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Corporate & Securities Advisory

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Preparation for 2013 Fiscal Year-End SEC Filings and 2014 Annual Shareholder Meetings

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As our clients and friends know, each year Mintz Levin provides an analysis of the regulatory developments that impact public companies as they prepare for their fiscal year-end filings with the Securities and Exchange Commission (the “SEC”) and their annual shareholder meetings. This memorandum discusses key considerations to keep in mind as you embark upon the year-end reporting process in 2014.[1]

- There are no significant changes to year-end disclosure requirements this year, with the meaningful exception of companies subject to the so-called “conflict minerals” rules. As described further below, the first reports under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), and related SEC rulemaking, are due on May 31, 2014. Companies that manufacture (or contract to manufacture) products in which conflict minerals are “necessary to the functionality or production of the product” are already (or will soon be) deeply familiar with these requirements.

- In other Dodd-Frank news, the SEC has proposed, but not yet finalized, the so-called “pay ratio” disclosure rules. These proposed rules, as described further below, will ultimately require companies to disclose the ratio between the total compensation paid to their CEO and their “median employee.” The rules as proposed afford a high degree of latitude and flexibility to companies in determining who that median employee is and how to calculate that employee’s compensation; some commenters on the proposed rules have opined that so much latitude and flexibility have been proposed as to make the disclosure essentially meaningless.

- Final changes to the national securities exchanges’ rules governing compensation committees are now in full effect. The last changes, also required by Dodd-Frank, require compensation committees to have all of their members be independent under rules solely applicable to compensation committee members by the earlier of (1) the date of a company’s first annual meeting held after January 15, 2014 or (2) October 31, 2014. NASDAQ-listed companies must also affirmatively certify to NASDAQ that their compensation committees comply with all of the new listing requirements relating to compensation committees by the earlier of (1) 30 days after the date of the first annual meeting held after January 15, 2014 or (2) October 31, 2014. The certification may also be made prior to that date if the company has taken all steps to comply with these requirements. The NYSE annual written affirmation of various corporate governance matters has been updated as of January 16, 2014 to include a certification regarding compliance with the new listing requirements relating to the compensation committee.

These topics, and other updates, are explored in further detail below.

Say-on-Pay: Considerations for 2014. Smaller reporting companies were required to propose both the say-on-pay and the say-on-frequency votes required by Dodd-Frank for the first time last year. Even with these additional companies conducting say-on-pay votes, overall voting results on say-on-pay were not meaningfully different in 2013 as compared to 2012, with shareholder support continuing to average around 90% across all companies. Say-on-pay continues to be perceived as a year-to-year item, in which success in past years is no guarantee of success in the current or future years, and companies should not become complacent about achieving the necessary support, even if they have enjoyed strong support in prior years. The advent of say-on-pay continues to cause companies to reevaluate their compensation-related disclosures in their proxy statements, in particular the CD&A section, with both advocacy and disclosure in mind. For further detail on the final say-on-pay rules, please review our client alert available at http://www.mintz.com/newsletter/2011/Advisories/0917-0210-NAT-SEC/web.htm.

We continue to see a trend of companies including an executive summary at the beginning of the proxy statement in an effort to highlight key messages, clearly define the company's views on pay-for-performance, and ensure the company has a reasonable narrative to support its decisions for last year's pay. A trend of disclosing "realized" or "realizable pay" is continuing to develop. Many companies believe that the summary compensation table overstates executive pay due to the values ascribed to stock options and unvested equity awards,[2] which leads to a distorted view of pay-for-performance alignment. Therefore, many companies have begun to add a supplemental "realizable" or "realized" pay table to assist shareholders in understanding the executive compensation value actually transferred during a fiscal year. The major difference between "realizable" and "realized" pay is in the value of equity awards, with the former showing the value of vested or earned equity based on actual stock performance as of a specified date that will be realized in the future, while the latter shows actual pay received upon vesting of awards and exercise of stock options in line with tax reporting. Companies that choose to provide this information should adapt the presentation to their particular circumstances and commit to providing similar disclosure using the same assumptions in future years.

