



Corporate Governance and Securities Compliance: Ten Key Topics for 2014

I. SHAREHOLDER ENGAGEMENT

A lot of the focus on shareholder engagement arose out of say-on-pay votes where companies tried to understand what it would take for shareholders to support the company's executive compensation. Also contributing to this phenomenon has been the increase in corporate governance-related shareholder proposals. Engagement with shareholders can be critical to these votes, particularly in light of the one-size-fits-all policies put forth by ISS and other proxy advisory firms.

- Do:* Develop a strategy for routine engagement with shareholders.
- Do:* Disclose shareholder engagement efforts in your proxy statement.

2. EXCLUSIVE FORUM BYLAWS

Following a Delaware court decision upholding the validity of exclusive forum bylaws, many companies are considering whether to follow suit, and many companies have already adopted such bylaws. The adoption of exclusive forum bylaws requires broad consideration of many factors:

- ▶ What is the company's exposure to multi-jurisdiction litigation?
- ▶ Where is the company most likely to be sued and how do the court systems in those jurisdictions rate?
- ▶ What will institutional investors say/do about the adoption of exclusive forum bylaws?
 - Do:* Conduct an evaluation of the above factors to provide a balanced perspective of this issue to the board of directors. (In particular, make sure that the board understands that Glass Lewis will recommend a vote against the Chair of the Governance Committee if a board unilaterally approves such a bylaw without shareholder approval.)
 - Do:* Consider engaging with shareholders to obtain their views on exclusive forum bylaws before proceeding with adoption.

3. SHAREHOLDER PROPOSALS

Shareholder proposals remain a fairly constant form of activism, with shareholders agitating for change on a variety of corporate governance, executive compensation and social issues. In the last year, potential abuses of the shareholder proposal machinery have come to light, with a particular focus on whether shareholders can give a proxy to someone else to submit a shareholder proposal on the shareholder's behalf, with a District Court in Texas suggesting that shareholders cannot do so. Common shareholder proposal topics include:

- ▶ Separation of Chairman/CEO; Independent Chairman
- ▶ Majority voting
- ▶ Repeal classified board
- ▶ Shareholder right to act by written consent
- ▶ Eliminate or reduce supermajority provisions
- ▶ Adopt proxy access
- ▶ Shareholder right to call special meeting
- ▶ Political contributions and lobbying
- ▶ Report on sustainability
- ▶ Equal opportunity employment policies
 - Do:* Carefully review shareholder proposals and enforce compliance with procedural requirements.
 - Do:* Review shareholder proposal "hot topics" with the Board so that directors understand the issues and can consider them while not under the pressure of responding to a shareholder proposal.

4. SAY-ON-PAY / PAY-FOR-PERFORMANCE

Executive compensation remains a lightning rod topic for shareholders, with the alignment between pay and performance receiving the most attention. Companies are continually revising compensation mix and metrics to maximize alignment.

- Do:* Consider structural changes to compensation programs that may increase alignment.
- Do:* Focus on "telling your story" about your compensation programs in your proxy statement, including through visual charts and graphs where possible.

5. BOARD PERFORMANCE AND QUALIFICATIONS

The performance of the Board and qualifications of particular directors often receive attention in proxy contests and contested director elections, and even in more routine shareholder proposals. Companies should be vigilant in setting expectations for director performance and qualifications. Hot button topics include independence issues, director attendance at board meetings and service on several public company boards (i.e., overboarded directors). The Board should also identify and disclose directors with qualifications particularly relevant to the company's business opportunities and risks. Shareholders are increasingly focused on board diversity and the impact of long-tenured directors on board effectiveness.

- *Do: Disclose all relevant qualifications of directors in the proxy statement.*
- *Do: Conduct meaningful annual director evaluations and deal with performance issues before they become more contentious governance issues.*

6. RISK MANAGEMENT / COMPLIANCE

Risk management remains a hot topic for boards. Companies should conduct annual risk reviews with the audit committee, and report to the full Board as appropriate. Companies should also embed risk analyses in each matter presented to the Board—new financing transactions, M&A transactions, etc.—and review both the risks of proceeding AND not proceeding with a proposed transaction. Particular risk/compliance topics receiving significant attention include: FCPA compliance, cybersecurity/data privacy risks and regulatory compliance risks.

- *Do: Benchmark your disclosure about board oversight of risk and your risk factors against your peer companies.*

7. ROLE OF PROXY ADVISORY FIRMS

Companies need to be aware of policies adopted by proxy advisory firms, such as ISS and Glass Lewis because their voting recommendations can carry significant influence in shareholder votes. However, boards should develop independent views on those issues and be able to articulate reasons why the board may not agree with proxy advisory firm policies. As noted above, companies should engage with shareholders on topics receiving significant attention by proxy advisory firms. Increased shareholder engagement is one of the factors weakening proxy advisory firm influence, and companies need to understand shareholders' own voting policies.

- *Do: Provide an annual review to the Board of proxy advisory firm policies to avoid surprises.*
- *Do: Review with the Board the reports issued by the proxy advisory firms in the prior year.*

8. COMPENSATION-RELATED LITIGATION

With plaintiffs' law firms all but shut out of what they hoped would be highly lucrative litigation arising out of failed say-on-pay votes, they are turning to other compensation matters. Some of these cases have come in the form of requests for injunctive relief, where they seek to enjoin an annual shareholders meeting, claiming that the company's disclosure on certain topics is insufficient or misleading. Proposals related to equity compensation plans and Section 126(m) incentive plans have been particular sources of such allegations. While the success of these suits has been limited, they can be distracting, especially if the Board is not prepared for the possibility of such a suit. In many cases, plaintiffs' firms may file press releases announcing "investigations" into these matters, many of which never transpire into actual litigation, but which can draw unwanted attention.

- *Do: Carefully review both legal requirements and best practices for disclosures related to proposals for equity compensation plans and Section 162(m) incentive plans.*
- *Do: Alert the Board to the possibility of litigation in these areas.*

9. SPECIALIZED DISCLOSURES

Recent rulemakings have resulted in additional disclosure requirements for public companies including topics such as business dealings in Iran, the use of conflict minerals in certain company products and risks related to cybersecurity. Because of the specialized nature of these issues, companies need to form cross-disciplinary teams to research and understand the issues and the company's disclosure obligations.

- *Do: Identify the appropriate, knowledgeable personnel to assist the people ordinarily responsible for SEC filings.*

10. RULEMAKING PIPELINE

The SEC proposed rules to implement the highly scrutinized CEO-to-median employee pay ratio disclosure requirement imposed by Dodd-Frank. Although the rules likely won't be effective until the 2015 proxy statement, various efforts are underway to challenge the rulemaking and companies are trying to get a sense for what their "ratio" may look like under the proposed rules. The SEC has additional rulemaking on its plate in the areas of clawback policies, disclosure of hedging policies and pay-for-performance disclosures.

- *Do: Keep the Board informed on the status of rulemaking and consider whether to voluntarily adopt some form of compliance in advance of final rules.*

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