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TWENTY-SIXTH ANNUAL
CORPORATE COUNSEL SYMPOSIUM
TUESDAY, OCTOBER 27, 2015

Coming Soon to a Board Room Near You: Hot Topics in Disclosure and Governance

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Program Materials are available on
www.dorsey.com at www.dorsey.com/mp-ccs-materials-2015

1. PowerPoint Presentation

2. Dorsey Seminar Playback and Materials: *SEC Pay Ratio Disclosure Rules: What's New? Compliance and Potential Consequences* (August 20, 2015)
   Available at: https://www.dorsey.com/newsresources/events/videos/2015/08/seminar-playback-sec-pay-ratio-disclosure-rules-

3. Dorsey Publication: SEC Gets Off the Sidelines - Publishes Guidance on Shareholder Proposal Exclusions
   By: Kimberley R. Anderson, Dorsey & Whitney LLP
   Available at: https://www.dorsey.com/newsresources/publications/client-alerts/2015/10/sec-guidance-on-shareholder-proposal-exclusions

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Dorsey & Whitney LLP

Tuesday, October 27, 2015

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Agenda

- **Proxy Access**
- **Universal Proxy Ballots**
- **Preparing for Pay Ratio Disclosure**
- **Shareholder Engagement Update**
- **The End of Quarterly Earnings Reports?**
- **Director Compensation after *Calma v. Templeton***

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Proxy Access

- **Defining our terms: permits shareholder-nominated directors to be included with management nominees in proxy statement and on proxy card**
  - **Many complexities to consider for process to work properly**
- **Dominated the headlines during 2015 proxy season**
- **It is at nascent stage, and is gaining momentum**
  - **Not unlike the successful attack on eliminating staggered boards**
  - **Similar to the sweeping movement for majority voting for election of directors**
- **Most observers expect even more activity in 2016**
  - **Particularly, with SEC's recently revised R.14a-8(i)(9) guidance**

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Proxy Access

- **Some data to consider: 2013-2015***

	2015	2014	2013
Proposals voted on	99	21	17
Passed (% of those voted on)	58 (58.6%)	9 (42.9%)	4 (23.5%)
Failed (% of those voted on)	41 (41.4%)	12 (57.1%)	13 (76.5%)
Avg. % Votes cast in favor (excluding abstentions)	54.7%	44.4%	39.2%

- **37 companies adopted proxy access procedures during 2015; total now up to 59 public companies**

*** Includes both shareholder and management proposals. Data derived from SharkRepellent.net (last accessed on October 13, 2015)**

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Proxy Access

- **Why it is growing in acceptance**
  - **Many institutional investors support it**
    - **BlackRock**
    - **CalPERS**
    - **CalSTRS**
    - **TIAA-CREF**
    - **T. Rowe Price**
    - **Vanguard (at higher minimum thresholds)**
    - **But: Fidelity generally votes against proxy access**
  - **CII recently (8.5.15) issued guidelines for "best practices" when adopting proxy access provisions**
    - **"Fundamental right of long-term shareowners"**
  - **ISS, starting in 2015, generally recommends in favor of proxy access proposals with "appropriate" features**
    - **Glass-Lewis remains at "case-by-case" stage**

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Proxy Access

- **Why you should care**
  - **It is coming**
    - **At minimum, you need to keep your board and governance committee updated on developments**
  - **If it is important to your significant shareholders, your board needs to listen**
  - **ISS is considering recommending "against" directors who do not adopt shareholder-approved proxy access proposals under "board responsiveness" policy**
    - **Business Roundtable opposes, based on rejection of "one-size-fits-all" approach, need to follow state corporate law and where disclosure shows good engagement activity**

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Proxy Access

- **Why it may not be broadly utilized**
  - **Activists are unlikely to use this route:**
    - **Many cannot meet holding period**
    - **Many campaigns seek more than maximum seats allowed**
    - **Traditional solicitation campaign allows more flexibility**
    - **Most bylaws require nominating shareholder to affirm lack of intent to influence control of company**
  - **Schedule 13G holders may be concerned about loss of eligibility, particularly if they must join with Schedule 13D holders to meet ownership threshold**
  - **Retail investors, to date, have not been supportive**
  - **No company has received a proxy access nominee to date**
- **But: even one elected nominee could disrupt board functioning, collegiality, effectiveness, etc.**

