



# The Public Company *Adviser*

Our Valued Friends and Clients:

We are happy to present the latest edition of *The Schiff Hardin Public Company Adviser*, the quarterly newsletter of Schiff Hardin's Public Companies Group. Each quarter we issue a collection of articles to provide information and insights on the most pressing legal issues of the day for public companies, to update you on recent developments and to highlight some of the key work Schiff Hardin is doing in the public companies arena.

In this Winter 2012 Edition we focus primarily on the current proxy season and the 2012 annual meeting, but also include some additional articles that may be of interest to you.

- **Key Issues and Practical Insights for the Current Proxy Season** — We first provide a round-up of the key issues and developments that will frame the current proxy season and provide practical tips to assist you in preparing for the 2012 annual meeting and drafting your proxy statement. (See Page 2)
- **ISS 2012 Policy and Methodology Updates** — The views and vote recommendations of proxy advisory firms such as Institutional Shareholder Services ("ISS") continue to be very influential to public companies and their directors and shareholders. In this article, we explore recent commentary and policy updates of ISS and the impacts they may have on the current proxy season. (See Page 8)
- In the **Also Of Interest** section, we highlight a few additional developments in the public companies arena. (See Page 13)
- Finally, in the **Spotlight on Schiff Hardin** section, we provide a brief review of recent developments and accomplishments at Schiff Hardin. (See Page 15)

We hope you enjoy this edition of *The Schiff Hardin Public Company Adviser* and find its content both informative and useful.

# The Current Proxy Season and 2012 Annual Meeting – Key Issues and Practical Insights

The 2011 proxy season was largely dominated by the new advisory votes on executive compensation (“Say on Pay”) and frequency of such advisory votes (“Say on Frequency”) and the continued efforts of public companies to comply with other enhanced disclosure obligations brought about by The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and related rules of the Securities and Exchange Commission (the “SEC”). As public companies navigate this year’s proxy and annual meeting season, they do so against a backdrop of continued change and evolution. Say on Pay continues to shine a spotlight on compensation issues. This is further exacerbated by the emphasis that proxy advisory firms and activist shareholders continue to place on executive compensation, pay for performance and questionable pay practices. The relative balance of power between companies and their boards on the one hand, and shareholders on the other, continues to evolve in new and dynamic ways. An environment predominates in which the role of shareholders and the voicing of their concerns continue to be increasingly amplified – whether through the continued influence of proxy advisory firms on behalf of institutional shareholders or the efforts of activist shareholders to bring their issues directly to the fore through shareholder proposals. Finally, against this backdrop, the various provisions of the Dodd-Frank Act continue to produce additional disclosure requirements, of which public companies will need to continue to keep track.

This article seeks to organize these issues into a concise set of considerations of which you should take account as you plan for your annual meeting and draft your proxy statement. It points out the key issues and new developments of which you should be aware.

## 1. Say on Pay, Say on Frequency and Executive Compensation Disclosures

Public companies now have a year of experience under the SEC’s mandatory Say on Pay and Say on Frequency rules, and the sense of uncertainty and concern about potential negative results that companies felt a year ago has dissipated in large part. Most companies enjoyed strong support for their executive compensation programs in 2011. But companies should not be complacent or lulled into a false sense of security. Say on Pay votes must be conducted at least every three years, but many companies have voluntarily chosen to conduct them every year and thus will have this item in their proxy statement once again this year.

Regardless of whether a Say on Pay vote is being conducted again this year, all companies will need to respond to new disclosure requirements in the Compensation Discussion and Analysis section of their proxy statements. New Item 402(b)(1)(vii) of Regulation S-K requires companies to discuss “[w]hether and, if so, how the registrant has considered the results of the most recent shareholder advisory vote on executive compensation required by [the SEC’s proxy rules] in determining compensation policies and decisions and, if so, how that consideration has affected the registrant’s executive compensation decisions and policies.” The SEC has not provided guidance on the type of disclosures it expects in response to this new disclosure requirement. The limited precedent that exists are the disclosures of companies that previously were required to hold Say on Pay votes under the Troubled Asset Recovery Program (TARP).

This disclosure requirement should be highlighted to the compensation committee so its members can consider and determine what disclosures it deems necessary or appropriate. Because the Say on Pay vote is advisory and non-binding, its result does not require the company or the board of directors to take any particular action. However, if the company’s Say on Pay vote failed to get majority support or did not receive strong majority support, activist shareholders or proxy advisory firms may expect enhanced disclosures and a discussion of the actions taken in response. In particular, under ISS voting guidelines, the voting recommendation on compensation committee members will be based partly on the response to the Say on Pay results from the previous year. A higher level of scrutiny will be placed on the compensation committees of those companies that received less than 70% support for their Say on Pay vote (even greater scrutiny will be placed on companies receiving less than 50% support). ISS has stated that an appropriate response “must include disclosure of [the company’s] outreach efforts to major institutional investors as

well as concrete actions that [the company] has taken or will take to address the compensation issue(s) that resulted in significant opposition votes.”

SEC rules only require the holding of a Say On Frequency vote once every six years. Since companies were required to include Say on Frequency in last year’s proxy, those proposals will not be required again this year. However, companies that adopted a policy to hold a Say on Pay vote less frequently than the one supported by a majority of their shareholders should consider the reaction of its shareholders and proxy advisory firms such as ISS and consider discussing the rationale for the decision. ISS has stated its intention to recommend a vote against or a withhold vote on all director nominees if a company adopts a frequency policy that is less frequent than the one favored by a majority of its shareholders.