Beginning with February 1, 2014 meeting dates, ISS's standard research report will generally show three-year realizable pay compared to the three-year granted pay for S&P 1500 companies. ISS will discuss realizable pay in its report when its quantitative analysis results in a "high or medium" concern that a company's compensation policies are not linked to overall corporate performance and will also look at realized and/or realizable pay at smaller companies to assist it in determining whether the company demonstrates a strong commitment to a pay-for-performance philosophy.[3]

This year ISS will continue to review say-on-pay proposals by making a quantitative assessment of each company's CEO pay and performance relative to its peers (RDA) over one and three years and of the absolute alignment between the trend in CEO pay and a company's total shareholder return (TSR) over the prior five fiscal years. It has however continued to modify its quantitative assessment in response to criticism. This year ISS will simplify its methodology for calculating the RDA. Instead of measuring this as the difference between the company's TSR rank and the CEO's total pay rank within a peer group, over one-year and three-year periods, weighing the former at 40% and the latter at 60%, ISS will now calculate the difference by measuring it only over a three-year period (or as many full fiscal years that the company has been publicly traded and has disclosed pay data). Under the new ISS model, each year of TSR will be weighted equally and calculated to produce the annualized TSR for the measurement period, thus providing a smoother performance measure that does not over-emphasize any particular year during the measurement period. This should provide a better view on long-term pay and performance alignment. Relevant performance and pay in particular years will be addressed during the qualitative phase of the ISS review, as applicable. The purpose of these quantitative measures is, in ISS's view, to identify outlier companies that have demonstrated significant misalignment between CEO pay and company performance over time. In cases where alignment appears to be weak, further in-depth analysis will determine causal or mitigating factors, such as the mix of performance- and non-performance-based pay, grant practices, the impact of a newly hired CEO, and the rigor of performance programs.[4]

In assessing executive compensation boards of directors should continue to bear in mind that their ultimate goal is not to secure a successful say-on-pay vote, but rather to attract, retain and incentivize executives who will contribute to the long-term value of the company. Directors should be aware of the executive compensation guidelines that ISS and similar groups promote, but should not allow this to override their own judgments as to the compensation programs and policies that are best for their companies. Directors should participate with

management in soliciting favorable say-on-pay votes from major shareholders in order to overcome a negative recommendation by ISS.[5]

In addition, although say-on-pay has resulted in increased shareholder litigation based on compensation decisions, in which the board, compensation committee members and executives are all named as defendants, the legal ramifications are limited. The Dodd-Frank Act expressly states that the shareholder vote "may not be construed" to "create or imply any change to the fiduciary duties of a company or its board of directors" or to "create or imply any additional fiduciary duties." This status quo was affirmed in January 2012, when a federal court dismissed a suit against bank directors arising out of a negative say-on-pay vote, finding that the Dodd-Frank Act did not alter directors' duties and that a negative vote does not suffice to rebut the business judgment protection for directors' compensation decisions. Similarly, in October 2012, a federal court and a state court separately refused to enjoin shareholder say-on-pay votes despite allegations of inadequate executive compensation disclosure. Although sufficiently bad facts could result in a contrary outcome, directors of companies incorporated in Delaware should generally take comfort that, if they act in good faith and with appropriate care, their compensation determinations will not be second-guessed or the subject of significant enhanced liability.

However, class action lawsuits alleging that boards of directors breached their fiduciary duties by approving purportedly deficient proxy statement disclosure and claiming that shareholders need more information in order to cast an informed vote, typically with respect to equity compensation plan approvals, have been on the rise and more successful than director duty claims. More than 20 of these actions have been filed. Plaintiffs typically bring these cases in state court and seek an injunction against the upcoming annual meeting until sufficient disclosure is provided in the proxy statement in order for shareholders to make an informed decision. The threat of an enjoined annual meeting has pushed many of these companies that have been sued into providing additional disclosures, thereby justifying a fee award to plaintiff's counsel. Although plaintiffs have not had great results with these lawsuits, there have been enough successes to believe that this trend will continue in 2014, especially since these cases are most often brought by plaintiffs' lawyers who specialize in shareholder strike suits. In many cases suits are never even filed as before filing a complaint plaintiff's counsel will send a demand letter to the company based on what it believes is misleading or omitted information in a proxy statement and at the same time post on its web page that it is looking for plaintiffs. Many of these demand letters target smaller companies that do not spend their resources on expansive proxy disclosure. Unfortunately, many of these companies still end up paying a fee to plaintiff's counsel to prevent litigation from being filed and spend additional time and resources filing proxy supplements in response to plaintiffs' demands.

Therefore, companies with a low or negative say-on-pay vote and companies seeking authorization for new or additional shares to be issued pursuant to equity incentive plans should take a careful look at their disclosure to ensure that it complies with proxy statement disclosure requirements as well as consider enhanced disclosures to reduce the possibility of litigation. Many companies have boilerplate compensation policy language that is vulnerable to being exploited by plaintiffs and which is not necessary to provide an accurate and reasonable basis for a company's compensation decisions. Some of the cases recently filed have focused on compliance with Section 162(m) of the Internal Revenue Code of 1986 by stating claims that the per share limit set forth in the company's equity plan has been exceeded or that there was inadequate or incorrect disclosure with respect to this rule in the CD&A and/or in the equity plan disclosure as language with respect to Section 162(m) was not properly drafted.