Proxy Access: What to do now

- **Stay informed of developments, and keep your board and governance committee up-to-date**
  - **McRitchie "proxy access lite" attack**
  - **Carpenters Union "zombie director"-triggered proposal**
- **Be aware of terms used by others adopting proxy access**
- **Follow SEC guidance on subject and related R.14a-8 procedural grounds for exclusion**
  - **SEC released guidance on October 22, 2015 on how Staff will address R.14a8(i)(7) and (i(9) exclusion requests**
- **Learn proxy advisory firms' policies on issue**
- **Understand the preferences of your top shareholders; review their published policies, if any**
  - **Consider including topic in regular engagement meetings**
- **Review existing bylaws governing advance notice and director qualification provisions**

Universal Proxy Ballots

- **Defining our terms: allow shareholders to vote for management and proponent nominees on a single ballot in a contested election**
  - **Shareholders may then "mix and match" nominees from different slates**
  - **Currently, in order to vote for nominees on different ballots, shareholders must attend meeting in person and vote**
    - **If a shareholder attempted to vote using two different proxies, the later dated proxy card would revoke earlier proxy card**
- **Universal ballots would likely be a powerful tool for shareholder activists**
  - **Greatly simplifies shareholders' ability to "split the vote"**

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Universal Proxy Ballots

- **SEC Ch. White has requested Staff to prepare rulemaking recommendations**
  - **"Providing shareholders with the same voting rights that they would have if they were present at the meeting and eliminating procedural obstacles should be a shared goal of both companies and shareholders"**
  - **In 2014, CII petitioned SEC for reforms to proxy rules to "facilitate" use of universal proxies**
- **Ch. White is encouraging voluntary use now**
  - **To our knowledge, no companies have done so to date**
  - **Canada's largest shareholder coalition is seeking voluntary compliance in contested elections**
- **Activists generally favor, while companies generally oppose (*e.g.*, Trian-DuPont proxy contest)**

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Universal Proxy Ballots: Some Considerations

- Would universal proxy ballots embolden activists?
  - Would they encourage settlements?
- Should universal proxy ballots be voluntary or mandatory?
- Should any eligibility requirements be imposed on shareholders to use universal ballots?
- What would the universal ballot look like?
  - Many details need to be sorted out
- Could combatants use different-looking universal ballots?

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Preparing for Pay Ratio Disclosure

- SEC adopted final pay ratio rules on August 5, 2015
  - New Reg. S-K Item 402(u)
- Very complex and detailed rulemaking
  - Dorsey eUpdate, and live presentation slides, may be found, respectively at:
    - https://www.dorsey.com/newsresources/publications/client-alerts/2015/08/sec-issues-final-rule-for-pay-ratio-disclosure
    - http://files.dorsey.com/files/upload/SEC-Pay-Ratio-Disclosure-Rules_082015.pdf
- First disclosure required for first full FY starting on or after January 1, 2017
  - For most calendar-year reporting companies, this will mean initial disclosure in proxy statement for 2018 annual meeting

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Preparing for Pay Ratio Disclosure

- New Item 402(u) requires disclosure of the ratio of:
  - The annual total compensation of a reporting company's principal executive officer (the "PEO"); to
  - The median of the annual total compensation of all of its employees, except its PEO
- Sounds simple, but, there are many complex questions hidden in the determination
  - Who constitutes an employee?
    - Part-time, seasonal, temporary?
    - U.S.; non-U.S.?
      - How to deal with overseas data privacy laws?
    - Independent contractors?
  - How to determine the "median employee?"

