Securities Alert: 2015 Proxy Season Action Items

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It is once again time for public companies to march into proxy season. While the SEC has not adopted any significant new rules or amendments that are effective for the 2015 proxy season, you should keep the following items in mind as you prepare.

Say-on-Pay

In the 2014 proxy season, shareholders generally approved say-on-pay proposals, and often did so by significant margins. Because say-on-pay can be a sensitive matter for directors and officers (particularly for those directors and officers whose pay is being scrutinized), you should take a fresh look at the compensation disclosure in your compensation discussion and analysis (CD&A) and accompanying compensation tables. Executive summaries to the CD&A have gained popularity in recent years. While not required, they can be useful in helping the reader (including shareholders and proxy advisors) better understand compensation programs. Many companies now include charts, graphs, tables and other visual aids in the CD&A to further assist the reader. Regardless of the complexity of your compensation program, a combination of plain English and some of these methods can help improve the result of the say-on-pay vote.

Also, keep in mind that you are specifically required to discuss in your CD&A the extent to which the prior year's say-on-pay vote impacted compensation decisions. This disclosure is required regardless of the outcome of the prior year's vote. You should remind your compensation committee of this requirement so that it can specifically address in its deliberations the consideration of the prior year's say-on-pay vote.

If ISS or Glass Lewis issue reports regarding your proxy statement, you should carefully review their reports to understand their concerns and to identify any errors in their analysis, and determine whether to specifically address their concerns or errors in your proxy disclosures. Even if proxy advisors did not criticize your compensation program in prior years, you may want to review the compensation issues that the proxy advisors are particularly focused on and consider how those issues apply to your compensation program. These issues of focus

include a "pay for performance disconnect," agreements with excise tax gross-ups, emphasis on time-based vesting as opposed to performance-based vesting, bonuses that are discretionary as opposed to formula-based, and guaranteed future equity grants.

Non-GAAP Financial Measures

Companies commonly discuss in their CD&A the performance measures applicable to executive compensation. The disclosure of performance targets relating to non-GAAP performance measures is not subject to Regulation G, although you must disclose how the number presented is calculated from your audited financial statements. This disclosure is also required for any discussion about the company's actual results in the context of the performance target.

If you include a non-GAAP financial measure in your proxy statement for any purpose other than with respect to performance target levels, you must comply with Regulation G and Item 10 of Regulation S-K. For compensation-related disclosures only, the SEC staff permits companies to include the required GAAP reconciliation in an exhibit to the proxy statement as long as the discussion in the proxy statement includes a prominent cross-reference to the exhibit. If the same non-GAAP measures are described in your Form 10-K, you may instead provide a prominent cross-reference to the section of the Form 10-K that contains the required reconciliation.

Internal Control Disclosures

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) has adopted, effective December 15, 2014, a revised internal control framework. The revised framework replaces COSO's 1992 version, which was widely used by public companies in management's evaluation of internal controls. You will need to determine whether any changes must be made to your internal controls to address the changes to the COSO framework. If you have adopted the revised framework, you should address the revised framework and any material changes to your internal controls resulting from your adoption of the revised framework in the disclosure regarding internal controls set forth in your Form 10-K. You should also disclose in your Form 10-K if you have not yet adopted the revised framework.

Shareholder Proposals

During the 2014 proxy season, common shareholder proposal topics included social and environmental proposals, such as those dealing with political contributions, climate change and sustainability. Those proposals, however, generally did not receive significant shareholder support. Whether or not they are successful, social and environmental proposals can present a platform for proponents to publicize their issues both in your proxy statement and at your annual meeting. If the proposals achieve the minimum required vote, they may be submitted in consecutive years, providing an ongoing forum for the proponents.

Governance proposals were also frequently submitted by shareholders in the 2014 proxy season, and had a much higher level of shareholder support. These governance proposals included board declassification, majority voting for director elections, elimination of supermajority voting requirements and independent board chairs. According to The Conference Board, 2014 proxy season proposals to declassify the board,

eliminate super majority voting and change director voting from plurality to majority received, on average, a majority of votes cast. Because of the success of these proposals in 2014, you should expect to see another round of these proposals in 2015. If you received such a proposal last year or anticipate receiving one this year, you should begin to consider whether you desire to present more favorable management proposals on the subject, or make other voluntary changes to satisfy the proponents.