Given the high level of scrutiny that compensation matters continue to receive, regardless of the level of support garnered in last year’s Say on Pay vote, it is advisable for a company to take a fresh look at its executive compensation disclosures, including the CD&A, and consider whether improvements can be made. How do your disclosures compare with those of your peers — are there best practices you should consider adopting in your disclosures? Are there particular issues with your compensation policies or particular compensation elements that have drawn criticism from shareholders or proxy advisory firms, despite relatively strong overall support for your compensation program? Policy updates promulgated by ISS are discussed in detail in the next article. Should those be addressed? Many companies have begun utilizing executive summaries at the beginning of their CD&As. Would such an addition add to the clarity of your presentation? These are a few of the considerations that company counsel and boards of directors should be discussing as they approach the executive compensation disclosures in 2012.

## **2. Proxy Access and Private Ordering**

On July 22, 2011, the U.S. Court of Appeals for the District of Columbia vacated SEC Exchange Act Rule 14a-11, which would have required public companies to include in their proxy materials nominees for director submitted by a shareholder or group of shareholders (subject to securities ownership and certain other conditions). The SEC did not seek a rehearing of the decision or appeal to the Supreme Court. SEC Chair Mary Schapiro has suggested that the SEC may attempt to rewrite the regulation at a future point, but that is not expected any time soon, particularly given the substantial rulemaking required of the SEC pursuant to the Dodd-Frank Act.

When the SEC adopted Rule 14a-11, it also amended Exchange Act Rule 14a-8. Once litigation concerning Rule 14a-11 was commenced, the SEC stayed the effectiveness of the amendments to Rule 14a-8 along with the effectiveness of new Rule 14a-11. In September 2011, the SEC allowed the stay to expire and this amendment, as well as certain other rule changes adopted in conjunction with Rule 14a-11, became effective on September 20, 2011. Prior to its amendment, Exchange Act Rule 14a-8(i)(8) permitted companies to exclude from their proxy statements shareholder proposals relating to a nomination or election to a board of directors or other analogous governing body, or a procedure relating to such a nomination or election. As now amended, Rule 14a-8(i)(8) no longer includes this as a basis to exclude shareholder proposals from proxy materials. Rule 14a-8(i)(8) will permit proposals relating to nomination procedures even if the proponents do not satisfy the ownership thresholds, holding periods or other conditions that had been contained in Rule 14a-11. It is important to note, however, that Exchange Act Rule 14a-8(i)(2) remains in place and provides a separate basis for excluding a shareholder proposal if it violates state law. Thus, Rule 14a-8(i)(8) cannot be used as an end-run around restrictions of state law.

The amendments to Rule 14a-8(i)(8) also codify certain prior staff positions permitting exclusion of a proposal if it (a) would disqualify a nominee who is standing for election; (b) would remove a director before his or her term expired; (c) questions the competence, business judgment or character of any director or nominee; (d) seeks inclusion of a specific individual for election to the board in the proxy statement; or (e) could otherwise affect the outcome of the upcoming election of directors.

### 3. Dodd-Frank Rulemaking

As in 2011, this year companies must be vigilant and ensure they are in compliance with any disclosure requirements arising from the Dodd-Frank Act that are effective for the 2012 proxy season. There are still a number of disclosure enhancements that have yet to be adopted by the SEC pursuant to the provisions of the Dodd-Frank Act. Some rules have been proposed and not yet adopted. In other cases, proposed rules have not yet been issued. Even where rules are not likely to be in place for 2012, it is not too early to begin to consider how the company will need to react to such disclosure requirements. The following is a brief summary of the state of play with respect to Dodd-Frank rulemaking:

- Clawback Policy: Under the Dodd-Frank Act, the SEC is required to promulgate rules concerning the implementation by public companies of clawback policies in the context of restatements of financial statements due to "material noncompliance" with reporting requirements. The SEC has stated its intention to propose these rules by June 2012 and adopt them by December 2012.
- Compensation Committee Independence: The Dodd-Frank Act also requires the SEC to issue rules directing the national security exchanges to mandate fully independent compensation committees. The SEC has stated its intention to adopt these rules by June 2012.
- Compensation Committee Consultants: Additionally, the Dodd-Frank Act requires that compensation committees have the authority and funding to retain independent compensation consultants, legal counsel and other advisors. Before selecting such advisors, a compensation committee is required to consider certain independence factors. The SEC has stated its intention to adopt rules on these topics by June 2012.
- Disclosure of Relationship of Executive Compensation to Performance: The Dodd-Frank Act also includes a requirement that the SEC promulgate rules requiring that public companies disclose in their proxy statements a clear description of compensation paid to NEOs, including information that shows the relationship between compensation actually paid to NEOs and the financial performance of the company, taking into account the change in share price (including dividends and distributions). The SEC has stated its intention to propose these rules by June 2012 and adopt them by December 2012.
- Pay Ratio Disclosure: Additionally, the Dodd-Frank Act calls for the SEC to adopt rules requiring disclosure of: (i) median annual total compensation of all employees other than the CEO; (ii) the CEO's annual total compensation; and (iii) the ratio of (i) to (ii). The SEC has stated its intention to propose these rules by June 2012 and adopt them by December 2012.
- Hedging Policy: The Dodd-Frank Act also requires the SEC to issue rules requiring disclosure of whether a company's employees or directors (or their designees) are permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities granted by the issuer as compensation or otherwise held by the employee or director, directly or indirectly. The SEC has stated its intention to adopt these rules by June 2012.
- Conflict Minerals: The Dodd-Frank Act requires the SEC to adopt rules requiring disclosure in periodic reports when "conflict minerals" (defined as columbite tantalite (also known as coltan and from which tantalum is extracted), cassiterite (from which tin is extracted), gold, wolframite (from which tungsten is extracted) or their derivatives or any other mineral or its derivatives determined to be financing conflict in the Democratic Republic of Congo or an adjoining country) are necessary to the functionality or production of a product manufactured by a company that files periodic reports under the Exchange Act. The SEC proposed rules in December 2010 and has stated its intention to adopt final rules by June 2012.

