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PREPARING FOR THE 2020 PROXY SEASON

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With the 2020 proxy season just starting to begin in earnest, companies preparing for their upcoming annual meetings should be aware of the 2020 proxy season's high-profile issues. These issues may be raised from several fronts, including the Securities and Exchange Commission ("SEC"), proxy advisory firms such as Institutional Shareholder Services Inc. ("ISS") and Glass, Lewis & Co. ("Glass Lewis"), and activist investors. In this LEGALcurrents®, we discuss what recent regulatory and advisory developments mean for companies entering the 2020 proxy season.

SEC Regulatory Developments

SEC Rulemaking. In December 2018, the SEC published Release No. 33-10593, titled "Disclosure of Hedging by Employees, Officers and Directors." These final rules, implemented as Item 407(i) of Regulation S-K, require companies to disclose their practices or policies regarding the ability of their directors, officers, and employees to engage in transactions that hedge or offset any decrease in the market value of equity securities granted as compensation ("Hedging Disclosure"). For companies that do not qualify as either smaller reporting companies or emerging growth companies, the Hedging Disclosure takes effect for their proxy and information statements filed on or after January 1, 2020. Companies that do qualify as either smaller reporting companies or emerging growth companies must include the Hedging Disclosure in their proxy and information statements filed on or after July 1, 2020. If a company does not currently have a policy regarding hedging, it may want to consider adopting such a policy or understand the potential consequences of disclosing the lack of a hedging policy. Companies with existing hedging policies should determine if any updates are needed before they will disclose any such policy in their proxy and information statements. For more information on the Hedging Disclosure, please review our prior LEGALcurrents®, [SEC Adopts Dodd-Frank Hedging Disclosure Rules](#).

In March 2019, the SEC published Release No. 33-10618, titled "FAST Act Modernization and Simplification of Regulation S-K." These final rules were intended to "modernize and simplify" disclosure items that mostly impacted companies' periodic reports and registration statements ("FAST Act Amendments"). For example, with respect to companies' annual reports on Form 10-K, the SEC now allows the omission of the discussion of the earliest of three years in their Management's Discussion and Analysis disclosures if the discussion is contained in a prior filing and the location of such discussion is identified in the current filing. Other Form 10-K changes implemented by the FAST Act Amendments include only requiring the Item 102 property disclosure only for materially important properties, updates that generally ease companies' burdens associated with filing material contracts, and cover page changes to the Form 10-K, including the inclusion of Inline XBRL tagging for Form 10-K cover pages. Large accelerated filers had to begin complying with this new Inline XBRL requirement with their reports for fiscal periods ending on or after June 15, 2019. Accelerated filers must begin complying with their reports for fiscal periods ending on or after June 15, 2020.

and all other filers must begin complying with their reports for fiscal periods ending on or after June 15, 2021.

However, two new rules from the FAST Act Amendments will affect companies' 2020 proxy statements. The first rule is an amendment to Item 405 of Regulation S-K. This amendment updated the required heading for Section 16 compliance disclosures in the proxy statement to "Delinquent Section 16(a) Reports" and clarified that the disclosure, including the heading itself, is only required if a company has a late filing to report. The second rule is an amendment to Item 407 of Regulation S-K. This amendment updates the disclosure that companies' audit committees must make in their audit committee reports to state that the audit committee has communicated with the company's independent auditors about "the applicable requirements of the Public Company Accounting Oversight Board ("PCAOB") and the Commission." For more information on the FAST Act Amendments, please review our prior LEGALcurrents®, [SEC Amends Rules to Modernize and Simplify Disclosure](#).

Auditing Standard 3101. Beginning with fiscal years ending on or after June 30, 2019, for large accelerated filers, pursuant to the additional disclosure requirements under Auditing Standard 3101, auditors must communicate "critical audit matters" arising from the current period's audit to registrants in the auditor's audit reports. Critical audit matters are those matters that are material to registrants' financial statements and involved challenging, subjective, or complex auditor judgment. When critical audit matters are identified, the auditor must discuss in its report the factors that led the auditor to designate such item as a critical audit matter, how the critical audit matter was addressed in the audit, and refer to the relevant financial statement or disclosure that contains the critical audit matter. For all filers other than large accelerated filers, these additional disclosure requirements apply for fiscal years ending on or after December 15, 2020.

