

Matters To Consider for the 2024 Annual Meeting and Reporting Season

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Companies have important decisions to make as they prepare for the 2024 annual meeting and reporting season. We have compiled this overview of key issues — including SEC disclosure requirements, recent SEC guidance, executive compensation considerations, and annual meeting and corporate governance trends — for companies to consider as they plan for the upcoming season. As always, we welcome any questions you have on these topics or other areas related to annual meeting and reporting matters.

Checklist of Matters To Consider for the 2024 Annual Meeting and Reporting Season



Disclosure Developments

- ❑ **Prepare for New Cybersecurity Disclosure Requirements**
page 4
- ❑ **Consider the Status of Recently Adopted Share Repurchase Rules**
page 5
- ❑ **Assess the Impact of SEC Staff Comments and Disclosure Trends**
page 6
- ❑ **Prepare for Compliance With California’s and the European Union’s New Climate Disclosure Rules**
page 7
- ❑ **Prepare for New Beneficial Ownership Rules**
page 9
- ❑ **Prepare for New Reporting of Short Position and Daily Short Activity**
page 10

Executive Compensation Considerations

- ❑ **Incorporate Lessons Learned From the 2023 Say-on-Pay Votes and Compensation Disclosures**
page 11
- ❑ **Prepare for 2024 Pay Ratio Disclosures**
page 16
- ❑ **Plan for the Second Year of Pay-Versus-Performance Disclosures**
page 18
- ❑ **Implement Clawback Policy and Comply With Clawback Policy Listing Standards**
page 21

- ❑ **Prepare for New Option Grant Practice Disclosures**
page 25
- ❑ **Evaluate Hart-Scott-Rodino Act Implications on Executive Compensation**
page 26

Annual Meeting and Corporate Governance Trends

- ❑ **Consider Amending Governance Documents To Provide for Officer Exculpation**
page 28
- ❑ **Evaluate Impacts on Form S-8 of Officer Exculpation Amendments**
page 28
- ❑ **Confirm Provisions in Employment/Separation Agreements and Related Documents Comply With SEC Whistleblower Rules**
page 29
- ❑ **Reassess Disclosure Controls and Procedures**
page 30
- ❑ **Update Insider Trading Policies To Address Amended Rule 10b5-1 and Other Recent Developments**
page 31
- ❑ **Consider Shareholder Proposal Trends and Developments**
page 32
- ❑ **Assess the Impact of Proxy Advisory Voting Guidelines and Significant Investor Publications**
page 34
- ❑ **Monitor the Status of the PCAOB’s Proposal To Expand the Scope of Audits and the Role of Auditors**
page 35

Disclosure Developments

Prepare for New Cybersecurity Disclosure Requirements

The SEC adopted [final rules in 2023](#) intended to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance and incident reporting by public companies (including foreign private issuers). Specifically, the SEC's amendments require:

- Current reporting of material cybersecurity incidents on a new Item 1.05 of Form 8-K.
- Annual reporting on Forms 10-K and 20-F of company processes for identifying, assessing and managing material risks from cybersecurity threats, management's role in assessing and managing the company's material cybersecurity risks, and the board's oversight of cybersecurity risks.

Companies (other than Smaller Reporting Companies (SRCs)) must begin complying with current reporting of material cybersecurity incidents on December 18, 2023. Companies must include the cybersecurity risk management, strategy and governance disclosures in their annual reports for fiscal years ending on or after December 15, 2023.

Form 8-K Disclosure of Material Cybersecurity Incidents

Item 1.05 of Form 8-K requires disclosure within four business days after a company determines that a "cybersecurity incident" experienced by the company is material. The trigger for Item 1.05 is the date on which the company determines that a cybersecurity incident it has experienced is material, rather than the date of discovery of the incident itself. Materiality determinations must be made "without unreasonable delay" after discovery of a cybersecurity incident. The SEC also explained in the adopting release that the analysis for materiality of cybersecurity incidents is the same as the materiality analysis for other securities laws purposes, and that the analysis should take into account quantitative and qualitative factors in assessing materiality.

Cybersecurity Risk Management, Strategy and Governance

New Form 10-K "Item 1C. (Cybersecurity)" and Form 20-F "Item 16K. Cybersecurity" require new annual cybersecurity related disclosures. In Form 10-K, companies must furnish the information required by Item 106 of Regulation S-K.

