure
 - Communicate your message

Governance Trends

- Continue to engage with shareholders
- Reassess internal compliance systems
- Attention to FCPA
- Stay abreast of regulatory developments
- Growing importance of sustainability reporting

Recent Comment Letter Trends

- Contingencies (S-K Item 103 vs ASC 450)
- Cybersecurity
- Executive compensation/CD&A
- Fair value
- Foreign currency fluctuation
- Foreign taxes
- Iran/Syria/Cuba
- Risks and risk factors

Other Developments in Corp Fin

- Likely expansion of continuous review program beyond financial services to other industries
- Creation of Office of Disclosure Standards to
 - assess outcomes of filing reviews and assist CF in future improvements
 - evaluate effectiveness of internal supervisory controls to ensure consistency across AD groups

New Statutes and Rules

- New SEC rules on lost securityholders/ unresponsive payees
- New exchange listing standards for comp committees
- New SEC rules on compensation consultant conflicts of interest disclosure
- New statutory reporting obligation under Iran Threat Reduction and Syria Human Rights Act

Lost Securityholders and Unresponsive Payees

- Old Rule 17Ad-17 addressed obligations of transfer agents only
- Section 929W of Dodd-Frank expands to broker-dealers
- BDs must now confirm customer addresses
- “Paying Agents” (may include issuers) must notify missing securityholder for certain uncashed checks
- Must comply one year from publication in Federal Register

NYSE Comp Committee Listing Standards

New independence criteria for directors:

- Consider consulting, advisory or compensatory fees paid by listed company
- Consider affiliation with listed company or its subsidiaries/affiliates
- Consider whether director receives other compensation that would impair judgment

Effective earlier of first annual meeting after 1.15.14 or 10.31.14

NYSE Comp Committee Listing Standards (cont'd)

Comp committee charter now requires:

- Authority to retain own advisers
- Authority to compensate and oversee advisers
- Must consider six independence criteria before selecting advisers (but adviser need not ultimately be independent)
- Company must provide funding for advisers

Effective 7.1.13

NYSE Comp Committee Listing Standards (cont'd)

- Rules exclude smaller reporting companies, controlled companies, limited partnerships, registered investment companies and certain other issuers
- Foreign private issuers may continue to follow home country practice

Nasdaq Comp Committee Listing Standards

- Similar to NYSE rules in many (but not all) respects
- Must for first time have formal compensation committee of at least two independent directors
- Committee must be independent and have authority to retain advisers
- Must consider six independence factors before retaining advisers, but advisers need not ultimately be independent
- Can have one non-independent director for up to 2 years
- Similar exceptions as NYSE rules
- Same effective dates as NYSE rules

Compensation Consultant Conflicts of Interest

- New Item 407(e)(iv) of Reg S-K provides:
 - “With regard to any compensation consultant . . . whose work has raised any conflict of interest, disclose the nature of the conflict and how the conflict is being addressed.”
- Six factors in determining whether a conflict exists
- Complement NYSE and Nasdaq compensation committee listing standards

Iran Threat Reduction and Syria Human Rights Act

- Section 219 requires SEC reporting companies to make certain disclosures in 10-Q and 10-K
- Effective for disclosures filed on or after February 6, 2013
- Does not require SEC rulemaking; disclosure obligation arises directly under Section 219
- Types of disclosures get at business activity in Iran

RULE 10B-5 PLANS

Rule 10b5-1 Plans Under Siege

- Affirmative defense – not a safe harbor
- Plan documented and established in good faith when insider not in possession of material non-public info
- Plan must specify price, amount and dates of trades or formula for doing so
- Trading agent not in possession of material non-public info
- Company and insider cannot have influence over future trades

Rule 10b5-1 Plans Under Siege (cont'd)

Some best practices:

- Company should review and approve each trading plan before it becomes effective
- No amendments to plans once effective
- No hedging
- Do not enter multiple or overlapping plans
- Cooling off period between entering plans and first trade

USE OF SOCIAL MEDIA UNDER REG. FD

Use of Social Media Under Regulation FD

- Reg FD adopted in 2000; broadly prohibits selective disclosure of material non-public info
- Adopted long before advent of social media and Web 2.0
- Commission interpretive release issued in 2008

Use of Social Media Under Regulation FD (cont'd)

- Website must be recognized channel of distribution
- Website posting disseminates information in a manner that makes it generally available
- Reasonable waiting period for investors and the market to react

**LATEST
PRONOUNCEMENTS
FROM
ISS**

ISS

- ISS's 2013 governance updates announced on Nov. 16, 2012
 - Available at: www.issgovernance.com/files/2013USPolicyUpdates.pdf
 - Q&A released on December 20, 2012
- New policies effective for meetings beginning on or after February 1
- Topics include:
 - Executive compensation (peer groups and realizable pay)
 - Board responsiveness/governance failures
 - Director attendance
 - Overboarding

ISS New Policies

- “Board Responsiveness”
 - Governance failures justifying a “withhold/against” recommendation now include:
 - any hedging; or
 - “significant” pledging of company stock
 - If stock is currently pledged, ISS will consider:
 - any proxy statement disclosure of anti-pledging policy that applies in the future;
 - magnitude of pledge shares (in terms of total shares outstanding, market value, and trading volume);
 - disclosure of progress in reducing magnitude of pledged shares;
 - disclosure that stock ownership and holding requirements do not include pledged company stock; and
 - “any other relevant factors.”