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Preparing for Pay Ratio Disclosure

- Additional disclosure permitted (not required)
  - Companies may supplement the required pay ratio disclosure with
    - Narrative discussion
    - Additional ratios
  - Any additional discussion or ratios must be
    - Clearly identified,
    - Not misleading, and
    - Not presented with greater prominence than the required pay ratio

Preparing for Pay Ratio Disclosure

- **External Considerations**
  - **Many institutional investors do not consider this useful or meaningful information**
  - **Published ratio may well be utilized by shareholder activists**
  - **Ratio will be fodder for the media; media will likely focus on largest and most well-known companies first**
  - **Will company's customer base care about ratio?**
- **Internal Considerations**
  - **Employee morale**
  - **Labor negotiations (unions strongly support this disclosure)**
  - **Effect on NEO compensation going forward**

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Preparing for Pay Ratio Disclosure: Questions to Consider Now

- **What systems do we need to put in place in order to comply with new rules?**
- **What other ratios should we consider?**
- **What do we want our disclosure to look like?**
- **How will we react if our ratio is significantly higher or lower than our competitors, or others in our industry?**
- **Will this, or should this, ratio calculation impact compensation discussions with our CEO or other NEOs?**

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Shareholder Engagement Update

- **Institutional shareholders are "routinizing" engagement**
- ***E.g.*, Vanguard reported that, for the 12 months ended June 30, 2015:**
  - **It spoke with management or directors of nearly 700 companies**
  - **In February 2015, Vanguard sent letters to chairpersons, lead independent directors, and/or CEOs of 500 of its funds' largest U.S. holdings to encourage enhanced discussions between directors and shareholders**
- **2015 FTI Consulting/Activist Insight survey of activists shows increasing cooperation with institutional investors**

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Shareholder Engagement Update

- **Retail investors becoming more aware and supportive of activists**
  - **Brunswick Group surveyed 800 U.S. individuals who are "active" in their personal investment decisions**
- **The majority surveyed:**
  - **Are aware of shareholder activism**
  - **Think there needs to be a greater focus on shareholder value in corporate America**
  - **Believe activists add long-term value**
  - **Want to be informed during the campaign, and most trust third-party sources**
  - **Are likely to vote if they care about an issue**

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Shareholder Engagement Update

- **Benefits of Engagement: 2015 DuPont proxy fight**
  - **Trian Fund Management, L.P., an activist fund, sought 4 (*i.e.*, 1/3) seats on DuPont's board in a proxy contest**
    - **Trian called for a break-up of DuPont and return of more cash to stockholders**
  - **ISS and Glass Lewis supported Trian's nominees**
  - **DuPont (senior management and directors) had been engaging their stockholders for years on Dupont's strategic plans**
    - **DuPont also had a large and loyal retail base of investors**
  - **DuPont defeated Trian, based in part on support by BlackRock, State Street and Vanguard, and large turn-out of retail**
    - **CalSTERS supported Trian**

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Shareholder Engagement Update

- **Have your engagement efforts changed in the last year?**
  - **Has increased activism caused any changes?**
  - **Has the DuPont fight affected how you approach retail investors?**
- **Are you concerned about reports of increasing "partnering" between activists and institutional investors?**
- **When appointing committee chairs, does ability to engage effectively matter?**
- **How do you prepare directors for effective shareholder engagement?**
- **Are your independent directors routinely meeting with shareholders?**

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The End of Quarterly Earnings Reports?

- In late 2014, the UK Financial Conduct Authority (FCA) began permitting public co's to move from quarterly to semi-annual reporting
- FCA's rationale:
  - Quarterly reporting focuses too much on the short term and takes too much of management's time
  - Co's should focus on long-term strategy, not short-term gains
- LGIM, one of Europe's largest asset managers, publicly supported the move to semi-annual reporting
  - Quarterly reporting "adds little value for companies that are operating in long-term business cycles"
  - But: "Industries with shorter market cycles and companies in a highly competitive global market environment may choose to report more than twice a year"

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The End of Quarterly Earnings Reports?

