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ATTACKS ON PROXY STATEMENT COMPENSATION DISCLOSURE:

AN UPDATE ON THE GATHERING STORM

March 22, 2013

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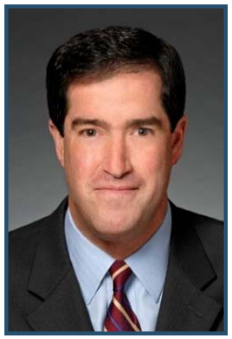
Presenters



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Background

- January 15, 2013 Presentation.
  - Plaintiffs' bar (and more specifically the law firm of Faruqi & Faruqi) had borrowed tactics from merger objection cases and initiated "investigations" and filed lawsuits seeking to enjoin annual shareholder meetings claiming inadequate disclosures.
    - Say-on-pay.
    - Say-on-shares reserved.
  - Other members of the plaintiffs' bar had also initiated "investigations" and filed a few shareholder derivative lawsuits concerning shares granted to executives.
    - Not seeking to enjoin an upcoming shareholder vote; claiming that the board or others did something wrong in the past with respect to equity grants to executives.

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Agenda

- Update January 15, 2013 Presentation.
  - More investigation notices, more lawsuits filed, more decisions reached.
  - Trends are becoming more apparent in hindsight.
- Say-on-pay.
- Say-on-shares reserved.
- Post-vote shareholder derivative cases.
- How to avoid becoming a target both in 2013 and beyond.
- What to do if you are “investigated” or sued.

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Say on Pay Injunction Cases

- Brought on the theory that the proxy fails to disclose sufficient information regarding executive compensation for shareholders to cast an informed "say-on-pay" vote.
- The pure "say-on-pay" cases, for the most part, have been unsuccessful at the preliminary injunction stage.
  - *See, e.g., AAR* (DuPage Cty., IL, filed Oct. 2, 2012): Say-on-pay vote, preliminary injunction denied, discovery stayed based on failure to state a claim, decision on motion to dismiss pending.
- Faruqi & Faruqi has indicated it intends to bring the pending cases (in which defendants have answered) to trial.

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Say on Pay Injunction Cases

- *Gordon v. Symantec Corp.*, 12-CV-231541 (Feb. 22, 2013).
  - Update - Court grants Defendants' motion to dismiss.
  - Plaintiff alleged that Defendants failed to disclose a "fair summary," other services provided by the consultant, the criteria used to select peer companies and target goals, and the decision to move target pay from the 65th percentile to the 50th percentile.
  - Court rejects Defendants' argument that the advisory nature of the say-on-pay vote makes the disclosure claims derivative in nature.
  - Court dismisses the complaint because (a) the occurrence of the vote moots the disclosure claim, and (b) Plaintiff failed to allege facts showing how any of the omitted details were material.
  - "Asking why does not state a meritorious disclosure claim."

Say on Pay Injunction Cases

- *Greenlight Capital, L.P. v. Apple, Inc.,* (S.D.N.Y, Feb. 22, 2013).
  - Four senior executives granted Restricted Stock Units (long-term equity compensation) - $60 million per executive.
  - Plaintiff alleges that the proxy statement's use of terms like "experiences", "inputs", and "peer group data" failed to provide an "intelligible basis" for shareholders to judge Apple's compensation decisions.
  - Court finds that Apple's sixteen-page Compensation Discussion & Analysis ("CD&A") is "plainly sufficient" and provides all information necessary for shareholders to render an informed say-on-pay vote.
  - The proxy statement fully disclosed the background of the Compensation Committee, the information provided by the CEO, and the data that the Committee considered in reaching compensation decisions.
  - The proxy was "wholly compliant" with Item 402(b).

