Securities Advisory

Preparation for 2014 Fiscal Year-End SEC Filings and 2015 Annual Shareholder Meetings

02.03.2015

BY MEGAN GATES AND PAMELA GREENE

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 2015.[1]
For the first time in many years, there are no SEC rule changes that will affect the year-end reporting process. In 2014, the SEC did not propose any rules relating to corporate governance and disclosure under the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), and the “pay ratio” disclosure rules proposed by the SEC in September 2013 have not yet been finalized.[2]
However, even if the “pay ratio” rule is adopted this year, this additional disclosure will not be required until proxy statements are filed during the 2017 reporting season (covering the 2016 fiscal year).
Shareholder activism remains strong, and institutional shareholders are continuing to put pressure on companies to conduct their affairs in a more transparent manner, encouraging the adoption of governance policies that benefit shareholders, such as executive compensation clawbacks, stock ownership guidelines, and majority voting, and discouraging policies such as plurality voting, staggered boards and “poison pill” plans. As the largest public companies have adopted many of these corporate governance initiatives already, institutional investors are moving their attention to smaller companies that may historically have lagged in the adoption of shareholder-friendly governance features.

We will continue to update you on important changes in these areas. We are excited to report that we recently joined forces with our colleagues in our securities litigation group to launch a new blog, *Securities Matters*. The blog provides comprehensive coverage of all aspects of the federal and state securities laws and regulations, capital market trends and best practices, corporate governance matters, Delaware corporate law, developments in securities and shareholder litigation and SEC enforcement, and related topics. Please subscribe to our blog at www.securitiesmatters.com/subscribe to stay current on new developments.

We have addressed topics that we believe continue to be of interest to the 2015 reporting season in further detail below.

Say-on-Pay: Considerations for 2015. Shareholder support on say-on-pay resolutions continued to average above 90% across all companies in 2014. 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 Compensation Discussion & Analysis (CD&A) section, with both advocacy and disclosure in mind. In addition, issuer engagement with institutional shareholders has become an integral part of the say-on-pay process, with many companies reaching out to their largest shareholders in the months following the annual meeting to discuss pay practices.

Institutional Shareholder Services (ISS) continues to define the standard as to what constitutes a “passing” voting percentage on a say-on-pay proposal, with 70% of the vote deemed by them to be acceptable and not require a company to alter its compensation strategy to demonstrate a stronger link between pay and performance.

Megan Gates, *Member*

Pamela Greene, *Member*

RELATED PRACTICES

- Securities & Capital Markets
- Mergers & Acquisitions
- Employee Benefits & Executive Compensation
- Corporate Compliance & Investigations
- Corporate Governance
- Venture Capital & Emerging Companies
- International
- EB-5 Financing

RELATED INDUSTRIES

- Life Sciences
- Energy Technology
- Technology, Communications & Media

RELATED BLOGS

- Securities Matters

ISS has not changed the way it analyzes say-on-pay this year[3] and continues to recommend a vote against a say-on-pay proposal if:

- there exists a significant misalignment between CEO pay and company performance (pay for performance);
- the company maintains significant problematic pay practices; or
- the board exhibits a significant level of poor communication and responsiveness to shareholders.

In addition ISS will recommend a vote against or withhold from the members of a company's compensation committee and potentially the full board if:

- there is no say-on-pay proposal on the ballot, and an against vote on a say-on-pay proposal would be warranted due to pay-for-performance misalignment, problematic pay practices, or the lack of adequate responsiveness on compensation issues raised previously, or a combination thereof;
- the board fails to respond adequately to a previous say-on-pay proposal that received less than 70% support of votes cast;
    - ISS looks at the following in evaluating whether a company has adequately responded:
        - disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support;
        - specific actions taken to address the issues that contributed to the low level of support;
        - other recent compensation actions taken by the company;
        - whether the issues raised are recurring or isolated;
        - the company's ownership structure; and
        - whether the support level was less than 50%, which would warrant the highest degree of responsiveness.
- the company has recently practiced or approved problematic pay practices, including option repricing or option backdating; or
- ISS views the situation as egregious.