ISS Voting Policies Updates

ISS, a proxy advisory firm, released updates to its Global Proxy Voting Guidelines. These updates take effect for annual meetings on or after February 1, 2020. Several notable updates follow.

Newly Public Companies—Problematic Governance Structure. ISS will generally recommend voting against or withholding votes from the entire board if, prior to or in connection with the company's public offering, the company or its board adopted a bylaw or charter provision that is considered materially adverse to shareholder rights, including a classified board structure or a supermajority vote requirement to amend the bylaws or charter.

Newly Public Companies—Problematic Capital Structure. ISS will generally recommend voting against or withholding votes from the entire board if, prior to or in connection with the company's public offering, the company or its board implemented a multi-class capital structure in which the classes have unequal voting rights without a reasonable sunset provision.

Independent Board Chair Proposals. ISS continues to generally vote for shareholder proposals requiring an independent board chair, but added six factors that will increase the likelihood of a "for" recommendation, including a material governance failure particularly if in response to shareholder concerns, failure to oversee

and address material risks, or evidence of a failure to intervene when management's interests are contrary to shareholders' interests.

Board Gender Diversity. For companies in the Russell 3000 or S&P 1500 indices, ISS may recommend voting against nominating committee chairs and other directors who are responsible for the board nomination process at companies with no gender diversity. The one-year transition rule for this policy has elapsed. Until February 1, 2021, a mitigating factor to ISS's recommendation is a firm commitment, as stated in the proxy statement, to achieve gender diversity within a year.

Share Repurchase Programs. ISS continues to generally recommend voting for management proposals for open-market share repurchase plans in which all shareholders may participate on equal terms in the absence of company-specific concerns, but updated its policy to identify certain company-specific concerns including greenmail, the use of buybacks to inappropriately manipulate incentive compensation, and threats to the company's long-term viability.

Restrictions on Shareholders' Rights. ISS will generally recommend voting against or withholding votes from governance committee members until shareholders are provided with an unfettered ability to amend the bylaws or a proposal providing for such unfettered right is submitted for shareholder approval. ISS further clarified that prohibitions on shareholders' being able to amend the particular bylaws that govern their ability to amend the bylaws are considered undue restrictions on shareholders' rights generally causing a recommendation by ISS to vote against or withhold votes from governance committee members.

Shareholder Proposals on Pay Equity. ISS updated its policy to evaluate on a case-by-case basis shareholder proposals for reports on pay inequities to now include race or ethnicity-based pay inequities.

Evergreen Equity Plans. ISS added a new negative overriding factor for equity plan proposals that contain an evergreen funding provision, meaning a plan provision for automatic share funding additions over the life of the equity plan.

Other issues addressed by ISS this year include clarifications regarding new director nominees and executive compensation.

Glass Lewis Voting Policies Updates

Glass Lewis, also a proxy advisory firm, released updates to its Approach to Proxy Advice. These updates take effect for annual meetings on or after January 1, 2020. Several notable updates follow.

Audit Committee Standards. Glass Lewis may recommend voting against the audit committee chair when fees paid to the company's external auditor are not disclosed.

Poor Attendance. Glass Lewis may recommend voting against the governance committee chair when directors' attendance records are not disclosed or when it is indicated that a director attended less than 75% of meetings but disclosure is sufficiently vague that it is not possible to determine which specific director's attendance was lacking.

Shareholder Proposals—Exclusion. Glass Lewis may recommend voting against members of the governance committee where the company omits a shareholder proposal from its proxy statement and the SEC did not explicitly concur with the company's argument in a no-action request to exclude the proposal. In cases where the SEC has verbally permitted the company to exclude a shareholder proposal, Glass Lewis expects disclosure of this fact or else it may recommend voting against members of the governance committee.

Shareholder Proposals—Gender Pay Equity. Glass Lewis will review on a case-by-case basis proposals that request companies disclose their median gender pay ratios (as opposed to proposals asking that such information be adjusted based on factors such as job title, tenure, and geography). In instances where companies have provided sufficient information concerning their diversity initiatives as well as information concerning how they are ensuring that women and men are paid equally for equal work, Glass Lewis will generally recommend voting against these resolutions.

Shareholder Proposals—Supermajority Vote Requirements. Glass Lewis may recommend voting against a proposal to eliminate a supermajority voting provision at a controlled company because the supermajority vote provision may act to protect minority shareholders.

Compensation Committee Performance. Glass Lewis may recommend voting against all members of the compensation committee when the board adopts a frequency for the advisory vote on executive compensation that differs from the frequency approved by a plurality of shareholders.