Item 106(b) of Regulation S-K requires a description of the company's processes, if any, for assessing, identifying and managing material risks from cybersecurity threats in sufficient detail for a reasonable investor to understand those processes and whether any risks from cybersecurity threats, including as a result of any previous cybersecurity incidents, have materially affected or are reasonably likely to materially affect the company, including its business strategy, results of operations or financial condition, and if so, how.

Item 106(c) of Regulation S-K requires companies to disclose information related to the board's and management's roles relating to cybersecurity. With respect to the board of directors, companies must describe:

- The board's oversight of risks from cybersecurity threats and, if applicable, any board committee or subcommittee responsible for such oversight.
- The processes by which the board or board committee is informed about such risks.

Companies must also describe management's role in assessing and managing the company's material risks from cybersecurity threats. The rule provides the following nonexclusive list of potential disclosure items:

- Whether and which management positions or committees are responsible for assessing and managing such risks and the relevant expertise of these persons in sufficient detail to fully describe the nature of the expertise.
- The processes by which such persons or committees are informed about and monitor the prevention, detection, mitigation and remediation of cybersecurity incidents.
- Whether such persons or committees report information about such risks to the board of directors or a board committee or subcommittee.

Preparing for Compliance With New Rules

When preparing to comply with the new rules, companies should evaluate whether current cybersecurity incident response plans and procedures, as well as disclosure controls and procedures, are designed to enable compliance with the new rules.

Materiality Analysis

In particular, companies should review materiality determination protocols, including whether they encompass assessment of both quantitative and qualitative costs that could arise when a cybersecurity incident occurs. In the adopting release, the SEC noted the following nonexclusive factors for companies to consider in making a materiality determination: “business interruption, lost revenue, ransom payments, remediation costs, liabilities to affected parties, cybersecurity protection costs, lost assets, litigation risks, and reputational damage.” Companies should consider carefully reviewing existing incident response plans and procedures to determine whether such plans include a materiality analysis at an appropriate time in the fact-finding process in light of the nature and scope of the incident. This review may also include an evaluation of existing disclosure controls and procedures to determine whether functions such as information technology, data security, cybersecurity and incident response are integrated and designed to facilitate streamlined communication between those functions, management and the board in the event of a cybersecurity incident.

Assessing Policies and Procedures

Companies should establish procedures for documenting board and committee discussions regarding cybersecurity risk oversight, including reports from management, which should provide the board or relevant committee with timely updates regarding the company’s risk management program and any related developments. Companies should consider updating and maintaining clear and concise documentation of their cybersecurity risk management processes and oversight structures to facilitate consistent and accurate disclosure of those areas. Companies should also closely

review existing governance documents, company policies and disclosure controls and procedures to evaluate whether their existing frameworks clearly articulate which members of management are responsible for managing cybersecurity risk and how such risks will escalate from employees to management, and then to the board.

Many companies already engage third-party vendors for certain aspects of cybersecurity risk management, including for security monitoring, managed services or incident response. As noted above, Item 106(b) requires disclosure of whether the company engages assessors, consultants, auditors or other third parties in connection with any such processes. Therefore, to the extent that a company engages a third party, it is important that the company document the engagement, scope of work and services provided, in order to facilitate accurate and complete disclosures. Lastly, companies should review their due diligence and third-party vendor oversight processes for cybersecurity vendors and third-party vendors generally, which processes must be disclosed under Item 106(b).

Preparing Disclosures

Finally, companies should consider how to accurately describe the processes, if any, for assessing, identifying and managing material risks from cybersecurity threats and the board’s and management’s roles relating to cybersecurity risk management and oversight. As these disclosures will be required for the first time in 2024, we encourage companies to start this process early and provide company management, members of the board and external auditors with adequate time to review and provide feedback.

Consider the Status of Recently Adopted Share Repurchase Rules

As discussed in more detail in our earlier client alert, the SEC adopted new share repurchase rules in May 2023.¹ On October 31, 2023, the U.S. Court of Appeals for the Fifth Circuit ruled that the SEC violated the Administrative Procedure Act when the agency adopted the new rules, and the court remanded the matter to the SEC to correct the defects by November 30, 2023.²

On November 22, 2023, the SEC announced that it was postponing the effective date of the new share repurchase rules, and as a result, the rules would be stayed pending further SEC action.³ After the court denied the SEC’s request for an extension, the SEC conceded that it was not able to correct the defects by the court-imposed deadline.