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" has also continued to assist shareholders in understanding the executive compensation value actually transferred during a fiscal year and ISS' standard research report now 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.[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 understand 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]

Class action law suits 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 continued but have not had much success in the courts. 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. 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 webpage 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 ISS Policy for Evaluating Equity Plan Proposals. ISS has changed the way it will evaluate equity compensation plan proposals. It has developed an equity plan scorecard (EPSC) whereby instead of only evaluating the shares to be authorized and voting against plans that it believes have egregious plan provisions, the new EPSC will base recommendations on a combination of factors related to (1) plan cost relative to peers, which will continue to be determined using ISS' proprietary shareholder value transfer model, (2) plan features, and (3) grant practices. The EPSC will assign a maximum number of potential points for each factor, which vary slightly depending on whether the company is an S&P 500, Russell 3000, Non-Russell 3000, or recent IPO company. However, ISS will continue to vote against equity plans that contain certain plan features that ISS deems egregious. These features, which have not changed from recent years, are:

- a liberal change in control definition that could result in vesting of awards before a change in control transaction is actually consummated;
- allowing for repricing or cash buyout of underwater options without shareholder approval;
- using the plan as a vehicle for problematic pay practices or a pay-for-performance disconnect; or
- any other plan features or company practices that are deemed detrimental to shareholder interests, such as tax gross-ups.

On December 22, 2014 ISS issued 20 FAQs to provide more details on the EPSC process.[6]

Plan Cost: The EPSC will now measure a company's shareholder value transfer relative to two benchmark calculations that consider:

- new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants, and
- only new shares requested plus shares remaining for future grants.

ISS believes that its new measurements will reduce the impact of grant overhang on the overall cost evaluation as it recognizes that high grant overhang is a sunk, expensed cost and that it may also reflect long-term positive stock performance, long vesting periods for grants, and/or employee confidence in future stock performance.

Plan Features: Based on investor and broader market feedback, the following factors that are newly examined for 2015 may have a negative impact on EPSC results:

- *Automatic single-triggered award vesting upon a change in control,* which may provide windfall compensation even when other options (e.g., conversion or assumption of existing grants) may be available;
- *Broad discretionary vesting authority* that may result in "pay for failure" or other scenarios contrary to a pay-for-performance philosophy;
- *Liberal share recycling* on various award types, which obscures transparency about share usage and total plan cost; and
- *Absence of a minimum required vesting period (at least one year)* for grants made under the plan, which may result in awards with no retention or performance incentives.

Grant Practices: The following factors may have a positive impact on EPSC results, depending on a company's size and circumstances:

- *The company's 3-year average burn rate relative to its industry and index peers* – This measure of average grant "flow" provides an additional check on plan cost. The EPSC compares a company's burn rate relative to its index and industry.
- *Vesting schedule(s) under the CEO's most recent equity grants* during the prior three years – Vesting periods that incentivize long-term retention are beneficial.
- *The plan's estimated duration*, based on the sum of shares remaining available and the new shares requested, divided by the three-year annual average of burn rate shares – Given that a company's circumstances may change over time, shareholders may prefer that companies limit share requests to an amount estimated to be needed over no more than five to six years.
- *The proportion of the CEO's most recent equity grants/awards subject to performance conditions* – Given that stock prices may be significantly influenced by market trends, making a substantial proportion of top executives' equity awards subject to specific performance conditions is an emerging best practice, particularly for large cap, mature companies.

- *A clawback policy that includes equity grants* – Clawback policies are seen as potentially mitigating excessive risk-taking that certain compensation may incentivize, including large equity grants.
- *Post-exercise/post-vesting shareholding requirements* – Equity-based incentives are intended to help align the interests of management and shareholders and enhance long-term value, which may be undermined if executives may immediately dispose of all or most of the shares.

Other Noteworthy FAQs:

- *162(m) Approval* – ISS generally will give a favorable recommendation to proposals that *only* seek approval to ensure tax deductibility of awards pursuant to Section 162(m), and that do not seek additional shares for grants, regardless of EPSC factors, as long as the compensation committee is 100% independent according to ISS standards. However, ISS will apply the full EPSC evaluation where a company is seeking Section 162(m) approval for the first time after its IPO or emergence from bankruptcy (*i.e.,* the first time that public shareholders have an opportunity to weigh in on the plan).
- *Non-Employee Director Plans* – ISS will not apply the EPSC to stand-alone non-employee director plans for which the company is requesting shareholder approval, except that, when the company is seeking approval of another stock plan proposal in the proxy, ISS will include the shares available for grant under a non-employee director plan into the plan cost evaluation for that plan.
- *Recent IPO companies* – Companies that have completed an IPO or emerged from bankruptcy within the prior three fiscal years may be evaluated under an EPSC model that includes fewer factors. As under its previous policy, neither the burn rate nor duration factors apply for companies that have less than three years of disclosed grant data.