New Listing Standards in Place for Compensation Committees. As directed by the SEC, all national securities exchanges[6] including the NASDAQ Stock Market LLC (NASDAQ) and the New York Stock Exchange, Inc. (NYSE) have finalized changes to their corporate governance requirements for companies listed on an exchange relating to compensation committee member independence and the powers and duties of such committees. These rules were required in response to Rule 10C-1 promulgated pursuant to Section 10C of the Exchange Act, which was added through the adoption of Section 952 of the Dodd-Frank Act. Listed companies that are not in compliance with these new rules are subject to delisting.[7] The listing standards address:

- the independence of the members of the compensation committee;
- compensation committees' authority to retain compensation advisers and to receive the necessary funding from the company to hire them;

- the requirement for compensation committees to evaluate independence of any compensation advisers before hiring them; and
- the requirement for compensation committees to be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser.

All of the above requirements other than those relating to the independence of compensation committee members were in effect in 2013. The compliance date relating to the independence of compensation committee members is the earlier of (1) the first annual meeting held after January 15, 2014 or (2) October 31, 2014. As of this date, both NYSE and NASDAQ-listed companies must have compensation committees comprised of at least two members who are independent directors. Previously, NASDAQ-listed companies could have executive compensation decisions made by a majority of the independent members of the board of directors.

NASDAQ's definition of independence was initially more stringent than what the SEC mandated under Rule 10C-1 specifically prohibiting any compensation committee members from accepting, directly or indirectly, any consulting, advisory or other compensatory fee, other than for board service, from an issuer or any subsidiary thereof consistent with current audit committee member requirements.[8] However on November 26, 2013 NASDAQ removed this prohibition on the receipt of compensatory fees and instead, like the NYSE, will require the consideration of the source of the fees paid to the director and will allow for a subjective determination as to whether the board believes such compensation will have any impact on the director's independence.

Under both the NASDAQ and the NYSE listing rules, when determining the independence of any director for service on the compensation committee, the company's board of directors is required to consider all factors relevant to determining whether a director would have a material conflict of interest that would impair the director's ability to make independent judgments including, but not limited to:

- the source of the director's compensation, including any consulting, advisory or other compensatory fee, paid by the company or any subsidiary thereof to the director; and
- whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer, and determine whether such affiliation would impair the director's judgment as a member of the compensation committee.

When considering the sources of a director's compensation in determining independence for purposes of compensation committee service, the board should consider whether the director receives compensation from any person or entity that would impair his or her ability to make independent judgments about the listed company's executive compensation. Similarly, when considering any affiliate relationship a director has with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company, in determining independence for purposes of compensation committee service, the board should consider whether the affiliate relationship places the director under the direct or indirect control of the listed company or its senior management, or creates a direct relationship between the director and members of senior management, in each case of a nature that would impair his or her ability to make independent judgments about the listed company's executive compensation.

Unlike with audit committees the SEC and the stock exchanges have acknowledged that for the affiliation test, some affiliations, such as those resulting from significant stock ownership, may in fact be appropriate and affiliate status should not, by itself, be considered an automatic disqualification for compensation committee service.

As of July 1, 2013 companies listed on Nasdaq must have a formal, written compensation committee charter and must review and reassess its adequacy on an annual basis. The charter must specify:

- the scope of the committee's responsibilities and how it carries out those responsibilities, including structure, process and membership requirements;
- the committee's responsibility for determining (or recommending to the board for determination) the compensation of the CEO and all other executive officers,
- that the CEO may not be present during voting or deliberations on his or her compensation; and

- the committee's responsibilities and authority with respect to retaining advisers, funding advisers and reviewing the independence of advisers as discussed above.

We have updated our form of compensation committee charter to include the above requirements.

Lastly, compensation committees must evaluate the independence of any compensation advisers, including outside legal counsel, before hiring them. The rules carve out a limited exception to the independence assessment requirement if the advice provided is limited to (a) consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the company, and that is available generally to all salaried employees; and/or (b) providing information that either is not customized for a particular company or that is customized based on parameters that are not developed by the adviser, and about which the adviser does not provide advice. In addition, the rules do not:

- require compensation committees to retain independent legal counsel;
- preclude a compensation committee from hiring legal counsel that is not independent from the company; or
- preclude a compensation committee from obtaining advice from in-house counsel or outside counsel retained by the issuer or management.

The factors which would need to be addressed by those who provide advice to the compensation committee are as follows:

- the provision of other services to the company by the entity that employs the compensation consultant, legal counsel or other adviser;
- the amount of fees received from the company by the entity that employs the adviser, as a percentage of the total revenue of the entity that employs the adviser;
- the policies and procedures of the entity that employs the adviser that are designed to prevent conflicts of interest;
- any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee;
- any stock of the issuer owned by the compensation consultant, legal counsel or other adviser; and
- any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the company.