- Mine Safety: The Dodd-Frank Act requires mining companies to disclose mine safety and health standards in their annual and quarterly reports filed with the SEC and to file a Form 8-K when they receive certain notices from the Mine Safety and Health Administration. The SEC adopted rules on this topic in December 2011.
- Resource Extraction: The Dodd-Frank Act requires resource extraction issuers (those that engage in the commercial development of oil, natural gas or minerals) to include in their annual reports information regarding certain payments to a foreign government or the U.S. federal government for commercial development of oil, natural gas or minerals. The SEC issued proposed rules relating to resource extraction issuers in December 2010 and expects to issue final rules before June 2012.

#### 4. Recent Guidance of Proxy Advisory Firms

Recent years have seen a rise in the influence of proxy advisory firms, particularly ISS, in establishing best practices on governance and compensation issues for many public companies. It appears that this trend will continue and that these firms' views and policies will continue to be a driving force for companies in the coming years. Thus, as you prepare for this year's annual meeting, you should remain familiar with recent guidance issued by proxy advisory firms and how that guidance relates to your particular compensation and governance policies and practices, particularly where these firms' recommendations are highly influential to significant shareholders. We provide a detailed discussion of the 2012 Policy Updates and other recent guidance from ISS in this issue of the *Schiff Hardin Public Company Adviser*, beginning on page 8 below.

#### 5. Prepare for Possible Shareholder Proposals

During the 2011 proxy season, we saw a decline in shareholder proposals — both in terms of overall number and in the terms of success in obtaining shareholder approval. Most commentators point to a handful of reasons why this trend was evident last year. First, the appearance of mandatory Say on Pay voting for the first time meant that many shareholder activists were willing to use the Say on Pay vote as a means to advance their particular agendas regarding compensation matters. Second, many of the most common shareholder proposals, such as majority voting for directors and declassified boards, have already been adopted by many public companies, and are not as prevalent now. Third, and on a somewhat related point, the proposals that continue to be brought forward in areas such as political spending, environmental and social issues do not generally receive widespread support and thus are more likely to fail than other proposals that have historically received strong support. Finally, some commentators believe that the mandatory Say on Pay process has spurred increased engagement of shareholder groups and that with further outreach by companies to shareholders more proposals are being withdrawn or not even submitted in the first place.

Looking ahead, there are a few key developments that will help shape the dynamics of shareholder proposal campaigns in 2012.

- As noted above, pursuant to amendments to Exchange Act Rule 14a-8 that recently became effective, this year will be the first proxy season during which companies will not have the ability to exclude shareholder proposals related to the process for nominating and disclosing shareholder candidates (commonly referred to as "proxy access") in the company proxy statement because of a change to one of the SEC's rules. It remains to be seen whether this change (along with the vacating of Rule 14a-11) will usher in a number of proxy access related proposals. Some believe that shareholder groups will hold back and take their time in developing the proxy access strategy they wish to undertake and that we may not see a deluge of proxy access proposals just yet.
- A new note to Rule 14a-8(i)(10) states that a company may exclude a shareholder proposal that would provide for a Say on Pay or Say on Frequency vote, provided that in the most recent mandatory Say on Frequency vote a single option (*i.e.*, one, two, or three years) received approval of a majority of votes cast on the matter and the company has adopted a policy on frequency that is consistent with

the choice of such majority. This new note will be helpful in responding to certain shareholder proposals, provided the company adopted a say-on-pay frequency policy that follows the advice of a majority of the shareholders.

- Three types of proposals that may continue to be seen this year are majority voting, declassified board and shareholder written consent proposals. Majority voting and declassified board proposals have been in vogue for several years now and they may have reached their peak. But companies that have not adopted these types of governance changes may still be targeted.
- We may see an uptick in proposals relating to disclosures concerning companies' political spending and lobbying practices. In part, this is due to reaction to the highly controversial and publicized U.S. Supreme Court decision in *Citizens United v. Federal Election Commission* and its opening for increased funding of election-related broadcasting by public companies. Moreover, as we approach the coming presidential election, political spending and lobbying will be hot-button issues this year.
- On October 18, 2011, the SEC staff issued a new staff legal bulletin (No. 14F) on shareholder proposals. The legal bulletin changes the requirements a shareholder must follow when providing proof of ownership in connection with the submission of a proposal and when proposals may be revised. The staff is also moving to a new electronic system when responding to companies seeking a no-action letter response from the staff related to shareholder proposals. These changes will need to be considered in responding to shareholder proposals submitted in connection with 2012 annual meetings.

## 6. SEC Staff Disclosure Guidance

In late 2011 and early 2012, the SEC staff provided additional disclosure guidance on two particular issues. You should review this guidance and consider whether your company faces any particular risks around these subject matters and whether enhanced disclosures are necessary or advisable. The publication of specific guidance by the SEC staff means that the SEC will be particularly attuned to these issues this year.

**Cybersecurity Risks:** On October 13, 2011, the Division of Corporation Finance issued disclosure guidance on cybersecurity risks to assist companies in their assessments of those risks and what disclosures should be provided with respect to them and cyber incidents. There is no explicit disclosure requirement with respect to these types of risks, but the guidance cautions that a number of existing disclosure requirements may impose an obligation to disclose such matters. For instance:

- Risk Factors — The risk of cyber incidents should be discussed if such risk is among the most significant risk factors that make an investment in the company speculative or risky. The SEC states that in assessing their level of risk, among other things, companies should consider prior cyber incidents, their severity, frequency and magnitude to the business of the company, the probability of future events, and the level and efficacy of the company's security measures to prevent such incidents. Although the disclosure guidance reiterates that SEC regulations do not require disclosure that itself would compromise a company's cybersecurity, appropriate disclosures may include:
  - Discussion of aspects of the registrant's business or operations that give rise to material cybersecurity risks and the potential costs and consequences;
  - To the extent the registrant outsources functions that have material cybersecurity risks, description of those functions and how the registrant addresses those risks;
  - Description of cyber incidents experienced by the registrant that are individually, or in the aggregate, material, including a description of the costs and other consequences;

