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Public Company Advisor

Practical Insights for Public Company Counsel

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King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.

Thought Leadership From the 2012 National Conference of the Society of Corporate Secretaries and Governance Professionals

The Society of Corporate Secretaries and Governance Professionals held its 66th National Conference in Washington, D.C., "The Shape of Things to Come", earlier this month. The conference brought together over 800 participants to discuss governance issues for public companies. In this edition of the *Public Company Advisor* we provide a recap of some of the highlights from the conference.

Director Deliberations and Decision Making

J. Travis Laster, Vice Chancellor, Delaware Court of Chancery, discussed the importance of the deliberation process by the board of directors. He warned against cognitive bias in decision making, noting that it is easy for a board to fall into the trap of "group think" and preferring data that confirms an existing belief rather than thinking through decisions with a clear, bias-free process. He stated that the court looks for cognitive bias as part of its analysis.

Also addressing the role of directors and director deliberations, Ralph V. Whitworth, founder and principal of Relational Investors LLC and a board member at Hewlett-Packard Company, discussed the responsibility of directors to ask tough questions. While he noted that board collegiality is important, he emphasized that it should not prevent directors from being "disruptive" from time to time. Mr. Whitworth summarized this concept as the need for a director to be likeable without having others believe that the director wants to be liked.

In several sessions, the concept of a "devil's advocate" in the board deliberation process was proposed. This process may assign one director at each meeting (rotating through the directors at subsequent meetings) the role of questioning the bases of each decision the board is expected to take at the meeting. The goal is to encourage constructive yet critical deliberation and dialog among the board members.

Vice Chancellor Laster also spoke of the importance of board minutes. He emphasized preparing minutes promptly and with enough detail to ensure that the process of thoughtful deliberation by the directors was undertaken. He noted that the court relies heavily on the content of board minutes in its analysis.

Shareholder Engagement

In a number of sessions in which representatives of the institutional investor community participated, the importance of public companies engaging with shareholders was emphasized. Investors noted that shareholder engagement has increased dramatically since the mandatory say on pay vote began in 2011, which was a helpful and welcome development. Investors suggested that conversations should be undertaken in the “off season”, so there is an existing relationship from which to work should any issues arise in a company’s proxy statement. Investors also stated they increasingly want to hear directly from directors on key issues.

SEC Commissioner Parades’ Thoughts on Upcoming Rulemaking

SEC Commissioner Troy A. Parades discussed his concern that Dodd-Frank and the JOBS Act, with their associated regulatory requirements, demonstrate the degree to which government decision making through regulation displaces and distorts private sector decision-making. He discussed the SEC’s effort to develop new guidance for performing economic analysis in the rulemaking process, focusing on the improvement of its cost-benefit analysis using better economic data.

In addressing four of the key items still to be undertaken by the SEC per Dodd-Frank — internal pay ratio, pay for performance, clawbacks and hedging — Commissioner Parades made several observations. He noted that regulation needs to be workable in practice for those who have to comply with it. With respect to the internal pay ratio, he stated that due consideration must be given to alternative approaches to the rule that could advance the goal of providing investors with material information about CEO pay but in a way that does not impose excessive obligations on companies that yield little marginal benefit. He also noted that the SEC needs to anticipate the consequences of any new regulation, and how regulatory developments might affect the incentives of boards, senior executives, and shareholders.

The SEC Staff Speaks

A number of senior members of the SEC’s staff spoke at the conference.

- The staff did not provide insight as to the expected timing of the “gang of four” rulemakings that are still to come (internal pay ratio, pay for performance, clawbacks and hedging). The staff noted that they have heard the concerns of public companies, especially with respect to the calculation of the internal pay ratio.
- With respect to regular reviews of Exchange Act filings mandated by Sarbanes-Oxley, the staff said they are generally reviewing companies more than once every three years. The comments from these reviews are generally shorter and more focused than in past years. As part of the review, the staff considers analyst reports, earnings calls and other press reports; in other words, the staff member assigned to the review is not limited to the four corners of the 10-K. The staff is seeking to more quickly post comment letters and responses, as they believe public availability of the comment letters is helpful to all issuers.
- The staff is focused on cyber security issues. If a company has been attacked or compromised and the company’s filings do not discuss it, the company may receive a comment.

- In IPO reviews, the staff is taking a “pragmatic” approach and is not looking for “foot faults”. The staff is focusing on big picture issues, such as the use of non-GAAP metrics.

Influence of ISS and Glass Lewis and the Increase in Additional Soliciting Materials

Representatives from ISS, Glass Lewis and several large institutional investors, along with representatives from public companies in the audience, engaged in a lively debate about the practical influence of the proxy advisory firms. The investors stated that they did not “blindly” follow the recommendations from the proxy advisory services, but used the research and recommendations to “flag” those companies in their portfolio that necessitate a more detailed review.

The increase in additional soliciting materials filed by public companies in response to negative recommendations from the proxy advisory firms was met with a negative reaction by several investors. The investors noted that they were rarely swayed by the additional soliciting materials. They stressed that the better additional soliciting materials made their point about the pay for performance connection without focusing too much on how ISS or Glass Lewis got it wrong.

Changes Coming to the Peer Group Selection Process for Both ISS and Glass Lewis

Both ISS and Glass Lewis acknowledged that many of the issues that were raised in the 2012 proxy season related to the peer groups used for their pay for performance analysis. Glass Lewis acknowledged that it is changing its peer group selection process to a “market based” approach developed with Equilar. ISS is also reevaluating and refining its process for selecting peer groups based on the input from institutional investor clients.

Using the Proxy Statement as a Communication Tool

Representatives from the institutional investor community noted that a company’s proxy statement is more than a compliance document — it is a communication tool. They suggested that companies reevaluate how they present information in the proxy statement to consider ways to make them more readable and to convey information in a more coherent manner. Institutional investors agree that CD&As have improved significantly overall, but many companies could see further improvement. They stressed that an overview or executive summary at the beginning of the CD&A highlighting the changes to the compensation program over the last year was very helpful to their review process.

A Focus on “Realizable” Pay

Several sessions discussed the trend of providing disclosure about “realized” or “realizable” pay. Institutional investors noted that there is no consistent standard for calculating or presenting this information, and that this makes it difficult to compare the information across companies. Since it may be some time before the SEC adopts rules addressing pay for performance, this is an area that is likely to continue to evolve in 2013 proxy statements. Investors agreed, despite the differing calculations and presentations, that providing disclosure about realizable pay was helpful in their say on pay analysis.

Shareholder Proposals on Political Contributions and Majority Voting

At a session addressing the growing focus on corporate political spending, representatives of several institutional investors noted that this issue should not go away, even after the presidential election. Participants discussed the increase in information that many large public companies now provide on their websites, and they debated the extent to which companies should provide additional data. Even for small and mid-cap companies where this may not be an issue of focus for shareholders, participants suggested that all public companies consider adopting a company-wide political contributions policy.

Institutional investors also noted that they continue to use the shareholder proposals process to target small and mid-cap companies that have not yet adopted majority voting. Often, when the company receives the proposal, it puts majority voting in place rather than include the proposal in the proxy statement for vote.

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King & Spalding's Public Company Practice Group is a leader in advising public companies and their boards of directors in all aspects of corporate governance, securities offerings, mergers and acquisitions and regulatory compliance and disclosure.

About King & Spalding

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