One proposal that will be much more prevalent in the 2015 proxy season is proxy access. After the U.S. Court of Appeals for the District of Columbia struck down the SEC's Rule 14a-11 that would have required companies to include shareholder nominees for directors in proxy materials under certain circumstances, proxy access is being addressed through the shareholder proposal process, or "private ordering" as it is called. During 2014, the most common and most successful proxy access proposal requested proxy access for shareholders owning 3% or more of the company's shares for at least three continuous years, which tracks the requirements of the invalidated SEC rule. This proposal garnered significant support, including majority approval at several companies. The number of proxy access proposals should increase dramatically during the 2015 proxy season, due largely to a move by the New York City Pension Funds. As part of their Boardroom Accountability Project, these funds have submitted proxy access proposals to 75 companies. These proposals request that the board adopt a bylaw provision that would give shareholders who own 3% of the company's stock for at least three years the right to include nominees in the company's proxy materials (with the number of shareholder nominees capped at 25% of the current number of directors).

If you receive a proxy access shareholder proposal, you should promptly review it for deficiencies as you would for any other shareholder proposal. If no procedural or eligibility grounds for excluding it exist, the SEC will generally not permit its exclusion. If no grounds for exclusion exist, you may consider adding a management proxy access proposal containing terms that you find more acceptable. Doing so should permit you to exclude the conflicting shareholder proposal. Before adding a management proposal, you should consider the reaction of shareholders and proxy advisors to the replacement of a shareholder proposal with a management proposal and assess the likelihood of shareholder approval of the management proposal. Further, even if you adopt your own proxy access framework, shareholders may submit proposals in the future to further amend your adopted structure.

Compensation Advisor Independence Assessment

NYSE and NASDAQ listing rules require compensation committees to assess the independence of compensation consultants, legal counsel or other advisors before selecting or receiving advice from them. The factors that the compensation committee should consider include:

- the provision of other services to the company by the compensation adviser or the adviser's employer;
- the amount of fees received from the company as a percentage of the total revenue of the adviser's employer;
- policies and procedures of the adviser's employer that are designed to prevent conflicts of interest;
- any business or personal relationship of the adviser or the adviser's employer with a member of the compensation committee;

- any stock of the company owned by the adviser; and
- any business or personal relationship of the compensation adviser or the adviser's employer with an executive officer of the company.

The SEC has emphasized that the compensation committee must conduct a conflict of interest assessment regardless of whether the compensation committee or management retained the advisor. The advisor, however, is not required to be independent. So long as the committee considers the independence factors, it may select or receive advice from any advisor, including one that is not independent. The SEC expects compensation committees to conduct an annual assessment of compensation advisors. As a result, you should add an independence assessment to your compensation committee's annual calendar, as well as perform an independence assessment before using or obtaining a new compensation adviser.

In the event that your compensation adviser has an actual conflict of interest based upon the items in the bullet points above, you must disclose in your proxy statement the nature of the conflict and how it is being addressed. To demonstrate compliance with this requirement, many companies choose to state that they conducted their required assessment and concluded that there was no conflict of interest, even though such a statement is not required.

Reapproval of Section 162(m) Plans

You should review your existing compensation plans to determine if any of them require reapproval by your shareholders to comply with Section 162(m). Even though the term of the plan may extend beyond five years, the regulations nonetheless require that shareholders reapprove the performance goals every five years.

Proxy Bundling

As you prepare your proxy statement, you should keep in mind the SEC's guidance on the "bundling" of matters to be voted on. When matters are presented to the shareholders for approval, they must be unbundled so that the shareholders have the opportunity to vote on each item individually. Further, your proxy card must clearly identify each separate matter to be acted upon, regardless if it is related to or conditioned on approval of other matters.

Cyber Security

Given recent headlines regarding security breaches, particularly the very public security breach at Sony regarding the film "*The Interview*," cyber security is a growing concern and has garnered significant attention. The SEC staff has identified cyber security as an important matter and it is an area upon which it will comment when reviewing company filings. As a result, you should consider whether or not you need to address this topic for the first time or expand or revise previous disclosures. Among other things, you must disclose your cyber security risks and incidents to the extent relevant. In some instances, this may also rise to a level that would require disclosure in your risk factors. It may also need to be discussed in management discussion and analysis if the cost or consequences of a cyber security breach would be reasonably likely to have a material effect on your results of operation or financial condition. Further, you

may need to disclose the impact of a cyber security breach on your products, services, customer or supplier relationships, or your competitive position.