- Risks related to cyber incidents that may remain undetected for an extended period; and
- Description of relevant insurance coverage.
- Management's Discussion and Analysis — The guidance states that companies should consider disclosure of cybersecurity risks and cyber incidents in the MD&A if the costs or consequences associated with one or more known incidents or risk of potential incidents represents a material event, trend or uncertainty reasonably likely to have a material effect on the company's results of operations, liquidity or financial condition or would cause reported financials not to be indicative of future operating results or financial condition. The guidance cites as an example the theft of material intellectual property in a cyber attack where the consequences of such theft to the company, its operations and the accuracy of its reported financial condition are sufficiently material or where a cyber attack has prompted a material increase in cybersecurity spending by the company.
- Additional Areas of Concern — The guidance cites as additional areas where cybersecurity issues may warrant disclosure, depending on the particular facts and circumstances, the company's description of its business, legal proceedings or financial statement disclosures. It also emphasizes that cyber attacks could compromise disclosure controls and procedures and that if such conditions are present, disclosure may be required.

**Exposures to European Sovereign Debt:** On January 6, 2012, the Division of Corporation Finance issued additional disclosure guidance focusing on exposures to the debt of certain European countries.

- The staff noted in particular its concern about disclosure of risks in this area by financial institutions and inconsistencies among registrants in both substance and presentation. The staff highlighted disclosure requirements in Management's Discussion and Analysis, risk factors and discussion of qualitative and quantitative market risks. It also emphasized the requirements of bank holding companies and other companies engaging in similar lending and deposit activities to make the disclosures required by the SEC's Industry Guide 3 (Statistical Disclosure by Banking Holding Companies).
- The staff states its view that disclosure of gross funded exposure should be provided separately by country, segregated between sovereign and non-sovereign exposures and by financial statement category. Companies should also consider providing separate disclosure of gross unfunded commitments. Finally, the staff suggests that disclosure be made with respect to hedges in order to present net funded exposure.
- In determining which countries companies should consider covering in their disclosures, the staff stated that the focus should be on countries "experiencing significant economic, fiscal and/or political strains such that the likelihood of default would be higher than would be anticipated when such factors do not exist." The staff encourages registrants to disclose the basis for including particular countries in its disclosures.
- The guidance concludes with an outline of detailed factors that companies should consider when determining the necessary level and substance of disclosure, including the gross funded exposures, unfunded exposure, total gross exposures (funded and unfunded), effects of credit default protection to arrive at net exposure, other risk management disclosures and post-reporting date developments.

## 7. Broker Voting

On January 25, 2012, the NYSE announced that, in response to congressional and public policy trends disfavoring broker voting of uninstructed shares, it would no longer continue its previous approach under Rule 452 of

allowing brokers to vote on corporate governance proposals supported by management without specific client instructions. Such proposals, which the NYSE had previously categorized as “Broker May Vote” including, for example, proposals to de-stagger the board of directors, majority voting in the election of directors, eliminating supermajority voting requirements, providing for the use of consents, providing rights to call a special meeting, and certain types of anti-takeover provision overrides will be treated as “Broker May Not Vote” matters. As a result, brokers will no longer have authority to vote shares on corporate governance matters unless they have received instruction from the beneficial owner. As a result, companies may find that it is more difficult to pass corporate governance proposals. Many of these corporate governance proposals are accomplished through amendments to a company’s charter, which typically requires the affirmative vote of a majority of the outstanding shares of the company. In instances where a broker has not received instruction from the beneficial owner, the new “Broker May Not Vote” rule will result in each broker non-vote share effectively becoming a vote against the proposal.

## 2012 ISS Policy and Methodology Updates — What to Expect in the Coming Proxy Season

Institutional Shareholder Services (“ISS”), the well-known proxy advisory firm, recently published several documents that are valuable to public companies and their directors during this proxy season. On November 17, 2011, ISS published its annual update of the policies it utilizes when crafting voting recommendations to its institutional investor clients. Roughly one month later, on December 20, 2011, ISS published detailed guidance on ISS’ approach to the evaluation of executive compensation, particularly pay for performance. Additionally, on December 19, 2011, ISS issued modifications to its GRId governance ratings system. Finally, on January 25, 2012, ISS issued a set of Frequently Asked Questions concerning its 2012 compensation policies. These documents, taken together, provide public companies valuable insight as to the hot-button issues for ISS in 2012 and the approach it will take in its evaluation of proxy materials and reports to institutional investors in the upcoming season.

### 1. ISS 2012 Policy Updates

On November 17, 2011, ISS issued policy updates applicable to shareholder meetings occurring on or after February 1, 2012. For the most part, the updates are consistent with the draft policy changes issued by ISS for comment in October 2011. The following is a summary of the key corporate governance and executive compensation related policy updates. The complete policy updates may be found at [www.issgovernance.com/policy/2012/policy\\_information](http://www.issgovernance.com/policy/2012/policy_information).

**Evaluation of Pay for Performance:** ISS has altered its methodology for evaluating a company’s pay-for-performance alignment, a crucial factor in its determination of whether to recommend a vote in favor of a company’s Say on Pay proposal. Under its prior method, ISS evaluated a company’s total shareholder return (“TSR”) against a peer group of companies in the same GICS code. Under the new policy, ISS will consider both peer group alignment and absolute alignment, as follows:

- Peer Group Alignment — ISS’s peer group alignment test will review: (i) the degree of alignment between the company’s TSR rank and the CEO’s total pay rank within a peer group, as measured over a one-year period (weighted 40%) and a three-year period (weighted 60%), and (ii) the multiple of the CEO’s total pay relative to the peer group median. The peer group will generally consist of 14-24 companies (as opposed to 8-12 under the current policy) determined based on market cap, revenue (or assets for financial firms) and GICS code.
- Absolute Alignment — ISS’s absolute alignment test will compare the trends in annual CEO pay and annualized company TSR over the prior five fiscal years.