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Say on Pay (Flashback)

- *Raul v. Rynd*, 2013 WL 1010290 (D. Del. Mar. 14, 2013) (Hercules Offshore, Inc.)
  - Board increases executive compensation 40% to 190%, while total revenue declined 11% and total assets declined 13%. In say-on-pay vote, 59% of stockholders reject compensation plan.
  - Complaint names Board, executives, and consultant.
  - Negative say-on-pay vote does not render demand futile under either *Aronson* prong; *Cincinnati Bell* is not good law.
  - Court rejects disclosure claims because the company's proxy never represented that "pay for performance" was the only compensation goal.

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Share Authorization Injunction Cases

- Not many cases being filed:
  - 15 investigation notices since January 15, 2013.
  - 2 cases filed.
- Primarily *Brocade*-type cases in which the plaintiffs allege deficient disclosures about details underlying the company's share authorization proposal.
- Some more recent cases rely on an alleged failure to disclose noncompliance with existing incentive plans to enjoin a shareholder vote regarding new or amended plans.

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Share Authorization Injunction Cases

- *Knee v. Brocade Communications Systems, Inc., et al.*, (Santa Clara Co., Cal., filed Mar. 7, 2012).
  - First successful injunction against shareholder vote
  - Plaintiff alleged proxy statement was deficient because it did not disclose, among other things:
    - Projected cost and "equity value of shares" being authorized;
    - Dilutive impact of additional shares;
    - Anticipated stock grants;
    - Reason for issuing more shares for use in an equity incentive plan when the company still had shares in reserve; and
    - Retention of experts and creation of subcommittees.

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Share Authorization Injunction Cases

- On April 10, 2012, the *Brocade* court granted plaintiff's motion to enjoin the shareholder vote.
  - Agreed with defendants:
    - Proxy statement accurately represented effect on dilution
    - No need to disclose publicly available, confidential or unreliable information
  - But, should have disclosed at least a "fair summary" of the projections and analyses considered by the board to tell shareholders how and why they came to the number of additional shares requested.
- Supplemental disclosures were made and parties later settled for $625K in fees and expenses to plaintiff's counsel.

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Share Authorization Injunction Cases

- Faruqi & Faruqi endeavors to replicate its victory in *Brocade*.
  - Class actions with two counts: (1) breach of fiduciary duty against the individual defendants and (2) aiding and abetting the individual defendants' breaches against the company.
- Following *Brocade*, several other companies settled similar cases:
  - *Martha Stewart* (New York Co., N.Y., filed May 16, 2012): Additional disclosures and up to $150K in fees; currently in dispute over fees.
  - *WebMD* (New York Co., N.Y., filed June 20, 2012): Additional disclosures and $275K in fees.
  - *H&R Block* (Jackson Co., Mo., filed Aug. 8, 2012): Additional disclosures and $225K in fees (subject to court approval).
  - PriceSmart (San Diego Co., Cal., filed Jan. 2, 2013): Additional disclosures and up to $200K in fees (subject to court approval).

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Share Authorization Injunction Cases

- Some defense victories:
  - *Amdocs* (New York Co., N.Y., filed Jan. 13, 2012): Plaintiff voluntarily dismissed after we opposed her motion for a preliminary injunction.
  - *Plantronics* (Santa Cruz Co., Cal., filed July 13, 2012): Preliminary injunction denied; defendants answered and case has been dismissed.
  - *Microsoft* (King Co., Wash., filed Oct. 11, 2012): Defendants opposed motion for preliminary injunction; plaintiff dismissed case without explanation.
  - *Applied Minerals* (New York Co., N.Y., filed Oct. 16, 2012): Plaintiff voluntarily dismissed after we moved to dismiss and the company voluntarily made further disclosures.