In addition ISS has launched a new data verification portal that allows companies with equity plan proposals on their ballots to verify data and request changes. A company should register with ISS before its proxy is filed. After the proxy is filed, ISS will notify the company that the portal is open. Upon notification, companies will have *two business days* to verify the data and/or request modifications.[7]

ISS 2015 Proxy Voting Guidelines. In addition to the guidance described above for equity plan proposals, ISS has provided additional proxy voting guidelines on a variety of topics, as described below:

Unilateral Bylaw or Charter Amendments. ISS has noted a recent "substantial increase" in the number of unilateral bylaw or charter amendments that it finds problematic and has in response adopted a stand-alone policy (as opposed to its prior policy, in which this topic was included as part of its overall "governance failures" topic) that it will generally recommend voting against or withholding votes from individual directors, committee members, or the entire board (except new nominees, who will be considered on a case-by-case basis) if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders. ISS does not specify what kinds of amendments would qualify as "materially diminishing" or "adversely impacting" shareholders' rights, but we can surmise that these would include provisions such as raising the voting threshold necessary to approve certain actions, or taking away the right to act by written consent of shareholders. ISS states that it will consider the following factors in deciding whether to recommend voting against board members if such an amendment was approved by the board during the year:

- The board's rationale for adopting the bylaw/charter amendment without shareholder ratification;
- Disclosure by the company of any significant engagement with shareholders regarding the amendment;
- The level of impairment of shareholders' rights caused by the amendment to the bylaws/charter;
- The board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions;
- The company's ownership structure;
- The company's existing governance provisions;
- Whether the amendment was made prior to or in connection with the company's initial public offering;
- The timing of the board's amendment to the bylaws/charter in connection with a significant business development; and
- Other factors, as deemed appropriate, that may be relevant to determine the impact of the amendment on shareholders.

Independent, Separate Board Chair. ISS will generally recommend voting in favor of shareholder proposals requiring that the board chair position be filled by an independent director, taking into consideration the following:

- The scope of the proposal, including:

    - whether the proposal is precatory or binding; and
    - whether the proposal is seeking an immediate change in the chairman role or the implementation of a change at the next CEO transition.
- The company's current board leadership structure, including:
    - the presence of an executive or non-independent chair in addition to the CEO;
    - whether there has been a recent recombination of the role of CEO and chair, and/or a departure from a structure with an independent chair; and
    - any recent transitions in board leadership and the effect such transitions may have on independent board leadership, as well as the designation of a lead director role.
- The company's governance structure and practices, including:
    - overall independence of the board;
    - the independence of key committees;
    - the establishment of governance guidelines;
    - board tenure and its relationship to CEO tenure;
    - poor compensation practices;
    - material failures of governance and risk oversight, related-party transactions or other issues putting director independence at risk;
    - corporate or management "scandals"; and
    - actions by management or the board with potential or realized negative impact on shareholders.
- Company performance over the past one, three, and five years compared to the company's peers and the market as a whole.
- Any other relevant factors that may be applicable.

ISS has noted that calls for independent board chairs were the most prevalent type of shareholder proposal offered for consideration at U.S. companies' annual meetings in 2014, and the number of proposals calling for independent board chairs has more than doubled over the past five years.

Litigation Rights (Including Exclusive Venue and Fee-Shifting Bylaw Provisions). ISS will use a case-by-case approach to recommendations as to voting on proposed bylaw provisions that impact shareholders' litigation rights, such as a provision requiring litigation to be brought in a particular forum, or a "fee-shifting" provision that requires a shareholder who sues a company unsuccessfully to pay all litigation expenses of the defendant corporation. The factors it will consider include:

- The company's stated rationale for adopting such a provision;
- Disclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or shareholder lawsuits outside the jurisdiction of incorporation;
- The breadth of application of the bylaw, including the types of lawsuits to which it would apply and the definition of key terms; and
- Governance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the bylaws) and their ability to hold directors accountable through annual director elections and a majority vote standard in uncontested elections.