¹ See our May 5, 2023, client alert “[SEC Adopts New Share Repurchase Disclosure Requirements](#).”

² See *Chamber of Com. of the USA v. SEC*, No. 23-60255 (5th Cir. 2023).

³ See the SEC’s press release “[Announcement Regarding Share Repurchase Disclosure Modernization Rule](#)” (Nov. 22, 2023).

As of the date of this checklist, the court is considering a motion to vacate the new share repurchase rules. If the court vacates the rules, the SEC then would have to decide whether to appeal the decision or issue a new proposal.

In the meantime, companies are likely to continue disclosing their share repurchases in annual and periodic reports in a manner that is consistent with past practice.

Assess the Impact of SEC Staff Comments and Disclosure Trends

The staff of the Disclosure Review Program (DRP) in the SEC's Division of Corporation Finance has remained extremely busy over the past year. During the 12-month period ended June 30, 2023, the SEC staff continued its trend from the prior year, issuing approximately 60% more comment letters on company filings this year.⁴ The number of companies receiving comment letters also increased by more than 70% from the prior year, primarily due to the SEC staff issuing more comment letters to companies with a smaller market capitalization.

The staff of the Division of Corporation Finance also published new interpretive guidance and "Dear Issuer" letters covering various topics. In December 2022, the SEC staff released new and updated [Compliance & Disclosure Interpretations for Non-GAAP Financial Measures](#). Also in December 2022, the SEC staff published a [Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets](#) in response to bankruptcies among crypto-asset market participants and related widespread disruption, noting that "companies may have disclosure obligations under the federal laws related to the direct or indirect impact that these events and collateral events have had or may have on their business[es]." More recently, the SEC staff published a [Sample Letter to Companies Regarding XBRL Disclosures](#) in September 2023 to remind companies to ensure proper tagging of disclosures and data.

Comment Trends

Non-GAAP financial measures and management's discussion and analysis of financial condition and results of operations (MD&A) remained the most frequent areas generating SEC staff comment, with the volume of comment letters addressing non-GAAP financial measures and MD&A increasing by more than 50% and 100%, respectively. Segment reporting and revenue recognition ranked third and fourth, respectively, once again rounding out the top four most frequent areas for comment. Climate-related disclosures remained in the top 10 areas of comment for the second consecutive year, where the SEC staff's comments on this topic

⁴ See Ernst & Young's *SEC Reporting Update "Highlights of Trends in 2023 SEC Staff Comment Letters"* (Sept. 14, 2023).

continued to apply the sample comments contained in the [Sample Letter to Companies Regarding Climate Change Disclosures](#) that the staff of the SEC's Division of Corporation Finance issued in September 2021.

Recent Areas of Focus

Below is a summary of the SEC staff's most noteworthy areas of focus.

Non-GAAP Financial Measures: The SEC staff continues to focus on non-GAAP financial measures and ensuring consistency with the staff's recently updated Compliance and Disclosure Interpretations (C&DIs) on non-GAAP financial measures. While the issuance of the new and updated C&DIs was intended to memorialize previously existing staff views, nearly half of the staff's comments on non-GAAP measures referenced the updated C&DIs following their December 2022 publication.⁵ For example, SEC staff comments have addressed adjustments to non-GAAP measures that remove or exclude cash operating expenses that the staff views as "normal" or "recurring" in the operation of a company's business, and thereby resulted in a misleading measure under C&DI Question 100.01 (which the staff updated in 2022 to provide additional context on what is a "normal" or "recurring" adjustment). Additionally, the SEC staff's comments have focused on non-GAAP adjustments to both revenue and expenses that could be viewed as resulting in "individually tailored" accounting principles and causing the presentation of a non-GAAP measure to be misleading based on C&DI Question 100.04 (which the staff updated in 2022 to clarify the view that such adjustments could be misleading and to include a list of examples of such adjustments that the staff may consider misleading). The SEC staff has also continued to issue comments to examine whether to identify certain performance indicators as non-GAAP measures and to request that companies present the most directly comparable GAAP financial measure with equal or greater prominence relative to the non-GAAP measure.

Although most of these comments address the use of non-GAAP measures in earnings releases and SEC filings, the SEC staff also reviews other materials, including information on company websites and in investor presentations. Accordingly, companies should ensure that any public disclosures of non-GAAP financial measures comply with applicable SEC rules and staff guidance.