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Share Authorization Injunction Cases

- Additional defense victories tell us the courts are still looking to *Brocade*:
  - *Ultratech* (Santa Clara Co., Cal., filed June 14, 2012).
    - Preliminary injunction denied:
      - Cannot speculate.
      - Distinguishes *Brocade* on issuance versus authorization.
    - Defendants moved to dismiss; case dismissed at plaintiff's request on February 28, 2013.
  - *The Clorox Company* (Alameda Co., Cal., filed Oct. 10, 2012).
    - Preliminary injunction denied:
      - "Plaintiff's meager evidentiary presentation does not begin to afford this court a foundation on which to engage in the kind of analysis reflected in the April 10, 2012 slip opinion in [*Brocade*]."
      - No irreparable harm because votes can be undone.
    - Defendants answered and the case is continuing.

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Share Authorization Injunction Cases

- Plaintiffs in two recent cases have claimed that a shareholder vote on new or amended incentive plans should be enjoined because the proxy statements failed to disclose historical failures to comply with existing plans:
  - *Abaxis* (N.D. Cal., filed Oct. 1, 2012).
    - Saxena White P.A.
    - Direct and derivate state law claims and violations of Section 14(a).
    - Could not rely on Form 8-K unless it was incorporate by reference.
    - Injunction granted in part; defendants made supplemental disclosures.
  - *Mindspeed Technologies* (D. Del., filed Jan. 2, 2013).
    - Levi & Korsinsky LLP.
    - Direct and derivative state law claims.
    - Also alleged that proxy failed to disclose that plan limits requested were substantially greater than existing plan.
    - Company voluntarily made supplemental disclosures and plaintiffs withdrew motion for preliminary injunction.

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Post-Vote Derivative Cases

- On January 15, 2013, we noted that following the lead of Faruqi & Faruqi, Levi & Korsinsky began noticing investigations raising questions about shares granted to executives in the past.
- Post-vote cases because not seeking to enjoin a shareholder vote but challenging something related to an earlier vote.
- Cases brought as shareholder derivative cases.
- Trend accelerated and joined by other firms including Faruqi & Faruqi, Bronstein, Gerwitz & Grossman, Kessler Topaz Meltzer & Check and Barrack, Rodos & Bacine.
  - At least 18 investigation notices issued since January 15, 2013.
    - Investigation notices are more vague than say-on-pay and say-on-shares issued/reserved notices.
  - At least 7 more cases filed since January 15, 2013.

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Post-Vote Derivative Cases

- Cases/investigations fall into three general categories.
  - IRC 162(m).
    - "Traditional" 162(m) cases.
    - Cases alleging failure to get renewed approval of plans under 162(m).
    - Shares of common stock issued to an executive in excess of the maximum individual grant amount listed in shareholder-approved equity incentive plan.
  - Shares collectively issued to executives in excess of total amount approved by shareholders.
  - Executives selling too many shares, and thus not holding the minimum number of shares required by the corporate policy to ensure executives' incentives aligned with shareholders.

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Post-Vote Derivative Cases

- "Traditional" IRC Section 162(m).
  - Imposes a corporate deduction limit of $1M annually on compensation paid to named executive officers listed in the proxy, but allows exemptions to the deduction limit for "qualified performance-based compensation" provided that shareholders have approved the plan pursuant to which the performance-based compensation is paid.
  - 162(m) Plans are plans implemented to take advantage of the performance-based exemptions.
- Shareholders have sued alleging waste and unjust enrichment if companies did not have a 162(m) plan in place when shares granted (thereby giving up an opportunity to reduce company's tax burden) or granted shares in excess of what is allowed under a 162(m) plan.
  - Delaware Chancery Court and Delaware Supreme Court have generally rejected claims based on this theory. See *Freedman v. Adams* (XTO Energy Inc.), No. 4199, 2012 WL 1345638 (Del. Ch. Mar. 30, 2012) aff'd by 58 A.3d 414 (Del. Jan. 14, 2013); see also *Seinfeld v. Slager* (Republic Services, Inc.), No. 6462, 2012 WL 2501105 (Del. Ch. Jun. 29, 2012) (dismissing all claims except those concerning directors' grants to themselves where stock plan put no real bounds on board's ability to set its own stock awards).
  - United States District Court for the District of Delaware has been more accommodating to plaintiffs on this issue. *Resnik v. Woertz* (Archer-Daniels-Midland Company), 774 F. Supp. 2d 614 (D. Del. Mar. 28, 2011). Case recently settled with agreed limits on maximum size of grants and attorneys' fees up to $1.5 million.