- Major UK companies in a variety of industries have announced the move to semi-annual reporting
  - *e.g.*, Diageo, National Grid, United Utilities
- Marty Lipton has publicly requested SEC to consider eliminating quarterly reports as part of its disclosure reform initiative
- Semi-annual reporting is permitted under SEC rules for foreign private issuers
  - But: no current activity at SEC to modify reporting periods for U.S. domestic issuers

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The End of Quarterly Earnings Reports?

- **Counter-arguments abound:**
  - **Semi-annual reporting will not generate longer term (*i.e.,* 5-year) investment horizon planning**
  - **Because projections will be further out, earnings "smoothing" will *increase***
  - **Investors and analysts strongly prefer more current earnings reports**
  - **Capital markets will operate less efficiently**

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The End of Quarterly Earnings Reports?

- **Would a shift from quarterly to semi-annual reporting change the focus of management to longer term results?**
- **Would institutional shareholders be in favor of the change?**
- **What would be the effect on trading windows for insiders?**
- **Would semi-annual reporting increase or reduce the concerns related to the existence of material, non-public information relating to financial results?**

Director Compensation after *Calma*

- **On April 30, 2015, in *Calma v. Templeton,* the DE Ch. Ct. denied a motion to dismiss a stockholder derivative suit claiming breach of fiduciary duty, waste of corporate assets and unjust enrichment**
- **Suit was based on Citrix's directors awarding themselves RSUs under a *stockholder-approved* equity plan for both insiders and non-employee directors**
  - **Plan contained the same IRS §162(m) limit on annual equity awards for both sets of recipients: 1 MM shares (or RSUs)**
  - **Directors had never come close to awarding themselves at this limit**

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Director Compensation after *Calma*: Court Holdings

- **"Blank check" approval from stockholders not sufficient to ratify awards under plan at issue**
- **Such advance approval also not effective to approve specific awards**
- **And, due to self-interest issue, appropriate standard for review is "entire fairness," not business judgment rule**
- **Therefore, only waste claim was dismissed; fiduciary duty and unjust enrichment claims were allowed to proceed at the motion to dismiss stage**

Director Compensation after *Calma*: Some Considerations

- Do your plans provide for appropriate limits or parameters on non-employee director awards?
- Do you use a formula plan for non-employee directors?
- Consider stand-alone plan to be approved by shareholders
- Consider seeking ratification of specific awards

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Appendix

- Proxy Access Terms to Consider
- Shareholder Proposal Exclusions: Recent SEC Guidance
- Bylaw Provisions Under DGCL: Exclusive Forum (Yes!) and Fee-Shifting (No!)
- Supreme Court *Omnicare* Decision – Liability for Statements of Opinion Just Got a Lot Harder to Prove
- Whistleblower "Pre-taliation" and SEC Guidance

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Appendix:
Proxy Access Terms to Consider

- **Minimum ownership thresholds and holding periods**
- **Maximum percentage of board seats available to proxy access nominees**
- **Maximum number of shareholders permitted in a single nominating group**
- **Nomination deadline (and coordination with advance notice shareholder nomination bylaw)**
- **Treatment of "loaned" shares in calculations**
- **Holding period, *post-meeting*, for shares held by nominating shareholders**

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Appendix:
Proxy Access Terms to Consider

- **Treatment of 3rd-party compensation arrangements for nominees (*i.e.*, prohibit, or mandate disclosure)**
- **Information required of nominees and their nominating shareholders**
- **Whether to exclude proxy access during activist campaign**

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Appendix:
Proxy Access Terms to Consider

- **Most commonly appearing provisions in adopted bylaw proposals:**
  - **3% ownership, held for at least 3 years**
  - **20% maximum of Board seats**
  - **Maximum of 20 shareholders in group**
  - **Deadline of 120-150 days prior to last year's mailing or meeting date**
  - **"Loaned" shares included, if lender has right to recall and vote**
  - **Post-meeting holding period varies – none to 1 year**
  - **Disclosure, more so than prohibition, of 3rd party compensatory arrangements for nominees**
  - **Extensive information delivery requirements by nominee and nominating shareholder**