MD&A: The SEC staff continues to request that companies quantify material changes in operations and include offsetting factors. The SEC staff also continued to highlight key performance indicators (KPIs) and operating metrics, including how they are calculated and period-over-period comparisons. SEC staff comments regularly

⁵ See PwC's *In Depth "To GAAP or To Non-GAAP"* (Nov. 2, 2023).

raised questions about KPIs discussed in earnings releases and investor presentations and how these compare to the information disclosed in MD&A reporting.

The SEC staff comments on MD&A reporting have also continued to focus on known trends or uncertainties, particularly those related to macroeconomic factors such as inflation, interest rates and supply chain issues. For instance, SEC staff comments have inquired about known trends and uncertainties that have had or are reasonably likely to have a material effect on sales, expenses or income from continuing operations as a result of the impact of higher interest rates. Where reporting companies cited negative macroeconomic trends such as wage inflation, global supply chain issues and inflation affecting revenues as factors impacting results, staff comments have requested that companies expand their MD&A disclosures to identify the principal factors contributing to these issues, clarify the resulting impact on the company and identify mitigating actions planned or taken with respect to these macroeconomic factors. SEC staff comments have also asked how known and anticipated events and trends may impact the company's future liquidity and capital resources as a result of macroeconomic factors.

We expect to see more SEC staff comments on these macroeconomic trends in MD&A reporting, given that global conflicts and supply chain disruptions continue and inflation and interest rates remain at high levels. As a result:

- We encourage companies to continually reassess and update their MD&A disclosures in light of new or evolving macroeconomic trends and uncertainties.
- Companies should continue to consider CF Disclosure Guidance Topic No. 9 and No. 9A related to COVID-19 and supply chains as well as the SEC staff's [Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues](#) issued in May 2022, as much of the guidance in these materials could apply to other macroeconomic trends.

New Disclosure Considerations

Companies should carefully review their legal proceedings disclosures in periodic filings following a recent decision from a federal district court in the fall of 2023.⁶ In *City of Fort Lauderdale Police and Firefighters' Retirement System v. Pegasystems Inc.*, Pegasystems Inc. and its CEO characterized claims that the company willfully misappropriated trade secrets in a prior lawsuit as "without merit" in the legal proceedings disclosures of the company's Form 10-K and in other statements made by the CEO. After the company was ordered to pay over \$2 billion in damages in connection with the prior lawsuit, the company's

share price decreased significantly. Based on that event, the plaintiff shareholders filed a class action suit against the company alleging that the company and its CEO falsely reassured investors in characterizing the claims in the prior lawsuit as "without merit," among other things.

In ruling in favor of the plaintiff shareholders, the court found that the "without merit" reassurances were actionable opinion statements, noting that they did not "fairly align" with the CEO's "awareness of, involvement in, and direction of [the company's] espionage campaign." In reaching this conclusion, the court explained that "a reasonable investor could justifiably have understood [the CEO's] message that [the prior trade secret] claims were 'without merit' as a denial of the facts underlying [the] claims — as opposed to a mere statement that [the company] had legal defenses against those claims." As a result of this decision, companies should be cautious about using boilerplate language characterizing litigation as "without merit" in their legal proceedings disclosures and instead consider using statements indicating that the company intends to contest the matter or present defenses.

Prepare for Compliance With California's and the European Union's New Climate Disclosure Rules

In October 2023, Gov. Gavin Newsom signed into California law sweeping climate disclosure rules:

- Senate Bill 253, Climate Corporate Data Accountability Act (SB 253).
- Senate Bill 261, Greenhouse Gases: Climate-Related Financial Risk (SB 261).
- Assembly Bill 1305, Voluntary Carbon Market Disclosures (AB 1305).

Notably, these rules will apply to many companies headquartered outside of California, and were enacted at a time when the SEC is considering adopting rules that would mandate extensive and prescriptive climate-related disclosures in public companies' annual reports and registration statements.⁷ The California rules would require certain disclosures that are broader than the SEC's proposed climate disclosure rules. Gov. Newsom expressed concerns about the implementation deadlines and costs for SB 253 and SB 261, and directed his administration to work with the legislature to address these issues.⁸

Similarly, at the end of 2022, the European Union adopted the Corporate Sustainability Reporting Directive (CSRD) and in July 2023 released the European Sustainability Reporting

⁶ See *City of Fort Lauderdale Police and Firefighters' Retirement Sys. v. Pegasystems Inc.*, No. CV 22-11220-WGY, 2023 WL 4706741 (D. Mass. July 24, 2023).

