

2013 Proxy Season Update — Five Key Executive Compensation Considerations

In addition to the normal disclosure required in the Compensation Discussion and Analysis (CD&A) portion of the annual proxy statement, companies should consider the following items when preparing the 2013 proxy statement:

- **Section 162(m) Compliance** — In general, Section 162(m) of the Internal Revenue Code limits the tax deductibility of compensation paid to the CEO and the next three most highly compensated officers (not including the CFO) of any public company to US\$1 million, unless the compensation is “qualified performance-based compensation” (QPBC). QPBC can only be paid pursuant to a plan or arrangement that is approved by shareholders. If the plan allows for discretion as to the type of performance goals pursuant to which QPBC could be paid (which is typical of many public company plans), then shareholder approval of the plan must be obtained at least every five years in order for the compensation payable under such plan to continue to qualify as QPBC. Special transition rules also apply for companies that become publicly traded through an IPO. Accordingly, companies whose equity and bonus plans which were last approved by shareholders in 2008, and companies with such plans that underwent an IPO in 2009 (or more recently), should review their plans to determine whether or not shareholder approval is necessary in 2013 for Section 162(m) purposes.
- **Compensation Consultant Independence** — Regulation S-K Item 407(e)(3)(iv) requires disclosure of any conflicts of interest involving compensation consultants. If not already started, companies should gather information and review whether there are any potential conflicts of interest with any compensation consultants used and named in the CD&A. Such review should include the six factors referenced in Regulation S-K Item 407(e)(3). Although no disclosure is required if a conflict does not actually exist, we believe that the best practice will develop for disclosure to the effect that the relationship was reviewed and there is no conflict of interest.¹
- **Director Award Limits in Equity Plans** — Many companies allow directors to receive equity grants under their omnibus equity plans. Based on the recent Delaware case *Seinfeld vs. Slager*,² a company should consider whether to include a specific limit on the awards that could be granted to non-employee directors under the company’s equity plan and have that limit approved by shareholders. The court in the *Slager* case found that directors could not rely upon the business judgment rule when awarding themselves stock under a stockholder-approved equity plan that did not have such limits in place.

Although we are not aware of any companies putting plans up for shareholder approval for the sole purpose of obtaining approval of limits on director awards, we believe it will be a developing best practice for companies that are adopting new plans, adding shares to or obtaining Section 162(m) re-approval of existing plans to include such a director award limit in the plan.

- **Changes in Peer Groups for 2013** — Institutional Shareholder Services (ISS) recently announced that in its Pay-for-Performance Analysis, it has revised its peer group methodology in an attempt to more closely align with the company's self-selected peer group. In December 2012, ISS provided companies an opportunity to communicate any changes made to their benchmarking peer groups following their 2012 proxy disclosures. A company that has made any changes to the peer group described in its 2012 proxy statement should consider disclosing such changes in its 2013 proxy statement and the reasons for such changes, including whether any changes resulted from the peer group company being considered no longer relevant (due to a business combination, bankruptcy, sale of assets or change of business).
- **Shareholder Suits** — A recent string of shareholder suits and investigations has emerged, seeking to enjoin companies from holding upcoming shareholder votes, including votes on say-on-pay and equity plan proposals, until shareholders are provided with additional information. These shareholder suits and investigations allege a number of proxy disclosure deficiencies, including that directors breached their fiduciary duties by failing to disclose material information relating to general executive pay practices, peer company benchmarking data and the effect of an increase in the equity plan share pool. Companies should review their proxy disclosure to determine whether additional disclosure is appropriate to mitigate such litigation risks. Based on the shareholder suits brought to date, we do not think additional proxy disclosure by itself will avoid an investigation or lawsuit. Latham & Watkins is preparing a *Corporate Governance Commentary* on this recent litigation with suggestions on how to prepare to defend against such actions.

¹ See our *Client Alert* "[What Companies and Boards of Directors Need to Know About the New Independence Rules for Compensation Committees and their Advisers](#)" for a list of the factors to be considered. Please note that since the publication of that *Client Alert*, the rules have been finalized and include certain changes to the rules discussed in the commentary, including, importantly, that the Compensation Committee's required independence analysis of any compensation consultant, legal counsel or other advisor is not effective until July 1, 2013 for NASDAQ and NYSE listed companies.

² 2012 WL 2501105 (Del. Ch. June 29, 2012).

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