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Appendix:
Shareholder Proposal Exclusions: Recent SEC Guidance

- **Many companies routinely seek to omit shareholder proposals for technical or substantive reasons**
- **Two of these reasons for exclusion were the subject of considerable attention in the last year**
  - **"ordinary business operations" (R.14a-8(i)(7))**
    - **due to the high-profile *Trinity Wall Street v. Wal-Mart* litigation, that was resolved in the Third Circuit this Spring, and**
  - **"directly conflicts" with company proposal (R.14a-8(i)(9))**
    - **due to the *Whole Foods* no-action dispute and the SEC's subsequent determination to withdraw from providing no-action relief on this basis during the 2015 proxy season**

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Appendix:
Shareholder Proposal Exclusions: Recent SEC Guidance

- **On October 22, 2015, the SEC issued SLB No. 14H, which provides guidance for both exclusions**
  - **14a-8(i)(7): the Staff reaffirmed its long-standing interpretation that, absent a "significant social policy issue," a proposal involving ordinary business operations may be excluded**
  - **14a-8(i(9): the Staff adopted a new, more rigorous standard for exclusion of a competing proposal: "a direct conflict would exist if a reasonable shareholder could not logically vote in favor of both proposals"**
    - ***i.e.*, are the management and shareholder proposals *mutually exclusive*?**

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Appendix:
Shareholder Proposal Exclusions: Recent SEC Guidance

- ***See Dorsey eUpdate for more detail:***
  - **https://www.dorsey.com/newsresources/publications/client-alerts/2015/10/sec-guidance-on-shareholder-proposal-exclusions**
- **Next battlefield: R.14a-8(i(10): "substantially implemented" exclusion**

Appendix:
Bylaw Provisions Under DGCL: Exclusive Forum (Yes!) and Fee-Shifting (No!)

- **In June 2015, the Delaware General Corporation Law was amended with respect to exclusive forum provisions and fee-shifting bylaws**
- **Authorized exclusive forum provisions for internal corporate claims, but the exclusive forum must be Delaware**
  - **Additional forums may be selected, but may not preclude litigating such claims in Delaware**
  - **However, this does not prevent contractual agreements, such as a stockholder agreement, from selecting a different jurisdiction**

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Appendix:
Bylaw Provisions: Exclusive Forum (Yes!) and Fee-Shifting (No!)

- **Invalidated fee-shifting provisions for internal corporate claims**
- **Internal corporate claims include claims based on a violation of a duty by a current or former director, or officer or stockholder, or as to which DGCL confers jurisdiction on the Delaware Court of Chancery**
  - **Includes derivative claims**
  - **Does not include federal securities class actions, which are based on material misstatements or omissions to state material fact, rather than a violation of fiduciary duty**

Appendix:
Omnicare –Liability for Statements of Opinion

- ***Omnicare Inc. et al. v. Laborers District Council Construction Industry Pension Fund et al.*** **(U.S. S. Ct. March 2015)**
  - **Supreme Court addressed an issuer's liability under Section 11 for statements of opinion or belief contained in a registration statement**
  - **Section 11 of the Securities Act imposes liability if the issuer's registration statement either (i) contains an untrue statement of a material fact, or (ii) omits to state a material fact required to be stated or necessary to make the statements not misleading**
  - **Under Section 11, an investor need not prove that the issuer intended to deceive or defraud**

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Appendix:
Omnicare –Liability for Statements of Opinion

- **The Supreme Court found two possible bases for liability under Section 11 for opinions**
  - **When it constitutes a misstatement of material fact**
    - **If the opinion contains embedded statements of material fact that were untrue**
    - **But: Court found that an opinion is not a fact if the issuer honestly believed the statement at the time it was made**
  - **When is "misleading" due to the omission of material facts**
    - **"Reasonable investor" standard applied**
      - **"The reasonable investor understands a statement of opinion in its full context, and §11 creates liability only for the omission of material facts that cannot be squared with such a fair reading."**
    - **Context matters**