⁷ See our March 24, 2022, client alert "[SEC Proposes New Rules for Climate-Related Disclosures.](#)"

⁸ See Gov. Newsom's signing statements (Oct. 7, 2023) for [Bill 253](#) and [Bill 261](#).

Standards (ESRS) implementing the CSRD, which require comprehensive, detailed disclosures covering a broad spectrum of sustainability topics.

Companies should confirm the applicability of these rules and, if applicable, prepare to provide the requisite disclosures. Highlights of each rule are summarized below.

California Climate Disclosure Rules

SB 253

SB 253 will require companies⁹ formed in the United States with more than \$1 billion in total annual revenues that are “doing business” in the state of California¹⁰ to annually disclose:

- **Scopes 1 and 2 emissions.** Starting in 2026, companies must report their Scope 1 and Scope 2 greenhouse gases (GHG) emissions for the prior fiscal year.
- **Scope 3 emissions.** Starting in 2027, companies must report their Scope 3 GHG emissions for the prior fiscal year.

Companies will be required to measure and report GHG emissions data that conforms with the Greenhouse Gas Protocol standards and guidance developed by the World Resources Institute and the World Business Council for Sustainable Development. The disclosure must be publicly available and easily accessible. Also, companies must obtain independent third-party assurance of their GHG emissions, subject to a phase-in period.¹¹

SB 261

SB 261 will require companies formed in the United States with more than \$500 million in total annual revenues that do business in California to biannually prepare and disclose a climate-related financial risk report that includes:

- **Climate-related financial risk.** A description of the company’s climate-related financial risk, which is defined as material risk of harm to immediate and long-term financial outcomes due to physical and transition risks.

⁹ For purposes of SB 253 and SB 261, “companies” includes corporations, partnerships, limited liability companies and other business entities formed under the laws of any U.S. state or the District of Columbia or under an act of Congress. SB 261 does not apply to a business that is subject to regulation by California’s Department of Insurance or that is in the business of insurance in any other state.

¹⁰ Although SB 253 does not define “doing business in California,” this phrase could be interpreted to have broad applicability.

¹¹ The assurance engagement for Scopes 1 and 2 emissions must be performed at a limited assurance level beginning in 2026 and at a reasonable assurance level beginning in 2030. On or before January 1, 2027, an assurance requirement for Scope 3 emissions may be established, in which case the assurance engagement for Scope 3 emissions would be performed at a limited assurance level beginning in 2030.

- **Countermeasures.** Any measures the company has adopted to reduce and adapt to the disclosed, material climate-related financial risk.

Companies must prepare the report: (i) in accordance with the disclosure framework established by the Task Force on Climate-Related Financial Disclosures (TCFD) or any successor; or (ii) pursuant to certain “equivalent” reporting requirements. The report may be consolidated at the parent company level.

The first report is due by January 1, 2026, and must be available at that time on the company’s website.

AB 1305

AB 1305 will require covered business entities to disclose on their company websites specified information related to, among other things, carbon offsets and net zero emissions claims. AB 1305 has broad applicability and covers both:

- (i) Business entities that market or sell voluntary carbon offsets within California.
- (ii) Business entities that make claims within California regarding the achievement of net zero emissions, carbon neutrality, or significant reductions to the company’s carbon dioxide or greenhouse gas emissions, or that the entity or a product does not add net carbon dioxide or greenhouse gases to the climate.

A company that makes certain climate-related claims that then qualifies the company to fall within the second category of covered business entities will be required to disclose on its company website:

- **Documentation.** All information documenting how, if at all, a “carbon neutral,” “net zero emission” or other similar claim was determined to be accurate or actually accomplished, and how interim progress toward that goal is being measured.¹²
- **Third-party verification.** Whether an independent third-party verified the company data and claims listed.

Initially, the legislation was anticipated to require companies to provide website disclosures by January 1, 2024. While not binding on courts or governmental agencies, the bill’s author recently clarified that his intent was for the rule to become effective on January 1, 2025. Given this uncertainty, we anticipate that companies will comply by the later date.