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Post-Vote Derivative Cases

- "Traditional" IRC Section 162(m) (cont'd).
- Shareholders have also sued alleging that company's disclosures were misleading with respect to operation of equity incentive plans intended to comply with 162(m).
  - Delaware Chancery Court rejected this claim in *Freedman v. Adams* (XTO Energy Inc.), No. 4199, 2012 WL 1345638 (Del. Ch. Mar. 30, 2012) aff'd by 58 A.3d 4*14* (Del. Jan. 14, 2013) but Delaware Supreme Court did not address.
  - United States District Court for the District of Delaware has rejected some of these claims, see, e.g., *Abrams v. Wainscott* (AK Steel Holding Corp.), No. 11-297, 2012 WL 3614638 (D. Del. Aug. 1, 2012); *Seinfeld v. O'Connor* (Republic Services, Inc.), 774 F. Supp. 2d 660 (D. Del. Mar. 30, 2011), and allowed others to proceed, see *Hoch v. Alexander* (Qualcomm), No. 11-217, 2011 WL 2633722 (D. Del. July 1, 2011).
    - IRS regs are complicated.

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Post-Vote Derivative Cases

- Failure to get renewed approval of plans under 162(m).
  - Regs under 162(m) require company to get re-approval of performance goals in equity incentive plan every five years (except in certain limited circumstances).
  - Some companies have failed at this corporate housekeeping and have been sued.
    - New Jersey Resources Corporation issued a supplemental proxy to provide for shareholder vote.
      - "Agreement in principle" for plaintiff to dismiss in return for the supplemental proxy and attorneys' fees of $135,000.
    - Dow Chemical Company (filed on March 5, 2013 in D. Del.).
      - Plaintiff filed as a federal action asserting claims under Section 14 of the Securities Exchange Act but also expressly claiming that interpretation of federal tax provisions is an important issue of federal law that belongs in federal court.

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Post-Vote Derivative Cases

- Shares of common stock issued to an executive in excess of the maximum individual grant amount listed in shareholder-approved equity incentive plan.
  - Most of the shareholder derivative cases filed recently have asserted this claim along with a claim that disclosures are inaccurate by claiming that grants (or some of them) are tax-deductible.
  - Others are not calling these 162(m)-related claims, but I believe that they are.
    - Companies include limits on the number of shares that can be granted to an individual under an equity incentive plan in order to comply with certain regulations under 162(m)
    - Companies, however, also usually retain discretion to grant additional shares that would not be tax deductible.
      - Some companies' equity incentive plans make it clear that the limits on individual grants set forth in the plan are solely for purposes of deductibility exception under 162(m) and some do not.
      - Company proxies also vary in how explicit they are that the company can issue shares to an individual in excess of the limits set forth in the equity incentive plans.
        - Only "repercussion" being that some of the value of the grant will not be tax deductible.
  - Some of these lawsuits are filed initially as shareholder derivative cases, but they are then amended to include direct claims seeking to enjoin annual meeting based on the theory that the descriptions of past grants to executives seem to suggest that all grants were tax deductible when they were not.

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Post-Vote Derivative Cases

- Shares issued to executives in excess of total amount approved by shareholders.
  - Not a grant to an individual in excess of limit in equity incentive plan but the company granted more shares in total than its shareholders had previously authorized for issuance under equity incentive plan.
  - Abaxis, Inc. (direct claim).
- Executives selling too many shares, and thus not holding the minimum number of shares required by the corporate policy to ensure executives incentives aligned with shareholders.