Although the assessment is only required to be undertaken by the compensation committee prior to the compensation committee's receipt of any new advice, we would expect that as a practical matter compensation committees will be requesting letters from their compensation consultants, legal counsel and other advisers on a yearly basis typically around the time that annual compensation decisions are made. Mintz Levin has developed a set of procedures that we will follow when you request information from us, to provide you with the facts necessary in connection with your assessment of our independence with respect to advice we provide to the compensation committee.

A smaller reporting company is not subject to the requirements of these new compensation committee rules, except that a smaller reporting company must have a compensation committee of at least two members, each of whom must be an independent director as defined under the current NASDAQ or NYSE independence rules. In addition, a smaller reporting company will be required in its certification to NASDAQ or NYSE to confirm that it has adopted a formal written compensation committee charter or board resolution that specifies certain of the content discussed above; however, it will not need to incorporate into its charter or board resolutions provisions regarding authority to retain and fund compensation consultants, counsel and advisers and responsibility to consider the independence of compensation consultants, counsel and advisers, nor will NASDAQ companies be required to review and reassess the adequacy of the charter or board resolutions annually.

Conflict Minerals Rules. At long last, assuming no last-minute stays on the implementation of the "conflict minerals" disclosure rules, the first reports required to be filed under Section 1502 of the Dodd-Frank Act (and related SEC rules) will be due by May 31, 2014. Rules implemented under this section require issuers to disclose whether or not their products contain tin, gold, tantalum, or tungsten mined from the Democratic Republic of Congo and nine of its neighboring countries. This provision was included in the Dodd-Frank Act at the request of legislators who believe that the process of mining for and producing these particular minerals in certain countries is contributing to a grave, ongoing humanitarian crisis in that region of Africa. Congress's intent is that this required disclosure will "enhance transparency" surrounding the use of these minerals, such that consumers will be able to make more informed decisions about purchasing a variety of products based on companies' direct or indirect involvement in the conflict minerals trade.

All public companies making filings pursuant to Sections 13(a) and 15(d) of the Exchange Act, including smaller reporting companies and foreign private issuers, are subject to the conflict mineral rules. Investment companies registered under the Investment Company Act of 1940 are not subject to the rule. The SEC rules require disclosure, on a calendar-year basis, of an assessment of whether products contain these minerals. Public companies will be required to disclose via EDGAR on a new form, known as Form SD ("Specialized Disclosure Report"), by May 31 of the year following the assessment if certain facts are present based on what the company determines in its conflict minerals evaluation. The first of these reports will be due by May 31, 2014, covering calendar year 2013.

The SEC's rules release provides in-depth guidance on how to maneuver through the rules using a three-step process. Companies must make a determination as to whether any conflict minerals are necessary to the functionality or production of a product manufactured, or contracted to be manufactured by the issuer (step one). If so then the company must then perform a "reasonable inquiry" into where the conflict minerals originated, and make disclosure of their efforts and conclusions on a Form SD (step two). If a company makes a determination that it manufactures (or contracts to have manufactured) a product using conflict minerals that originate or may originate from the Democratic Republic of Congo or one of the adjoining countries, it must conduct a supply chain due diligence analysis and include an additional Conflict Minerals Report as well as an auditors' report as an exhibit to its Form SD (step three).

If conflict minerals are not necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by an issuer, the issuer will not be subject to the conflict mineral rules and no further action and no filing of a Form SD will be necessary.

A group of business organizations has filed an administrative legal challenge to the conflict minerals rules. If the rules are stayed pending resolution of the challenge, this could delay the first filing deadline, but in the meantime, companies should move forward with their assessments in order to be prepared to make the necessary disclosure by May 2014.

SEC Rules on Compensation Consultant Conflicts of Interest. Last year, proxy and information statements for annual meetings of shareholders (or special meetings in lieu of annual meetings) at which directors will be elected were required to include disclosure under Item 407(e)(3)(iv) of Regulation S-K about any conflicts of interest raised by the work of certain compensation consultants involved in "determining or recommending" executive or director compensation. As discussed above, compensation committees will again this year need to conduct an assessment to determine whether any conflicts exist, taking into account six factors set forth in Rule 10C-1(b)(4) under Section 10C of the Exchange Act. Although not required, as we have seen with the risk assessment disclosure requirement, many companies have opted to make an affirmative statement in their proxy statements regarding these matters in order to show that they have complied with the new disclosure obligation on compensation consultant conflicts of interest.

The Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA). On August 10, 2012, President Obama signed the Iran Threat Reduction and Syria Human Rights Act of 2012 into law. This act added new Section 13(r) to the Exchange Act, which includes specific disclosure obligations for companies that are engaged in, or affiliated with entities that are engaged in, commercial activity with Iran and Syria, or nationals of those countries. While the SEC was not required to engage in any rulemaking under Section 13(r), it has issued Compliance and Disclosure Interpretations addressing questions that have arisen under that section. The disclosures required by Section 13(r) became effective for quarterly and annual reports filed after February 6, 2013, and now constitute an ongoing

reporting obligation. Public companies, even companies that concluded that they did not need to include ITRA disclosure in their most recent annual and quarterly reports, need to ensure that they have disclosure controls in place to determine each quarter whether any such disclosure is needed with respect to the period covered by the report.

Among other things, Section 13(r) covers a broad scope of commercial activity conducted by reporting companies with the “Government of Iran,” unless the activity has been specifically authorized by a U.S. Federal department or agency. The Government of Iran is defined for this purpose to include all of that government’s political subdivisions, agencies and instrumentalities, entities owned or controlled directly or indirectly by the government, persons acting directly or indirectly for or on behalf of the government or any of its owned or controlled entities, and any other person who may be determined by the U.S. Office of Foreign Assets Control to fall within the definition of the Government of Iran.

This definition encompasses entities that are organized under the laws of Iran, including most transactions with Iranian financial institutions, individuals and entities located in Iran (and, in the case of persons whose assets have been frozen pursuant to executive orders dealing with terrorism or the proliferation of weapons of mass destruction or United Nations Security Council resolutions relating to Iran, some individuals who reside outside of Iran), and non-Iranian entities that are owned or controlled by any of these persons and entities.

Among the transactions that require disclosure under Section 13(r) are transactions relating to Iran’s energy industry; transactions facilitating Iran’s procurement or proliferation of weapons or terrorism; and the transfer of technology or services to Iran that are likely to be used in connection with human rights abuses in Iran, including the restriction of the free flow of unbiased information and the disruption, monitoring or restriction of free speech.

The disclosure requirement does not contain a materiality threshold with respect to the need to disclose any of these activities. As such, even a very small transaction in terms of dollar size or overall significance could result in the need to provide this disclosure.

In addition, under Section 13(r), companies may be liable for, and have to provide disclosure regarding, conduct that is known or should have been known to have been engaged in by their affiliates. For this purpose, the term “affiliate” includes any “person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the issuer.” This definition is interpreted to include directors and executive officers, subsidiaries and entities controlled by the issuer, and controlling shareholders, to the extent the shareholder has the power to direct or cause the direction of the management and policies of the issuer as a result of its ownership.

There is no requirement to affirm the absence of any activity covered by Section 13(r), if an issuer and its affiliates have not engaged in any Iran-related activities subject to disclosure under the Act. These requirements relate to any company that files periodic reports under Section 13(a) of the Exchange Act, including smaller reporting companies and foreign private issuers.

An issuer that is required to make disclosure under Section 13(r) must also file a concurrent notice with the SEC referencing the information included in the annual report filing, which will be posted on the SEC’s website and sent to the President and Congressional committees. The President will then be required to initiate an investigation within 180 days to determine whether and to what extent sanctions should be imposed on the reporting issuer. There is no specified location for the ITRA disclosure in a company’s filings. Companies have presented the disclosure as a component of various items of the applicable report, including in the business section, risk factors or legal proceedings of the applicable SEC report or separately in the “other information” item.

Disclosure Rules Proposed on “Pay Ratios.” On September 18, 2013, the SEC proposed rules to implement the requirements of Section 953(b) of the Dodd-Frank Act, which instructed the SEC to amend existing rules under Item 402 of Regulation S-K to require public companies to disclose the ratio of the CEO’s compensation to that of a company’s median employee. All public companies will be subject to this new disclosure requirement, with the exception of emerging growth companies, smaller reporting companies and foreign private issuers.

Under the proposed rules, companies would be required to disclose:

a. The median of the annual total compensation of all company employees, excluding the CEO;

b. The annual total compensation of the company's CEO; and

c. The ratio of (a) to (b).

Disclosure describing the methodology used to identify the median employee, determine total compensation and any estimates and assumptions used will also be required. When calculating the median of the company's employee compensation, the proposed rules require companies to include all employees, including full-time, part-time, temporary, seasonal, and non-U.S.-based employees employed by the company or any of its subsidiaries. However, such determination must be based solely on the number of employees who were employed as of the last day of the company's prior fiscal year. The proposed rules allow companies to annualize the compensation of permanent employees who were not employed for the entire year, such as new hires. Companies may not, however, annualize the compensation of part-time, temporary, or seasonal employees.