¹² AB 1305 notes that this information may include, but is not limited to, disclosure of independent third-party verification of all of the entity’s GHGs, identification of the entity’s science-based targets for its emissions reduction pathway, and disclosure of the relevant sector methodology and third-party verification used for the entity’s science-based targets and emissions reduction pathway.

EU ESG Disclosure Rules

The CSRD will require comprehensive, detailed disclosures covering a broad spectrum of sustainability topics. The EU plans, however, to allow disclosures made under similar rules in other jurisdictions to satisfy the EU requirements, which could reduce the risk of conflicting demands for multinational companies.

Notably, the CSRD requires disclosures not only about how ESG issues impact a company's business, but also about the business's impact on a range of sustainability matters — referred to as “double materiality.” The CSRD also requires third-party audits for all reported sustainability information.

Initially, the CSRD will apply only to EU-incorporated companies. However, for financial years starting on or after January 1, 2028, non-EU companies must report if they have a significant presence in the EU (defined by minimum EU revenues and asset thresholds), and companies are encouraged to begin preparation early.¹³

Prepare for New Beneficial Ownership Rules

On October 10, 2023, the SEC adopted amendments to its beneficial ownership rules. Pursuant to the adopted rule amendments, Schedules 13D and 13G will be filed on a more accelerated basis.¹⁴ The new beneficial ownership rules become effective beginning on February 5, 2024. However, compliance with the new Schedule 13G deadlines commences on September 30, 2024.

Schedule 13D Deadlines

Schedule 13D will now be due within five business days after crossing the 5% threshold (instead of within 10 calendar days). Any Schedule 13D amendments will be due within two business days of a material change (instead of being due “promptly,” which is not currently defined).

Schedule 13G Deadlines

The Schedule 13G deadlines were also accelerated. There are three categories of Schedule 13G filings, each with its own filing deadlines and amendment requirements.

- Passive investors must file their initial Schedule 13Gs within five business days (instead of ten calendar days).
- Other initial Schedule 13Gs, including qualified institutional investors, are eligible to be filed within 45 days after the end of the first calendar quarter-end in which a person beneficially

owns more than 5% percent (instead of within 45 days after the end of the calendar year if over 5% at year-end).

- The exception is that a qualified institutional investor that beneficially owns more than 10% at the end of a calendar month must instead file its initial Schedule 13G within five business days after the end of such month (instead of within 10 calendar days after the end of such month).

One of the bigger rule changes is that under the old rules, all Schedule 13Gs must be amended annually within 45 days after the end of the year, unless there was no change in the information previously reported. The SEC eliminated the annual amendment requirement for Schedule 13Gs. Instead, all Schedule 13Gs must be amended within 45 days after the end of a calendar quarter in which there is a material change in the information previously reported. The SEC did not define material changes for purposes of any quarter-end Schedule 13G amendments. However, the SEC signaled that any acquisitions or dispositions of 1% or more of the outstanding class of securities should be deemed material for purposes of amending a Schedule 13G, similar to the Schedule 13D amendment requirement for 1% changes prescribed under Rule 13d-2(a).

The accelerated deadlines are intended to help investors disclose positions and amend their filings more promptly. However, with no annual Schedule 13G requirement, some filings may not require amending as frequently if no material changes occurred over a period of time.

Cash-Settled Derivatives

The SEC had also proposed rules that would include cash-settled derivatives (other than security-based swaps) toward a person's beneficial ownership if such derivatives were held with a control purpose. However, these amendments were not adopted. The SEC did amend Schedule 13D to specifically require that any derivatives, including cash-settled derivatives, relating to an issuer's securities held by a reporting person be disclosed in Item 6 of the Schedule 13D. While many filers believed this was already required, some had argued otherwise.

Group Formation

The SEC had also proposed amending the definition of “group” for beneficial ownership purposes. The current rule states that a group is formed when two or more persons agree to act together for the purposes of acquiring, holding, voting or disposing of company equity securities (unlike Sections 13(d) and (g) of the Exchange Act which make no reference to an “agreement” to act together and only require that such persons act together as a group for such purposes). The SEC had proposed deleting the reference

¹³ See our client alert “[The Informed Board, Summer 2023 – The EU's New ESG Disclosure Rules Could Spark Securities Litigation in the US](#).”