ISS New Policies (cont'd)

- Board Responsiveness
 - Majority Supported Shareholder Proposals
 - Will recommend “against/withhold” where directors have not been sufficiently “responsive” to a proposal that received a majority of the votes **cast**, rather than votes **outstanding**, at last shareholder meeting
 - Effective for proposals submitted in 2013, so implications will be felt in 2014
 - What constitutes a sufficient “response”?
 - Note important change to Glass Lewis policies:
 - Will “scrutinize” company’s responsiveness where 25% or more of stockholders voted **against** any management proposal

Recent Delaware Law and Corporate Litigation Developments

Important 2012 Delaware Cases for Corporate Governance

- Several key DE cases in 2012 on a variety of topics
 - Conflicts of Interest
 - *Southern Peru*: \$2 billion judgment entered against controlling stockholder and its director-representatives
 - Dissident Directors
 - *Shocking Technologies*: Dissident director breached duty of loyalty in actively campaigning against company
 - Duty of Oversight
 - *Pyott* (Allergan): Court allowed new stockholder to bring suit relating to claims of off-label drug use, even though non-Delaware court dismissed case
 - *South v. Baker* (Hecla Mining): Court dismissed claims that board ignored “red flags” leading to a mining accident

Important 2012 Delaware Cases (cont'd)

- *Seinfeld v. Slager* (Del. Ch. 2012)
 - Stock incentive plan was previously approved by stockholders
 - Plan had a limit of 1,250,000 restricted shares to any individual in a single year
 - But no “dollar” limit on the value of any grant of restricted shares
 - Because of the company’s then-trading price, the maximum annual grant permitted under the plan would have been worth \$21.7 million
 - Actual value of grants of restricted stock, however, was approximately \$750,000 in 2009 and \$215,000 in 2010 (the years in dispute)
 - Stockholder challenged grants as “interested transactions”

Seinfeld (cont'd)

- 3COM (Del. Ch. 1999) held that director compensation granted under a stockholder-approved incentive plan was entitled to Business Judgment Rule protection
- But *Seinfeld* refused to dismiss the claims challenging grants to directors
 - Rather, the restricted stock grants to directors are subject to “entire fairness” review
- Reasoning:
 - Although the equity plan was approved by stockholders, it did not have “sufficiently defined terms” to implicate the Business Judgment Rule
 - “The more definite a plan, the more likely that a board’s compensation decision will be labeled disinterested and qualify for protection under the business judgment rule.”
- Given the procedural posture of the case, *Seinfeld* did not delve into whether the grants were “entirely fair”

Seinfeld: Possible Consequences

- For plans that already have been approved:
 - Some companies may seek shareholder approval of amendments to implement additional parameters around board's discretion
- For plans being submitted for approval in 2013:
 - Consider including more specific limits on director compensation
 - Plans may need to distinguish between inside and outside directors in establishing limits
- For director grants generally:
 - Benchmarking and outside advice to support grants, including in the event of entire fairness review

Challenging the Annual Meeting: Executive Compensation Suits

- New “strike suit” challenges executive compensation disclosures in annual meeting proxy statements
 - M&A strike suits adapted for annual meetings where everyone’s a target every year
- Most vulnerable companies:
 - Those seeking an increase in the number of authorized shares under an equity plan
- Some suits have resulted in disclosure-based settlements
 - At least two annual meetings have been enjoined

Lawsuit Relating to Political Spending

- NY State Comptroller has sued Qualcomm to inspect its books and records relating to political spending
 - Suit is pending in Delaware
 - Books and records inspections generally require plaintiff-stockholder to show a “proper purpose”
- Larger picture: This is a continuation of the corporate political spending issue
 - NY pension funds have been lead proponents of these stockholder proposals

**OUTLOOK
ON
SEC RULEMAKING**

Outlook on SEC Rulemaking

- Chairman Schapiro resigned in December 2012
- President elevated Commissioner Walter to Chairman
- Chairman Walter may hold over until December 2013
- 2-2 split
- Commissioner Paredes (R) term expires June 2013
- Lots of senior officer turnover

Outlook on SEC Rulemaking (cont'd)

Unfinished Dodd-Frank rules include:

- Volcker rule
- ABS risk retention and conflicts
- Executive compensation disclosure (CEO pay ratio, clawbacks, pay for performance, hedging)
- “Bad actor” disqualifications under Reg D
- Uniform fiduciary standards for investment advisers and broker-dealers

Outlook on SEC Rulemaking (cont'd)

Unfinished JOBS Act rules include:

- Crowdfunding
- General solicitation under Reg D
- Regulation A+

Outlook on SEC Rulemaking (cont'd)

Other Potential Rules:

- IFRS
- Corporate political spending
- Rule 10b5-1 plans
- Short-term borrowing
- Money market funds

Questions



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