The proposed rules allow for flexibility in identifying a median employee and do not specify a required methodology for purposes of such analysis. Companies may use any methodology so long as it consistently applies "reasonable estimates to identify the median and … to calculate the annual total compensation or any elements of total compensation for employees other than the [CEO]." In determining the employees from which the median is identified, companies may choose to use their entire employee population, statistical sampling or other reasonable methods.

Once the company identifies a median employee, the company must calculate such employee's total compensation using the definition of "total compensation" in Item 402(c)(2)(x) of Regulation S-K. The proposed rules define "annual total compensation" to mean total compensation for the last completed fiscal year. Moreover, the proposed rules permit companies to exclude perks, such as broad-based health coverage, in the calculation of total compensation, provided that such benefits in the aggregate are less than $10,000. However, the company must use the same approach in calculating the CEO's total compensation.

This "pay ratio" information would initially need to be disclosed for a company's first fiscal year commencing on or after the effective date of the final rules, provided, however, that such disclosure will not be required until the company files its Form 10-K or, if later, the proxy filing for the next annual stockholder meeting following the end of that fiscal year. This disclosure would then have to be included in any filings that are required to include executive compensation information under Item 402 of Regulation S-K.

The SEC has received over 20,000 comment letters on these proposed rules to date, and the comment process ended December 2, 2013. These rules will not be in effect for the 2014 proxy season, but may be finalized in time for next year.

Other Sections of the Dodd-Frank Act Are Still Subject to Rulemaking. The Dodd-Frank Act contains several other sections that will impact companies' proxy statements in coming years, including the requirements to provide disclosure on measuring pay-for-performance, hedging of shares by employees and directors, and clawback of "erroneously awarded compensation." Although it has been almost four years since the passage of the Dodd-Frank Act, these sections of the Dodd-Frank Act still remain subject to SEC rulemaking, and the SEC has not set a timetable for issuance of proposed regulations. We will update our clients and friends separately as these rules are proposed and issued.

Although Dodd-Frank has not yet required companies to make changes regarding hedging and pledging and clawbacks, ISS and institutional stockholders have pressured companies into adopting policies relating to these topics as part of good governance practices. Under ISS policy a company that allows its executive officers or directors to hedge company stock or pledge a significant portion of company stock may receive an "against" or "withhold" vote for directors individually, committee members, or the entire board. ISS has not established a bright-line test for what constitutes "significant" pledging, but it has indicated that a determination of whether pledging is significant is going to be based primarily on the number of shares pledged as a percentage of the number of shares outstanding, market value and trading volume in the company's stock as well as the company's current views on future pledging arrangements.[9] ISS views both hedging and pledging as adverse to shareholder interests because these practices sever the alignment of directors and executive officers' interests with shareholders by reducing the directors' or officers' economic exposure to holding company stock while maintaining voting rights. ISS believes that pledging, which often occurs in connection with a margin loan, can have a detrimental effect on a company's stock

price in the event of forced sales to meet a margin call and such forced sales could also violate a company's insider trading policies. Therefore, if a company does allow these practices, and pledging is described in a company's beneficial ownership table, the company should be sure to address its policies on this practice in its CD&A.

Each year more companies are adopting clawback policies in response to investor pressure. Although many of these policies aim to comply with Dodd-Frank, it seems to be more important to investors that a company has a clawback policy as opposed to the requirements of the policy as policies vary greatly from company to company. In addition, in 2013 certain institutional investors developed compensation recoupment principles aimed at pharmaceutical companies as many of them have been entering into settlements because of executive misconduct. These recoupment policies are more rigorous than the provisions set forth by the Dodd-Frank Act and contemplate that the compensation committee would have the discretion to determine if there was any material violation of a company policy, related to the sale, manufacture or marketing of health care services, which has caused significant financial harm to the company and should therefore trigger consideration of a possible recoupment of incentive compensation.

Forum Selection Bylaws. Recent cases brought in the State of Delaware regarding the appropriate jurisdiction for certain kinds of shareholder lawsuits have prompted many companies to explore the possibility of including a bylaw provision that requires these lawsuits to be brought within specified jurisdictions. Given the significant cost and management distractions that usually accompany these lawsuits, taking a step now to amend the bylaws to include this kind of provision may save at least some time and expense in the event of a covered suit.

A so-called "forum selection clause" requires any derivative lawsuit, claim for breaches of fiduciary duties, or claim based on the corporate statute of the state in which the company is incorporated, to be brought in a state or federal court located in the state of incorporation, as opposed to the state of residence of the stockholder bringing the claim or another location if so specified in the company's charter or bylaws. These provisions are designed to prevent the waste that can occur when duplicative lawsuits asserting the same claims on behalf of the same constituencies, seeking the same relief, are commenced at the same time by multiple shareholders in multiple courts. These provisions also allow corporations to better plan and manage the litigation landscape by imposing order and consistency before litigation begins. Of course, we hope that such litigation never occurs, but in the event that it does, the company should be able to control the process to the greatest extent possible.

