Preparing for the 2014 Proxy Season

February 6, 2014

Latham & Watkins partners Jim Barrall, global Co-chair of the firm's Benefits and Compensation Practice, and Steven Stokdyk, global Co-chair of the firm's Public Company Representation Practice, discuss how companies can prepare for the 2014 proxy season.

Can you describe the recent change ISS made to the pay-for-performance metric adjustment?

**Barrall:** The relative degree of alignment (RDA) is now only a relative comparison to peers on a three-year basis. I think it makes great theoretical sense to be measuring a pay-for-performance alignment on the longer-term period, and three to five years is the period that most people think is most relevant. But it will hurt some companies that have had flat total shareholder return (TSR) years in the past and then had a big pop in 2013.

Can you describe the recent changes Glass Lewis made to its hedging and pledging policies for company stock?

**Barrall:** According to Glass Lewis, companies should adopt strict policies prohibiting hedging by executives. I think what we are looking at here in terms of the proxy advisory firm policies is simply — do you have a fairly garden-variety anti-hedging policy? Most companies have them, often in their insider trading policies. This is not a hedging policy that would meet the requirements in the new Dodd Frank Act Section 955, which has very broad definitions of what constitutes hedging. There is no point, from our perspective, in trying to draft in advance of those rules for something quite that broad. We can deal with Section 955 when the SEC comes out with proposed rules later this year.

With respect to pledging, it really was a hot button issue in 2013. We saw a couple of cases where company CEOs had substantial margin calls that really hit the price of the stock, causing a drop of 50 percent or more. So that is something of concern to shareholders and the advisors. And one important point to note is that if shares are disclosed as being held in margin accounts in the proxy, they are treated as being pledged. Companies should look at this and consider doing disclosure to make it clear to the shareholders exactly what the facts are.

What is the SEC focusing on in 2014?

**Stokdyk:** The SEC continues to focus on performance metrics and non-GAAP financial measurements, whether you include them in your 10K or your proxy statement. The SEC’s Division of Enforcement formed a 12-member task force in July 2013 to look at this issue. It's not just an issue of potentially receiving comments from the Division of Corporation Finance, the Enforcement Division itself is taking more of an interest in this topic. I think we can expect to see some activity and potentially one or two high profile enforcements in 2014. So you should revisit how you are using your performance metrics, your non-financial operating metrics and the non-GAAP financial measurements.

Companies should also revisit their social media disclosure policies. The SEC continues to monitor and comment on companies use of social media, and continues to compare what is said in social media versus disclosure in the SEC filings.

What bylaw amendments are companies making or considering in response to shareholder activists and their nominees to boards of directors?

**Stokdyk:** We are seeing some companies put in a requirement that directors agree to comply with their policies, which gives potentially a little bit more teeth, including consequences, for breach of compliance with board policies. And one primary example of this is the confidentiality requirements, including limitations on disclosing to employers or shareholder nominees.
What proxy drafting tips do you have?

Barrall: I think that the SEC will be looking at proxies carefully in 2014 and that we will see some enforcement actions this year. In practice, that means that companies should pay careful attention in a couple of areas, including pay-for-performance alignment. If a company is going to state that the pay of a CEO and the other officers of the company is aligned with performance, it should be prepared to say why.

If the company makes a statement like this based upon supplemental definitions of pay, like realized pay or realizable pay, it is critically important that the disclosure and numbers be accurate and that in talking about how the test is applied — explain how you are defining realizable or realized pay. The discussion should explain how it is different from the summary compensation pay table definition, and explain why you think it is a better measure of pay for determining pay-for-performance alignment.

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