ISS will generally recommend a vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits (i.e., in cases where the plaintiffs are partially successful).

Disclosure Regarding Political Contributions. ISS will generally recommend a vote in favor of shareholder proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities, considering:

- The company's policies, and management and board oversight related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes;
- The company's disclosure regarding its support of, and participation in, trade associations or other groups that may make political contributions; and
- Recent significant controversies, fines, or litigation related to the company's political contributions or political activities.

Disclosure on Greenhouse Gas Reduction Goals. ISS will apply a case-by-case standard to shareholder proposals that call for the adoption of greenhouse gas (GHG) reduction goals from products and operations, taking into account:

- Whether the company provides disclosure of year-over-year GHG emissions performance data;
- Whether company disclosure lags behind that of industry peers;
- The company's actual GHG emissions performance;
- The company's current GHG emission policies, oversight mechanisms, and related initiatives; and
- Whether the company has been the subject of recent, significant violations, fines, litigation, or controversy related to GHG emissions.

Enforcement of Section 16 Filing Delinquencies. This past September, the SEC announced charges and financial penalties totaling $2.6 million against 28 officers, directors, and major shareholders of public companies for repeated late filing of stock ownership forms as required pursuant to Section 13 and Section 16 of the Exchange Act, as well as against six companies for contributing to filing failures by insiders or failing to report their insiders' filing delinquencies in the companies' proxy statements. The SEC stated that it had used "quantitative data sources and ranking algorithms to identify these insiders as repeatedly filing late." This enforcement initiative evidences the SEC's increasing use of data analytics to identify potential violations of the securities laws since the Enforcement Division's establishment of its Center for Risk and Quantitative Analytics in July 2013.

Significantly, a number of the individuals charged by the SEC had relied on their brokers or on the companies of which they were officers, directors or shareholders to make the required filings, yet the SEC still held them personally responsible for the filing delinquencies. The SEC also assessed penalties against companies that had agreed to make the required filings on behalf of their officers and directors, yet failed to do so in a timely manner. Further, the SEC cited certain companies for failing to disclose the untimely filings in their annual reports or proxy statements as required in Item 405 under Regulation S-K.

This initiative is consistent with the "broken windows" approach to enforcement that Mary Jo White has emphasized since becoming SEC Commissioner. As she stated in a speech last October,

"when a window is broken and someone fixes it – it is a sign that disorder will not be tolerated. But, when a broken window is not fixed, it 'is a signal that no one cares….' The same theory can be applied to our securities markets – minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines. And so, I believe it is important to pursue even the smallest infractions."

In light of this approach and the SEC enforcement actions, public companies and their officers, directors, and shareholders should take a second look at their procedures for filing even routine forms to make sure that they are complying with the SEC's requirements.

Risk Factor Reviews: Cybersecurity in Focus. As you prepare and update the Risk Factors section of your Form 10-K this year, it's important to take a fresh look at what new and emerging risks may require disclosure. In light of recent, high-profile cybersecurity breaches, we recommend that all companies consider their potential vulnerability to breaches and the consequences of those breaches.

The SEC and its Staff last provided broad guidance on this topic in October 2011, in Disclosure Guidance Topic No. 2.[8] However, the Staff continues to view this as a key focus area in its filings review and comment process, and it has been taken up as a cause by members of Congress, by board members, investors and by proxy advisors.

Here are a few suggestions for addressing this topic in your Risk Factors this year:

Don't use boilerplate, and be specific. To the greatest extent possible, tailor the language of the risk factor to your company's own security needs, risks and steps taken to guard against breaches. If you have encountered particular situations, such as cyber attacks, that are relevant to an investor's understanding of your risk profile in this area, address them. The SEC is aware of the tension between not wanting to provide disclosure that could give hackers a road map to launch a future attack and needing to provide sufficient disclosure to investors, but encourages sufficient detail that the disclosure is not merely applicable to all companies in a particular industry.