If the analysis above demonstrates a “significant unsatisfactory long-term pay-for- performance alignment,”

ISS will apply the following qualitative factors to determine if there are mitigating or causal factors that support or undermine long-term value creation and alignment with shareholder interests:

- the ratio of performance-based to time-based equity awards;
- the overall ratio of performance-based compensation to overall compensation;
- the completeness of disclosure and rigor of performance goals;
- the company's peer group benchmarking practices;
- actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc. both absolute and relative to peers;
- special circumstances related to, for example, a new CEO in the prior fiscal year or anomalous equity grant practices (e.g., biennial awards); and
- any other factors deemed relevant.

**Company Response to Prior Year Say on Pay Vote:** In those circumstances where last year's Say on Pay vote received less than 70% support, ISS will employ a higher level of scrutiny when determining its vote recommendations regarding Say on Pay proposals and the re-election of compensation committee members (or the full board, in extraordinary circumstances). This higher level of scrutiny will take into account the following:

- the company's response to concerns raised by shareholders in the previous year, including disclosed engagement efforts with major institutional investors regarding the issues that contributed to the low level of support and specific actions taken to address the issues that contributed to the low level of support;
- the company's ownership structure; and
- whether the issues raised are recurring or isolated.

Where the support level was less than 50%, ISS expects companies to have exhibited the "highest level of responsiveness." Companies should avoid "boilerplate" disclosure and should highlight the specific, new actions taken to address the issues that resulted in such significant opposition.

**Company Response to Prior Year Frequency Vote:** ISS will recommend "against" or "withhold" votes for the entire board of directors (new nominees will be considered on a case-by-case basis) if the board implements a frequency vote that is less than the frequency option that received a majority of the votes cast. ISS will recommend votes on a case-by-case basis on the entire board if the board implements a frequency vote that is less than the frequency that received a plurality (but not majority) of the votes cast, taking into account the following factors:

- the board's rationale for selecting its frequency vote;
- the company's ownership structure and vote results;
- ISS's analysis of whether there is a history of problematic compensation practices or compensation concerns; and
- the previous year's support level on the company's Say on Pay proposal.

**Proxy Access:** ISS will evaluate management and shareholder proxy access proposals on a case-by-case basis when making a vote recommendation, taking into account various company and proposal specific factors including:

- the proposal's minimum share ownership threshold;
- the proportion of directors that shareholders could nominate under the proposal; and
- the proposed method of determining which nominations should appear on the ballot if multiple shareholders submit nominations.

**Incentive Plans and Tax Deductibility Proposals:** ISS formalized a position it issued earlier in 2011 regarding voting recommendations on proposals by newly public companies to approve equity (and executive incentive bonus) plans. In this circumstance, the plan will now be given a full equity plan evaluation.

- ISS generally will recommend a vote "for" proposals to approve or amend executive incentive plans if the proposal (1) only includes administrative features; (2) places a cap on the annual grants any one participant may receive to comply with the provisions of Code Section 162(m); (3) adds performance goals to existing compensation plans to comply with the provisions of Code Section 162(m) unless they are clearly inappropriate; or (4) covers cash or cash and stock bonus plans that are submitted to shareholders for the purpose of exempting compensation from taxes under the provisions of Code Section 162(m) if no increase in shares is requested.
- ISS generally will recommend "against" such proposals if: (1) the compensation committee does not fully consist of independent outsiders; or (2) the plan contains excessive problematic provisions.
- ISS generally will recommend "case-by-case" analysis of such proposals if: (1) in addition to seeking Code Section 162(m) tax treatment, the amendment may cause the transfer of additional shareholder value to employees; or (2) a company is presenting an equity plan to shareholders for Code Section 162(m) favorable tax treatment for the first time after the company's initial public offering.

**Other Matters:** ISS also updated its policies with respect to a few other matters, including:

- Board Accountability/Governance Failures — the list of factors considered in recommending "against" or "withhold" votes from individual directors, members of a committee, or the entire board, was expanded to include failures of "risk oversight."
- Dual-Class Structure — ISS will vote against proposals to create a new class of common stock (regardless of voting rights) unless there is a compelling rationale for the dual-class capital structure, the new class is intended for financing purposes with minimal or no dilution to current shareholders, and the new class is not designed to preserve or increase the voting power of an insider or significant shareholder.
- Political Spending and Lobbying Activities — Proposals calling for additional disclosure regarding any lobbying activities will be evaluated on a case-by-case basis. ISS will generally recommend a vote for a proposal for additional disclosures of corporate political spending.
- Management Proposals for Exclusive Venue for Shareholder Litigation — ISS voting recommendations will be on a case-by-case basis, taking into account whether the company has in place "good governance" features and whether the company has disclosed any "material harm" caused to it by shareholder litigation in other jurisdictions.
- Hydraulic Fracturing — ISS will generally recommend in favor of proposals requiring disclosure of a company's natural gas hydraulic fracturing activities. Specific recommendations were made on current disclosure practices and operating activities, past incidents or related litigation, and industry and regulatory developments.

## 2. ISS White Paper on Evaluating Pay for Performance

In December, ISS published a white paper to provide additional detail surrounding its new approach to evaluating pay for performance. As discussed before, ISS first undertakes a quantitative analysis of both peer group and absolute alignment of pay for performance. Based on the results of the quantitative assessment (*i.e.*, if there is an apparent misalignment of pay and performance), ISS may then undertake a further qualitative analysis. The following are some additional details concerning the new approach discussed in the white paper.