Boards of directors generally have the ability to amend company bylaws to include this kind of provision without the need for a shareholder vote; however, the amendment would need to be reported on a Form 8-K within four business days of the decision. Companies may also want to consider including a forum selection provision in an amendment to their certificates of incorporation. This step would require shareholder approval under state corporate law, but receipt of shareholder approval would presumably eliminate the possibility of a subsequent shareholder challenge to the validity of the forum selection clause.

"Proxy Plumbing." In July 2010, the SEC issued a concept release on the U.S. proxy system.[10] This release, which has come to be known as the "proxy plumbing" release, addresses three principal questions regarding the current proxy system in the United States: whether the SEC should take steps to enhance the accuracy, transparency, and efficiency of the voting process; whether the SEC's rules should be revised to improve shareholder communications and encourage greater shareholder participation in the shareholder meeting process; and whether the voting power held by shareholders is aligned with the economic interest of such shares. No rulemaking has yet been issued by the SEC in response to this concept release, but we understand that the SEC is continuing to evaluate the issues it raised in that document. In addition the SEC is also looking at proxy advisory firms and the role they play in shaping shareholder votes. Although the SEC has no ability to regulate these firms, the SEC is concerned about the lack of competition and the sway they seem to have over the voting decisions by many institutional investors.

On December 5, 2013 the SEC hosted a roundtable regarding proxy advisory services to continue its examination of the proxy process with a discussion about the use of proxy advisory services by investment advisers and institutional investors. The roundtable focused on the factors that have contributed to the use of proxy advisory services and the purposes they serve as well as current topics of interest, including conflicts of interest that may exist, the transparency and accuracy of the recommendations made by proxy advisory firms, and what the nature and extent of reliance by investors on proxy adviser recommendations is and should be.

2014 Periodic Report Filing Deadlines

For companies that qualify as large accelerated filers and have fiscal years ending on December 31, annual reports on Form 10-K are due 60 days after fiscal year-end (Monday, March 3, 2014).[11] Form 10-K reports continue to be due 75 days following fiscal year-end for accelerated filers[12] (Monday, March 17, 2014 for December 31 year-end companies) and 90 days after fiscal year-end for non-accelerated filers (Monday, March 31, 2014 for December 31 year-end companies).

In addition, Form 10-Q reports filed by accelerated filers and large accelerated filers continue to be due 40 days after the close of the fiscal quarter. The deadline for Form 10-Q reports for non-accelerated filers continues to be 45 days after the close of the fiscal quarter.

These changes do not affect the existing proxy statement filing deadline of 120 days after fiscal year-end for companies that choose to incorporate by reference from their definitive proxy statements the disclosure required by Part III of the Form 10-K.

Board of Director and Committee Membership

Each year as part of the year-end reporting process, we recommend that companies carefully examine the membership profiles of their board and board committees. Sarbanes-Oxley, the SEC rules issued under Sarbanes-Oxley, and the listing requirements of NASDAQ, NYSE and NYSE MKT (formerly NYSE AMEX) relating to board and committee membership requirements all impact who may serve.[13] Mintz Levin has prepared a director independence and qualification checklist to assist with this analysis, which we have updated this year for the changes to compensation committee independence requirements, and we encourage you to evaluate each director and director nominee to ensure compliance with the new compensation committee independence requirements and continued compliance with all other requirements.

Shareholder Approval of Equity Compensation Plans

NASDAQ, NYSE and NYSE MKT all require shareholder approval for the adoption of equity compensation plans and arrangements for employees, directors and consultants and for any material modification of such plans and arrangements, including the addition of new shares to a plan. Exemptions from the shareholder approval requirement continue to be available for inducement grants to new employees if such grants were approved by a compensation committee or a majority of the company's independent directors and promptly following the grant a press release is issued specifying the material terms of the award, including the name of the recipient and the number of shares issued, and in certain situations relating to an acquisition or merger. An exemption from the shareholder approval requirement is also available for certain tax-qualified, non-discriminatory employee benefit plans (such as plans that meet the requirements of Section 401(a) of the Internal Revenue Code and Employee Stock Purchase Plans meeting the requirements of Section 423 of the Internal Revenue Code), provided that such plans are approved by the issuer's compensation committee or a majority of the issuer's independent directors. Equity plans adopted prior to June 30, 2003 are unaffected under this rule, until a material modification is made to such a plan.

As noted above, companies considering option repricing programs in light of significant declines in their stock prices should note that such programs may require shareholder approval, depending on the terms of the equity compensation plan under which the options were granted. In the event that shareholder approval is required, the company will need to file a preliminary proxy statement with the SEC, which would not be required for approval of a new plan or an amendment to an existing plan.