¹⁴ See our October 13, 2023, client alert “[SEC Amends Beneficial Ownership Reporting Rules, Shortening Deadlines and Offering Guidance on ‘Groups’ and Cash-Settled Derivatives](#).”

to “agreement” from the rule to bring the rule and statute in alignment. The SEC wanted to make clear that an explicit agreement is not required to establish that a group was formed; circumstantial evidence of two shareholders acting in concert as a group for one of the above purposes is sufficient. One SEC focus was “wolf pack” activities, where multiple activist investors act together regarding a company without entering into any explicit agreement. The SEC did not make these amendments, but emphasized that nonetheless, the agency’s view is that no explicit agreement is required to form a group under the current rules.

The SEC provided additional guidance and amendments to clarify other group issues.

Prepare for New Reporting of Short Positions and Daily Short Activity

On October 13, 2023, the SEC adopted new short sale position and activity reporting rules.¹⁵ Pursuant to new Rule 13f-2 under the Exchange Act, institutional investment managers will be required to disclose certain short sale positions and certain net short-position trading activity on a new Form SHO.

Under the new rule, any required Form SHO will be due within 14 days after the end of a calendar month in which applicable short positions exceeded the below thresholds. Any errors that affect the accuracy of the information reported must be amended within 10 calendar days of discovery of such error. Form SHO is a confidential filing (*i.e.*, not available publicly on EDGAR).

The SEC will then take the details provided in the privately filed Forms SHO and publish at the end of each calendar month aggregate

information on large short positions related to individual equity securities (gross position as of the end of such month and dollar value of such position) and net activity during the applicable month.

An institutional investment manager must file Form SHO to report each gross short position over which the investment manager and any person under the manager’s control has investment discretion that collectively, after the end of a calendar month, has:

- For reporting issuers:
 - A monthly average gross short position at the close of regular trading hours in the equity security of at least \$10 million; or
 - A monthly average gross short position at the close of regular trading hours as a percentage of shares outstanding in the equity security of at least 2.5%.
- For nonreporting issuers
 - A value that meets or exceeds \$500,000 at the close of regular trading hours on any settlement date during the calendar month.

Institutional investment managers will need to determine whether they have Form SHO filing obligations on a month-by-month basis.

New Rule 13f-2 becomes effective on January 2, 2024. However, compliance begins on January 2, 2025, with public dissemination of the aggregated reporting data by the SEC to follow three months later.

Companies will not see the individual Form SHO filings but, beginning in 2025, will receive a monthly update from the SEC on aggregate gross short positions and daily net short trading activity with respect to their securities.

¹⁵ See our October 27, 2023, client alert “SEC Adopts Short Sale Disclosure Rules.”

Executive Compensation Considerations

Incorporate Lessons Learned From the 2023 Say-on-Pay Votes and Compensation Disclosures

Companies should consider their recent annual say-on-pay votes and best practices for disclosure when designing their compensation programs and communicating about those programs to shareholders. This year, companies should understand key say-on-pay trends, including overall 2023 say-on-pay results, factors driving say-on-pay failure (*i.e.*, those say-on-pay votes that achieved less than 50% shareholder approval), say-on-golden-parachute results and results of equity plan proposals, as well as recent guidance from the proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis.

Overall Results of 2023 Say-on-Pay Votes

Below is a summary of the results of the 2023 say-on-pay votes from Semler Brossy's annual survey¹⁶ and trends over the last 12 years since the SEC adopted its say-on-pay rules. Overall, say-on-pay approval results at Russell 3000 companies surveyed in 2023 were generally the same or slightly more favorable than those in 2022.

- Approximately 97.9% and 96.3% of Russell 3000 companies in 2023 and 2022, respectively, received at least majority support on their say-on-pay votes, with approximately 90% receiving above 70% support in 2022 and 93% receiving above 70% support in 2023. This demonstrates slightly increased say-on-pay support in 2023 compared with 2022.
- To date thus far in 2023, approximately 87.5% of Russell 3000 companies and 90.5% of S&P 500 companies have received "For" recommendations by ISS, a slight increase from the 86% and 87.3% "For" recommendations averages in 2022.
- Russell 3000 companies received an average vote result of 90% approval in 2023, which is slightly higher than the average vote result of 89.2% approval in 2022.
 - The average vote result exceeded 90% approval in 2023 across multiple industry sectors, including utilities, materials, energy, consumer staples, industrials, financials and consumer discretionary. The percentage of Russell 3000 companies receiving more than 90% support is 71%, which is slightly lower than the 72% of companies receiving greater than 90% support at this time last year.
 - The communication services sector featured the lowest level of average support, at 86.3%, compared with other industry sectors.
- As of September 2023, approximately 2.1% of say-on-pay votes in 2023 for Russell 3000 companies failed, which is below the 3.7% failure rate for 2022.
- Approximately 13% of Russell 3000 companies and 15% of S&P 500 companies surveyed have failed to receive majority support for a say-on-pay vote at least once since 2011.
- 39% of S&P 500 companies and 32% of Russell 3000 companies surveyed have received less than 70% support in a say-on-pay vote at least once since 2011.