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How to Reduce the Likelihood of Being Sued and Increase the Likelihood of Prevailing in any Subsequent Litigation

- Create a process and build a record that will support the directors' ability to meet their fiduciary duties.
  - Board and Compensation Committee materials should:
    - be distributed well in advance of meetings; and
    - contain all information necessary to make informed decisions.
  - Adequate time should be reserved for discussions with advisors and among Board members.
- Minutes should be prepared with a view towards subsequent proxy disclosures and potential litigation.
- Advise Compensation Committee of the litigation risk.

How to Reduce the Likelihood of Being Sued and Increase the Likelihood of Prevailing in any Subsequent Litigation (cont'd)

- Prepare the proxy statement with potential litigation in mind.
  - Know which disclosures are likely to raise issues.
  - Go beyond the requirements of Items 402 and 407 of Regulation S-K to ensure adequate disclosure.
  - Provide reasons why changes in executive compensation were made.
  - Take a reasoned approach to providing additional disclosure - providing disclosure that is not material may raise more questions than answers and thus raise your litigation risk.
  - Consider retaining outside counsel who have defended these cases to review draft disclosures.

How to Reduce the Likelihood of Being Sued and Increase the Likelihood of Prevailing in any Subsequent Litigation (cont'd)

- In connection with executive compensation (say-on-pay) votes, consider:
  - Including in the CD&A, the reasons the company selected:
    - its compensation consultant.
    - the particular mix of salary, cash incentive compensation and long-term incentive compensation.
    - particular companies as peers for purposes of benchmarking compensation.
  - Not including in the CD&A:
    - Details concerning the compensation consultant analyses provided to the company's board of directors.

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How to Reduce the Likelihood of Being Sued and Increase the Likelihood of Prevailing in any Subsequent Litigation (cont'd)

- In connection with votes to increase the number of shares authorized, or available for issuance under equity plans, consider disclosing:
  - The reasons that the company determined to increase the number of shares at this time;
  - How the company determined the number of additional shares requested to be authorized, including burn rates.
  - The potential equity value and/or cost of the authorization of additional shares.
  - The potential dilutive impact of the authorization of the additional shares.
  - More disclosure here is generally better; consider exceeding the requirements of Item 10 of Schedule 14A.
- Carefully consider timing of submission of equity plans for shareholder approval.

How to Reduce the Likelihood of Being Sued and Increase the Likelihood of Prevailing in any Subsequent Litigation (cont'd)

- After the annual meeting has occurred:
  - Watch the shares available and do not grant shares in excess of the authorized amount.
  - When hiring new executives, make sure grants do not exceed the number permitted to be issued to executives during a calendar or fiscal year.
  - If executives and directors are required to hold a certain minimum number of shares under stock ownership guidelines, confirm that they do not fall below the minimum levels.
  - If the performance-based goals in your plan need to be reapproved by shareholders every 5 years under Section162(m), make sure the plan is put up for a vote accordingly.

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What to Do When You Are Targeted

- If you receive notice that your company is being investigated, contact outside counsel immediately.
  - Sometimes best to use someone other than usual corporate counsel, because some cases—particularly in the 162(m) and disclosure contexts—may have advice of counsel defense.
  - Use a lawyer experienced in these cases to try to stop a lawsuit before it is filed.
  - Consider making a preemptive disclosure of the investigation, and going on the offensive against the plaintiffs' firm.
- Expect a books and records demand, or potentially, a demand for settlement before a claim is filed.

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After a Lawsuit Is Filed

- Notify insurance carriers.
- Assess goals—settlement, litigation.
- Consider removal to federal court.
  - This may require fast action, removing before the company is served.
- Review documents and assess strength of claim.

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CLE and Q&A

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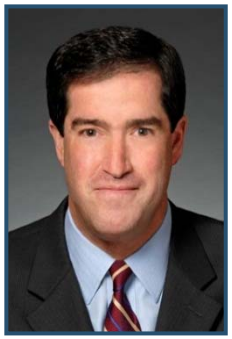

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