Companies should review their existing equity compensation plans as part of their year-end reporting preparation in order to determine whether shareholder approval will need to be obtained for new plans, increases in the numbers of shares available under old plans, option repricing programs, or material plan amendments. This is another area that ISS continues to weigh in on heavily both with respect to the number of shares to be authorized under the plan and some of the substantive disclosure within the plan itself, so plenty of time should be allotted to proposals in this area.

Other Year-End Considerations

We also recommend that companies take the opportunity while planning their year-end reporting to consider what amendments may be necessary or desirable to their corporate documents over the coming year that may require shareholder approval. Some items to consider are:

- Does the company have enough shares authorized under its certificate of incorporation to achieve all of its objectives for the year, including acquisitions for which it may want to use its stock as currency?
- Does the company have adequate shares available under its equity compensation plans to last throughout the year?
- Are there other material changes that should be made to the company's equity compensation plans that would require shareholder approval?
- Has the company reviewed its charter and bylaws to assess any anti-takeover measures in place?

To the extent that a company expects any proposal in its proxy statement to create controversy among its shareholder base, it may want to consider hiring a proxy solicitor to assist with the process of seeking the requisite shareholder vote.

Mintz Levin Website: Publications

We would also like to call your attention to the many advisories and alerts regarding topics of current interest that are available to you on our website, www.mintz.com. New alerts and advisories are posted frequently, and we hope that you will find the information useful. Below is a link to recent SEC cybersecurity guidance regarding disclosure relating to cybersecurity risks and data breaches: http://www.privacyandsecuritymatters.com/2013/12/on-the-fifth-day-of-privacy-the-sec-gave-to-me/

Please contact the Mintz Levin attorney who is responsible for your corporate and securities law matters if you have any questions or comments regarding this information. We look forward to working with you to make this year's annual reporting process as smooth as possible.

* * *

View Mintz Levin's Corporate & Securities attorneys.

Endnotes

[1] We invite you to review our memorandum from last year, which analyzed regulatory changes that were new for fiscal year 2012, and we would be happy to provide you with another copy upon request.

[2] The SEC requires equity awards to be valued as of their grant date fair value, which value is a formula based on certain assumptions and is supposed to represent the potential value of the award over the life of the award if fully realized.

[3] See ISS Frequently Asked Questions on U.S. Compensation Policies at http://www.issgovernance.com/files/ISSUSCompensationFAQs12192013.pdf, which discusses how ISS will calculate a company's realizable pay.

[4] The ISS 2013 policy in evaluating say-on-pay is available on its website at http://www.issgovernance.com/sites/default/files/EvaluatingPayforPerformance.pdf.

[5] Companies must be mindful of Regulation FD (Fair Disclosure) and not disclose material nonpublic information selectively nor risk sending mixed messages from the disclosures contained in the company's proxy statement or other SEC filings when speaking with stockholders.

[6] Companies listed on the OTC Bulletin Board (OTCBB) and the OTC Markets Group (previously known as the Pink Sheets and Pink OTC Markets) are not required to comply with these rules unless their securities also are listed on a national securities exchange. In addition, limited partnerships, companies in bankruptcy proceedings, registered open-end management investment companies, controlled companies and foreign private issuers continue to be exempt.

[7] Please see Release No. 33-9330, available on the SEC's website at http://www.sec.gov/rules/final/2012/33-9330.pdf (the "Adopting Release").

[8] This does not include fees received as a member of the board or any committee thereof, nor will it include receipt of fixed amounts under a retirement plan, including deferred compensation, for prior service with an issuer.

[9] Item 403 of Regulation S-K requires a footnote to the beneficial ownership table if a director or executive officer has stock subject to pledging.

[10] Concept Release on the U.S. Proxy System (Release No. 34-62495, July 14, 2010), *available at* http://www.sec.gov/rules/concept/2010/34-62495.pdf.

[11] *Large accelerated filers* are domestic companies that meet the following requirements as of their fiscal year-end:

- have a common equity public float of at least $700 million, measured as of the last business day of their most recently completed second fiscal quarter (i.e., for calendar fiscal year-end companies, this test would be applied as of June 30, 2013);
- have been subject to the reporting requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, for at least 12 months;
- have previously filed at least one Annual Report on Form 10-K; and
- do not qualify as small business issuers under SEC rules.

[12] *Accelerated filers* are those that meet all of the above tests but have a common equity public float of at least $75 million, but less than $700 million, measured as of the last business day of their most recently completed second fiscal quarter (i.e., for calendar fiscal year-end companies, this test would be applied as of June 30, 2013).

[13] Please see our Client Advisory, dated November 2003, entitled "Changes to Corporate Governance Standards for Nasdaq-Listed Companies," for a further description of these changes.

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