Contractual Payments and Arrangements. Glass Lewis clarified its approach to analyzing executive contractual payments and arrangements to add factors that may cause it to recommend voting against a say-on-pay proposal, including excessive severance payments, new or renewed single-trigger change-in-control arrangements, excise tax gross ups, multi-year guaranteed awards, and the failure to address any of these in a revised employment agreement.

Company Responsiveness. Glass Lewis expanded its discussion of what it considers an appropriate response following a significant level of shareholder opposition (20% or greater) to the say-on-pay proposal at the previous annual meeting, including differing levels of responsiveness depending on the severity and persistence of shareholder opposition. Glass Lewis may recommend voting against a say-on-pay proposal in the absence of robust disclosure of engagement activities and specific changes made in response to shareholder feedback.

Other issues addressed by Glass Lewis this year include board adoption of an exclusive forum provision without shareholder approval, executive compensation, and minor clarifying amendments and housekeeping changes.

Companies should carefully consider their position on the issues that ISS and Glass Lewis deem to be important for the coming year when preparing for the proxy season. ISS and Glass Lewis each released their updates on these issues in November 2019.

Recent SEC Updates

Facebook Settlement. On July 24, 2019, the SEC announced a settled enforcement action with Facebook in connection with Facebook's alleged failure to adequately disclose the misuse of its customer's data and its alleged misleading presentation of the misuse of such data as a hypothetical risk only. The settlement relates to the well-publicized allegations that Facebook was aware that a researcher with access to Facebook's customers' data sold the data to Cambridge Analytica in violation of Facebook policies. The SEC violation occurred when, after learning of the policy breach, Facebook did not disclose the breach in subsequent SEC filings and it maintained risk factor disclosure that suggested that third-party misuse of Facebook customer data was only a hypothetical risk. Facebook and the SEC settled these charges for \$100 million.

In the wake of the Facebook settlement, companies should understand the SEC's expectations for risk factor disclosures. Item 105 of Regulation S-K requires the disclosure of "the most significant factors that make an investment in the registrant or offering speculative or risky." In most cases, warning investors of contingent risks is prudent. However, when the presentation of a risk suggests that the risk is only hypothetical and the risky event has in fact already occurred, the SEC will view such risk factor disclosure as misleading.

New Rule 14a-8 No-Action Procedures. On September 6, 2019, the SEC published an announcement regarding its current position on Rule 14a-8 no-action requests for shareholder proposals. Rule 14a-8 allows companies, in certain situations, to exclude shareholder proposals from their proxy materials. When companies submit no-action requests seeking to exclude shareholder proposals, the SEC staff will inform all parties of its position, which may be that the staff concurs, disagrees, or declines to state a view with respect to the excludability of a proposal by a company. The SEC staff's position will be publicly disclosed on the SEC's website in its "Shareholder Proposal No-Action Responses Chart." Additionally, the announcement indicated that the SEC may respond orally to some no-action requests and will generally reserve issuing formal response letters for instances where doing so would "provide value, such as more broadly applicable guidance about complying with Rule 14a-8."

If the SEC staff declines to state a view on any particular no-action request, the parties involved should not interpret such position as a requirement for the shareholder proposal to be included in the proxy materials. Rather, the SEC indicates that the parties may seek binding adjudication of the merits of the exclusion in court.

Companies seeking to exclude shareholder proposals pursuant to Rule 14a-8 should generally include a board analysis of why such proposals should be excluded in their no-action requests to best provide the SEC with all relevant information it needs to consider the requests.

Shareholder Activism Trends

The 2020 proxy season will largely follow trends from 2019, in that companies should expect social issues (such as board diversity and culture in the context of the #MeToo era), environmental issues (like carbon footprints and climate consciousness) to continue as pervasive elements of shareholder activism. Additionally, with the approaching U.S. elections in 2020, some activist shareholders may push for corporate transparency with respect to corporations' political spending.

What to Do Now

Companies preparing for the 2020 proxy season should educate board members about updated SEC developments. Companies may also want to engage significant shareholders and activist investors about any concerns they may have to determine the proper process for resolving any such concerns. If you would like more information on how to prepare for the 2020 proxy season, please contact a member of Harter Secret & Emery LLP's [Securities and Capital Markets](#) group at 716.853.1616, 585.232.6500, or visit www.hselaw.com

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