If a breach does occur… In addition to forward-looking disclosure about the consequences of a potential breach, the SEC asks for specific disclosure of actual breaches or attacks that take place. This would include information about the following:

- the materiality of the breach;
- the consequences of the breach, as well as its scope and magnitude;
- known or potential costs of remediation or other costs; and
- what has been done to prevent future similar occurrences.

Of course, if an attack has occurred, the costs or consequences of the attack will likely need to be addressed elsewhere in the Form 10-K as well, such as in the MD&A or financial statements.

Consider cybersecurity as its own topic, and don't bundle it in with other risks. Most issuers with any degree of reliance on computer systems have recognized their risk at some level to cyber attacks, although their degree of vulnerability and appeal to hackers as a target may vary. To the extent you have not yet addressed your company's risks in this area, or have attached cybersecurity to another, general category of "risks of doing business in the 21st century," now may be a good time to give cybersecurity its due, with its own, separate risk and profile.

Update on Conflict Minerals Rules. After much anticipation, the first reports under Section 1502 of Dodd-Frank Act and related SEC rules were due on May 31, 2014. Issuers that manufacture (or contract to manufacture) products in which conflict minerals are "necessary to the functionality or production of the product" are required to disclose whether or not their products contain tin, gold, tantalum, or tungsten mined from the Democratic Republic of Congo (the "DRC") and nine of its neighboring countries. This provision was included in the Dodd-Frank Act at the request of legislators who believed 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.

In April 2014, a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit issued a decision finding that a portion of the conflict minerals disclosure requirement violated the First Amendment of the United States Constitution, to the extent that issuers were required to state (if true) that their products were "Not DRC Conflict Free." The Court stated:

"At all events, it is far from clear that the description at issue — whether a product is 'conflict free' — is factual and nonideological. Products and minerals do not fight conflicts. The label 'conflict free' is a metaphor that conveys moral responsibility for the Congo war. It requires an issuer to tell consumers that its products are ethically tainted, even if they only indirectly finance armed groups. An issuer, including an issuer who condemns the atrocities of the Congo war in the strongest terms, may disagree with that assessment of its moral responsibility. And it may convey that 'message' through 'silence.' *See Hurley*, 515 U.S. at 573. By compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment….We therefore hold that [the conflict minerals rules] violate the First Amendment to the extent the statute and rule require regulated entities to report to the Commission and to state on their website that any of their products have 'not been found to be 'DRC conflict free.'"[9]
In response to this decision, the SEC issued an order in May 2014 noting that "[n]o company is required to describe its products as 'DRC conflict free,' having 'not been found to be 'DRC conflict free,' or 'DRC conflict undeterminable.'" The SEC (along with Amnesty International) filed a petition for a rehearing of the panel decision, which was granted by the court in November. As of the date of this memorandum, a date for the rehearing has not been set.

In the meantime, 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, remain subject to these rules (with the change noted in the SEC's May 2014 order); investment companies registered under the Investment Company Act of 1940 are not subject to the rules. Public companies are required to make the necessary disclosures via EDGAR on a 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 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.

Unless and until further decisions are made overruling all or any additional portion of the rules, Form SDs covering 2014 will be due on June 1, 2015.

"Pay Ratio" Disclosure Rules Remain in Proposal Form. 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]." [1] 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, and the comment process ended December 2, 2013.

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 five 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 continues to postpone the 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.[10] 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 director or officer's 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 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 that has caused significant financial harm to the company and should therefore trigger consideration of a possible recoupment of incentive compensation.

Forum Selection Bylaws. Notwithstanding ISS' unenthusiastic view of forum selection bylaws (as noted above under "ISS 2015 Proxy Voting Guidelines"), recent cases in the state of Delaware regarding these provisions have affirmed their validity as a mechanism to control the venue for shareholder lawsuits.[11] Given the significant cost and management distraction that usually accompany shareholder lawsuits, taking a step now to include this kind of a provision in your bylaws may save at least some time and expense in the event of a covered suit. Companies may also want to consider including a forum selection provision in an amendment to their certificates of incorporation. Including the provision in the charter would require shareholder approval under state corporate law, but receipt of shareholder approval for the provision should reduce the possibility of success of any subsequent shareholder challenge to the validity of the forum selection clause.