**Quantitative Analysis:** The quantitative assessment is made up of the following three inputs:

- **Alignment of CEO Pay and Total Shareholder Return (One-Year and Three-Year) Relative to Peer Group:** This factor is given the greatest weight in the quantitative assessment. It calculates the difference between (a) the percentile rank within an ISS-selected peer group of a company's total shareholder return ("TSR") and (b) the percentile rank within that peer group of a company's CEO pay. The company's score is based on this difference calculated on a one-year basis (40% weight) and a three-year basis (60% weight). If the weighted pay percentile exceeds the weighted TSR percentile by 30 percentage points or more, "high concern" is triggered. ISS estimates this will occur at approximately 25% of companies.
- **Prior-Year CEO Pay to Peer Group Median:** The second factor is prior-year CEO pay as a multiple of the peer group median. ISS may register a "high concern" if this multiple is 2.33x or higher, which it estimates will be the case for approximately 8% of companies.
- **Absolute Alignment of CEO Pay and Five-Year TSR:** The third quantitative component measures alignment between the trend in the CEO's pay and the company's shareholder returns over a five-year period. In this analysis, ISS compares the straight-line slopes of five-year trend lines (based on a linear regression) for each of CEO pay and TSR. The document indicates that a "high concern" may be triggered if the CEO pay trend slope exceeds the TSR trend slope by 30 percentage points or more, which ISS estimates will occur at approximately 10% of companies.

**ISS Determination of Peer Group:** The peer group for purposes of ISS' pay-for-performance evaluation is a group of 14 to 24 companies selected by ISS based on size (based on assets for financial companies and revenues for other companies), industry (based on six-digit GICS code (or two-digit GICS code, if needed to reach the requisite number of peers)) and market capitalization. The approximately 25 largest non-financial companies (so-called "super-mega" non-financial companies) will be compared with each other, since in ISS' view, these companies likely have few, if any, industry peers of comparable size.

**Determination of Total CEO Pay:** "CEO pay" for a particular year for these purposes is the total compensation reported in that year's Summary Compensation Table in the proxy statement.

## 3. FAQs on Compensation Policies

The FAQs present guidance on a number of specific questions relating to the methodology presented in the white paper discussed above, many of which are specific to particular circumstances that may not be relevant to your company. A detailed discussion of each of the FAQs is beyond the scope of this article, but we note the following, which may have more universal application:

- ISS provides further detail as to the calculations of the one-year and three-year total shareholder returns, including a sample calculation.
- For companies with meetings early in 2012 before peer group 2011 compensation has been released, ISS clarified that it will utilize the latest available data, even if it is for the previous year.

- If a significant portion of a CEO's misaligned pay is attributed to non-performance-based equity awards, and there is an equity plan on the ballot with the CEO as one of the participants, ISS may recommend a vote AGAINST the equity plan. Considerations in recommending AGAINST the equity plan may include, but are not limited to: (1) magnitude of pay misalignment; (2) contribution of non-performance-based equity grants to overall pay; and (3) the proportion of equity awards granted in the last three fiscal years concentrated at the named executive officer level.
- ISS recommends that, regardless of the result of a company's Say on Pay vote, the company should discuss key actions taken in response to the Say on Pay result.
- In considering a company's response to a Say on Pay result (in particular, where the company has resolved certain issues through engagement with shareholders), low or negative Say on Pay results can roll over and impact voting recommendations in certain circumstances. ISS states that, in general, the compensation committee (and/or full board in rare cases) will be held accountable (*i.e.*, receive negative recommendations) under two conditions: (1) if an issue is deemed sufficiently egregious, even if Say on Pay is on the ballot; and (2) if ISS determines that the board has failed to respond adequately to issues that led to high opposition to the prior Say on Pay proposal.

#### 4. Updates to the GRId Governance Rating System

One additional set of updates published by ISS in advance of the 2012 proxy season relates to its methodology for evaluating and presenting corporate governance ratings under its GRId system. The GRId system, which was originally introduced in 2010, provides corporate governance scores in each of four areas: Audit, Board, Shareholder Rights and Compensation. The GRId ratings compare a company's practices against prevailing best practices as perceived by ISS. The ratings are based on a series of several dozen questions in each of the four subject areas.

On December 19, 2011, ISS published modifications to the GRId system. Labeled as "GRId 2.0," the modified ratings system will become effective in February 2012 and be in place for the 2012 proxy season. The changes to GRId system, which are detailed in a Technical Document available at [http://www.issgovernance.com/grid/technical\\_document](http://www.issgovernance.com/grid/technical_document) (the "Technical Document") basically fall within two major categories: (1) Content Changes and (2) Ratings Methodology Changes.

**Content Changes:** The following is a basic summary of the content-related changes.

- Updates to Compensation Category: Content changes in the compensation category were focused principally on conforming to ISS' pay for performance evaluation. Multiple questions were added to align with ISS' new methodology discussed above. Questions on equity pay were also added or modified and compensation subcategories were modified to better align with ISS' framework for evaluating Say on Pay.
- Refinement and Reorganization of Subcategories: The other categories were also reorganized or expanded to better group questions.
- Data Transparency: Several questions were added or refined in an attempt to better reflect underlying data. For instance, questions concerning poison pills have been recast in a manner that will elicit more information about the features of the pills.
- New and Modified Questions: ISS has added or modified several questions in each of the categories. Detailed discussion of each of the new or modified questions can be found in the Technical Document. The following are some highlights:
  - *Audit:* Two questions have been added or modified, which focus on enforcement action/investigation issues.

- *Board*: Seven questions have been added or modified. The changes focus on the role of board chairs or lead independent directors, company affiliations and related-party transactions.
- *Shareholder Rights*: Eight questions have been added or modified. Most of them focus on poison pill issues. Additional questions focus on majority voting and the calling of special meetings.
- *Compensation*: Twenty-seven questions have been added or modified. As referenced above, most are focused on aligning GRI content with ISS' framework for evaluating Say on Pay and pay for performance.