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Appendix:
Omnicare –Liability for Statements of Opinion

- **Takeaways**
  - **Review non-factual statements in SEC filings to determine if they are true opinions or forward-looking statements**
    - **Forward-looking statements should be identified as such**
    - **Provide meaningful cautionary disclosure identifying important facts that could cause actual results to materially differ**
  - **For true opinion statements, consider disclosing:**
    - **Basis for the opinion, or**
    - **The tentativeness of the issuer's belief**

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Appendix:
Omnicare –Liability for Statements of Opinion

- **Recent S.D.N.Y. decision shows power of *Omnicare* decision in §10(b) context: *City of Westland Police and Retirement System v. MetLife, Inc.* (9.11.15)**
  - **Plaintiffs challenged statements of opinion regarding adequacy of loss reserves**
  - **Court dismissed fraud claims for failure to plead under *Omnicare* standards; held that plaintiff must plead that MetLife did not believe statements when made or that material facts were omitted**

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Appendix:
Whistleblower "Pre-taliation" and SEC Guidance

- **Who is a "whistleblower"? It depends who and why you ask**
  - **SEC's August 2015 Interpretive Guidance**
    - **For purposes of award and confidentiality provisions of Dodd-Frank, whistleblower must report possible securities law violation to SEC**
    - **For purposes of anti-retaliation provisions of Dodd-Frank, protection is available to individuals who report possible securities law violation internally, rather than to SEC**
  - ***Berman v. Neo@Ogilvy LLC*, 2015 WL 5254916 (2d Cir. Sept. 10, 2015)**
    - **Agrees with SEC, holds that Dodd-Frank Act's anti-retaliation provisions protect employees who reported suspected wrongdoing internally, but did not report to SEC prior to suffering retaliation**

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Appendix:
Whistleblower "Pre-taliation" and SEC Guidance

- **Who is a "whistleblower"? It depends who and why you ask**
  - ***Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013)**
    - **Held that whistleblowers are protected by anti-retaliation provisions of Dodd-Frank only if they reported suspected violation to SEC**
  - **Given split between 2d and 5th Circuits, scope of DFA anti-retaliation protections may be ripe for Supreme Court review**

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Appendix:
Whistleblower "Pre-taliation" and SEC Guidance

- **SEC is actively investigating retaliation. Recent enforcement actions:**
  - **Retaliation (Paradigm Capital, June 2014)**
  - **"Pre-taliation" (KBR, April 2015)**
- **Paradigm Capital (June 2014)**
  - **Whistleblower reported securities law violations to SEC, then employer**
  - **Paradigm retaliated by removing substantial responsibilities, but did not reduce compensation**
  - **Whistleblower received the maximum allowable reward (30% of amount paid by Paradigm to SEC), due in part to the evidence that the "whistleblower suffered unique hardships"**

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Appendix:
Whistleblower "Pre-taliation" and SEC Guidance

- **KBR, Inc. (April 2015)**
  - **KBR's standard confidentiality agreement provided that employee could not talk to anyone about internal investigation without KBR's legal dept.'s permission**
    - **Violation could lead to employment termination**
  - **SEC charged that this could stifle potential whistleblowers**
  - **KBR settled for $130,000**
  - **KBR also agreed to amend confidentiality provision to add lengthy exception explicitly acknowledging employee's right to report federal law violations to regulators, without obtaining permission and without informing company**

Appendix:
Whistleblower "Pre-taliation" and SEC Guidance

- **Takeaways**
  - **SEC is more aggressively protecting whistleblowers**
  - **Retaliation can occur even without a change in compensation and benefits**
  - **Whistleblowers may be protected under DFA even if no report is ever made to SEC (except in 5th Cir.)**
  - **Be cautious in taking any action that could be perceived as retaliation against an individual who has reported alleged misconduct internally**
  - **Review and revise confidentiality agreements with employees to avoid *KBR* problem**
  - **Penalties for retaliation can be harsh: fines to SEC, reinstatement of whistleblower, double back pay, payment of attorneys' fees and other litigation costs**