Forum selection clauses require 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 provision. These provisions are designed to prevent the expense and distraction 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 on the process 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.

Corporate boards are increasingly considering forum selection bylaws as a means of avoiding the costs, inconvenience, and uncertainty of dealing with shareholder suits in multiple jurisdictions. While many Delaware corporations will focus on the Delaware courts as the natural choice for a forum selection bylaw, Delaware case law makes it clear that even Delaware corporations can validly choose another jurisdiction, such as the state in which the corporation is headquartered, as the exclusive forum for intra-corporate litigation.

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 bylaw amendment would need to be reported on a Form 8-K within four business days of the decision.

"Proxy Plumbing." In July 2010, the SEC issued a concept release on the U.S. proxy system.[12] 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. The SEC is continuing to evaluate the issues it raised in that document.

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 advisors 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 advisor recommendations is and should be. On June 30, 2014, the SEC issued Staff Legal Bulletin No. 20 ("SLAB 20") to provide guidance regarding investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms. SLAB 20 discusses the fiduciary duties of investment advisors, the level of oversight they should have on proxy advisors they engage, the consideration they should give to conflicts of interest at proxy advisory firms on which they rely and the solicitation exceptions that are provided for proxy advisory activities under the proxy rules. ISS has stated that since SLAB 20 was published they have seen an increase in inquiries and due diligence from investment advisors about ISS' conflicts of interest policy, as well as their internal procedures for ensuring the accuracy of the information that is contained in their analyses. As discussed above ISS has also launched a new data verification portal to verify data and request changes in connection with equity plan proposals.

The SEC recently announced another roundtable to take place on February 19, 2015 which will explore ways to improve the proxy voting process in two separate panel discussions. The first panel will focus on the state of contested director elections and whether changes should be made to the federal proxy rules to facilitate the use of universal proxy ballots by management and proxy contestants as well as state law, logistical, and disclosure issues presented by a possible universal proxy ballot process. The second panel will focus on strategies for increasing retail shareholder participation in the proxy process.

2015 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 2, 2015).[13] Form 10-K reports continue to be due 75 days following fiscal year-end for accelerated filers[14] (Monday, March 16, 2015 for December 31 year-end companies) and 90 days after fiscal year-end for non-accelerated filers (Tuesday, March 31, 2015 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.

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?
- Does the company need shareholder approval of its equity compensation plans for continued compliance with the tax deductibility of performance-based equity awards under Section 162(m) of the Internal Revenue Code? [15]
- 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 to be useful.

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.

Endnotes

[1] We invite you to review our memorandum from last year, which analyzed regulatory changes that were new for fiscal year 2013, and we would be happy to provide you with another copy upon request.

[2] On January 20, 2015, a bill was introduced into the U.S. House of Representatives to repeal this section of the Dodd-Frank Act and all rules thereunder.

[3] The ISS 2015 policy in evaluating say-on-pay is available on its website at: http://www.issgovernance.com/file/policy/usconcisevotingguidelines2015.pdf

[4] 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.

[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] http://www.issgovernance.com/file/policy/2015faqusequityplanscorecard.pdf

[7] For more information on this portal review the ISS FAQs at: http://www.issgovernance.com/file/faq/equity-plan-data-verification.pdf

[8] Our Client Alert on this Disclosure Guidance can be found here: http://www.mintz.com/newsletter/2011/Advisories/1443-1011-NAT-SECPRIV/web.htm.

[9] National Association of Manufacturers, et al., v. Securities and Exchange Commission, et al., No. 13-5252 (D.C. Cir. April 14, 2014).

[10] 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.

[11] United Technologies Corp. v. Treppel, No. 127, 2014 (Del. Dec. 23, 2014) (en banc).

[12] 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.

[13] *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, 2014);

[14] *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, 2014).

[15] Section 162(m) denies a publicly held corporation a deduction for compensation paid to "covered employees" to the extent the compensation exceeds $1,000,000. "Performance-based compensation" is not subject to this deduction limitation. The material terms of a performance goal under which performance-based compensation is to be paid must be disclosed to and approved by the corporation's shareholders before the compensation is paid and these goals must be disclosed to and reapproved by the shareholders every five years in order for the corporation to continue to rely on the performance-based compensation exception.

4621-0215-NAT-CORP