**Ratings Methodology Changes:** The primary changes focus on the scoring process — how answers to questions are scored and how those scores are aggregated into levels of concern. ISS has refined the scoring mechanism to ensure the risks from individual governance practices are properly reflected in the high-level scores and concerns. Explicit weights have been eliminated and the number of points associated with an answer directly reflects the relative significance of any particular answer within its category. Additionally, the thresholds for concern levels have been standardized and the normalization of scores has been simplified. Total category scores will fall within a predefined range that is consistent across all categories. The threshold between low and medium concerns and between medium and high concerns is identical across all categories and across all markets. Companies will receive a numeric score between zero and 100 in each of the four categories, rather than an indication of high, medium or low concern. A core of greater than 75 will equate to low concern and a score of 50 or less will equate to high concern.

## Also of Interest

### FTC Announces Upward Revision of HSR Thresholds

On January 25, 2011, the Federal Trade Commission announced upward revisions to the thresholds for premerger notification under the Hart-Scott-Rodino Act. The HSR Act requires the FTC to revise the jurisdictional thresholds annually, based on changes to the gross national product for the most recent fiscal year. The new levels are 3% higher than in 2011. The new thresholds will take effect for reportable transactions at the end of February.

	<b>Original 1976 Thresholds</b>	<b>2012 Thresholds</b>
Size-of-Transaction Test	\$50 million	\$68.2 million
Size-of-Persons Test	\$100 million and \$10.0 million	\$136.4 million and \$13.6 million
Transactions not subject to size-of-persons test	Above \$200 million	Above \$272.8 million
HSR filing fee of \$45,000 (no change in fee amount)	Between \$50 million and \$100 million	Between \$68.2 million and \$136.4 million
HSR filing fee of \$125,000 (no change in fee amount)	Between \$100 million and \$500 million	Between \$136.4 million and \$682.1 million
HSR filing fee of \$280,000 (no change in fee amount)	\$500 million or more	\$682.1 million or more

Additionally, a new HSR form (Version 1.0.1, effective January 31, 2012) is now required for reportable transactions. Among the important changes from prior year forms is that Item 5 now requires reporting revenues for the most recent year only, using the most recent NAICS 6-digit non-manufacturing codes and 10-digit manufacturing codes.

## Changes to “Accredited Investor” Definition

On December 21, 2011, the SEC adopted amendments to the definition of “accredited investor” for purposes of rules adopted pursuant to the Securities Act of 1933, as amended (the “Securities Act”). The amendments exclude the value of a person’s primary residence from his or her net worth for purposes of determining whether the person is an “accredited investor” under the Securities Act rules applicable to private and other limited offerings. The final Securities Act rules, which become effective 60 days after publication in the *Federal Register*, reflect a requirement of the Dodd-Frank Act that became effective upon its enactment in July 2010. The amendments were adopted to implement the requirements of Section 413(a) of the Dodd-Frank Act, which requires Securities Act rules to reflect the new standard.

Rules 501 and 215 under the Securities Act now define “accredited investor” to include any natural person whose individual net worth or joint net worth with his or her spouse exceeds \$1 million, excluding as an asset the value of the investor’s primary residence and excluding as a liability any indebtedness secured by the residence up to the fair market value of the residence. Indebtedness in excess of the fair market value is counted as a liability in the net worth test.

The final rules reflect two notable additions to the rules proposed in January of 2011:

- a provision treating as a liability for purposes of calculating net worth, incremental debt secured by a primary residence that is incurred within 60 days prior to the sale of securities to the individual; and
- a grandfather provision allowing use of the former net worth test where the individual is exercising a right to purchase securities and, as of July 20, 2011, the individual held the rights to purchase the securities and held securities of the issuer.

Section 413(b) of the Dodd-Frank Act states that, every four years commencing with the enactment of the Dodd-Frank Act, the SEC may review the definition of “accredited investor” as it applies to natural persons, and must undertake such a review of the definition in its entirety, in each case to determine whether the definition should be amended in the interest of investors and the general public, in light of the economy.

## First Annual Report on the Dodd-Frank Whistleblower Program Submitted to Congress

In November 2011, the SEC issued its first Annual Report on the Dodd-Frank Whistleblower Program. The first report is based on a relatively short seven week period – the time between effectiveness of the regulations establishing the Whistleblower Program (August 12, 2011) and the end of the SEC’s fiscal year (September 30, 2011). The data is nevertheless interesting and revealing:

- During the seven week period, the Office of the Whistleblower received 334 tips. While this may seem like a large number, it is highly likely that a number of whistleblowers (and their counsel) were ready and waiting for the effective date of the regulations to hit and that the deluge of tips at or shortly following commencement inflates the initial numbers somewhat.
- Nearly half of the tips fell into one of three categories (as identified by the reporting whistleblower) – market manipulation (16.2%), offering fraud (15.6%) and issues concerning corporate disclosures and financial statements (15.3%). Roughly 25% of the tips were uncharacterized by the submitter.
- Tips came from individuals in 37 different states (California, New York, Texas and Florida being the most prevalent) and several foreign countries (China and the United Kingdom being the most prevalent).
- As of September 30, 2011, the Investor Protection Fund, which funds the whistleblower award program, had a balance of over \$452 million. No awards have been made and it will likely be some time before

any awards are issued given that the program is in its relative infancy and there are a large number of tips that will be subject to intensive investigation.

## Spotlight on Schiff Hardin

### New Ann Arbor, Michigan Office Focuses on Antitrust Litigation and Sports Law

Schiff Hardin further expanded our nationwide capabilities and our Midwest presence with the opening of an Ann Arbor, Michigan office in January. Our Ann Arbor office focuses on complex commercial litigation matters nationwide. Attorneys in this office concentrate in disputes involving antitrust, restraint of trade and trade regulation, corporate contracts and transactions, mergers and acquisitions, partnership agreements, business torts, class action defense, securities, intellectual property, media law, entertainment, academic institutions, and athletic organizations, among others, as well as fair trade issues arising out of federal, state and foreign law.

Our four new partners, who form the nucleus of the Ann Arbor office, are nationally recognized in both antitrust and sports law. Gregory L. Curtner serves as our coordinating partner in Ann Arbor and also leads the Antitrust Group firm-wide. Among other clients, Greg and his team will continue to represent the National Collegiate Athletic Association in a number of matters nationally.

Our office is located in the heart of Ann Arbor's vibrant downtown.

### Our Commitment to Diversity

Schiff Hardin has been known for many years for our deep commitment to diversity in our firm, the legal community and all of society. Our attorneys work to develop diverse legal talent within our firm and to foster diversity in the legal and professional world. We are proud of our initiatives and would like to take this opportunity to share some highlights from the past year:

- *Vault* ranked Schiff Hardin #25 on "Law Firm Rankings 2012: The Best Law Firms for Diversity."
- Schiff Hardin received a 100% score on the Human Rights Campaign's 2012 Corporate Equality Index, based on lesbian, gay, bisexual and transgender workplace policies and benefits. This is the second year in a row that Schiff Hardin has achieved a 100% score.
- Schiff Hardin was ranked by Equality Illinois as a leading law firm for LGBT workplace equality in 2011.
- *DiversityBusiness.com* included Schiff Hardin on its 12th annual "Top Privately Held Businesses in Illinois" list in 2012.

In addition, Schiff Hardin's diverse attorneys achieved great individual accomplishments and recognition during the past year. The Diversity Scholarship Foundation honored Patricia Brown Holmes, an African-American Schiff Hardin partner and Diversity Committee co-chair, with the 2011 "Advocate for Diversity Award." She also received an "Award for Excellence in Pro Bono Service" from the United States District Court. Schiff Hardin partner Janet M. Johnson was elected president of CREW (Commercial Real Estate Executive Women) Chicago. Tracy A. Campbell, an African-American partner, was named a "40 Under Forty" attorney to watch by the *Chicago Daily Law Bulletin* and *Chicago Lawyer* magazine, and also was elected President of the Black Women's Lawyers Association (BWLA) of Greater Chicago. Renee Cipriano, a partner in Schiff Hardin's Environmental Group, was named the 2012 Chicago Environmental Law Lawyer of the Year by *Best Lawyers*.

Please visit the Diversity page of our Web site for a comprehensive overview of our commitment to diversity and related initiatives and honors.



# The Public Company Adviser

[www.schiffhardin.com](http://www.schiffhardin.com)

**Darren C. Baker**

312.258.5538  
dbaker@schiffhardin.com

**Lauralyn Bengel**

312.258.5670  
lbengel@schiffhardin.com

**Peter V. Fazio**

312.258.5634  
pfazio@schiffhardin.com

**Stuart L. Goodman**

312.258.5711  
sgoodman@schiffhardin.com

**Frederick L. Hartmann**

312.258.5656  
fhartmann@schiffhardin.com

**Allan Horwich**

312.258.5618  
ahorwich@schiffhardin.com

**Jon K. Jurva**

312.258.5630  
jjurva@schiffhardin.com

**Shirley M. Lukitsch**

202.778.6477  
slukitsch@schiffhardin.com

**Stephen A. Marcus**

312.258.5778  
smarcus@schiffhardin.com

**Dale L. Matschullat**

312.258.5507  
dmatschullat@schiffhardin.com

**David S. McCarthy**

312.258.5653  
dmccarthy@schiffhardin.com

**David P. McHugh**

(Co-Leader)  
312.258.5668  
dmchugh@schiffhardin.com

**Richard T. Miller**

312.258.5596  
rmiller@schiffhardin.com

**Robert J. Minkus**

(Co-Leader)  
312.258.5584  
rminkus@schiffhardin.com

**Peter L. Rossiter**

312.258.5579  
prossiter@schiffhardin.com

**Edward Spacapan**

312.258.5788  
espacapan@schiffhardin.com

**Alexander B. Young**

312.258.5737  
ayoung@schiffhardin.com

**Jason L. Zgliniec**

312.258.5795  
jzgliniec@schiffhardin.com

**Christopher J. Zinski**

312-258-5504  
czinski@schiffhardin.com

350 S. Main Street  
Suite 210

**Ann Arbor, MI** 48104  
t 734.222.1500  
f 734.222.1501

One Atlantic Center  
Suite 2300

1201 West Peachtree Street NW  
**Atlanta, GA** 30309  
t 404.437.7000  
f 404.437.7100

225 Franklin Street  
Suite 2600

**Boston, MA** 02110  
t 617.848.5750  
f 617.848.5784

233 S. Wacker Drive  
Suite 6600

**Chicago, IL** 60606  
t 312.258.5500  
f 312.258.5600

One Westminster Place  
**Lake Forest, IL** 60045

t 847.295.9200  
f 847.295.7810

666 Fifth Avenue  
Suite 1700

**New York, NY** 10022  
t 212.753.5000  
f 212.753.5044

One Market  
Spear Street Tower  
Suite 3200

**San Francisco, CA** 94105  
t 415.901.8700  
f 415.901.8701

1666 K Street, NW  
Suite 300

**Washington, DC** 20006  
t 202.778.6400  
f 202.778.6460

This publication is for the general information of clients and friends of our firm. It does not provide legal advice for any specific matter. Readers should consult a lawyer directly for such advice. This publication, or parts of it, may be considered attorney advertising material under professional conduct rules applicable to lawyers.