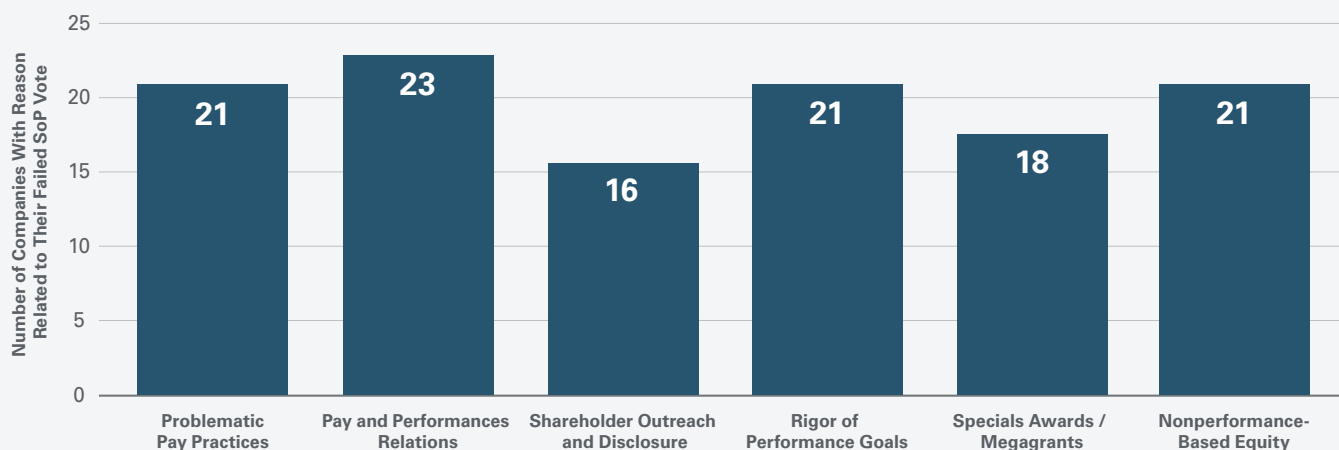
Factors Driving Say-on-Pay Failure

Overall, the most common factors voters used to reject say-on-pay proposals were pay and performance relation, problematic pay practices, rigor of performance goals, shareholder outreach and disclosure, nonperformance-based equity and special awards, as summarized in the chart below.¹⁷

¹⁶ See Semler Brossy's report "[2023 Say on Pay & Proxy Results](#)" (Sept. 28, 2023). See also Semler Brossy's report "[2022 Say on Pay & Proxy Results](#)" (Jan. 12, 2023). Unless otherwise noted, Semler Brossy's report is the source of pay ratio, say-on-pay and equity plan proposal statistics in this guide.

¹⁷ See Semler Brossy's report "[2023 Say on Pay & Proxy Results](#)" (Sept. 28, 2023).

Summary Table: Likely Causes of Failed Say-on-Pay (SoP) Votes in 2023*



*46 companies with failed SoP were included in this survey. The same company may be counted toward multiple cases of votes resulting in SoP failure.

Consistent with 2022 results, pay and performance relation was among the leading causes of say-on-pay failure for 2023. Notably, though voters issues with problematic pay practices significantly decreased from 38 instances in 2022 to 21 instances in 2023, the issue was still a top cause of SoP rejections in 2023. Also, the tally shows that rigor of performance goals and nonperformance-based equity have slightly outpaced special awards as leading causes of say-on-pay failure.

ISS Guidance

When evaluating pay practices, the focus of proxy advisory firms tends to center on whether a company's practices are contrary to a performance-based pay philosophy. In December of each year, ISS publishes FAQs to help shareholders and companies understand changes to ISS compensation-related methodologies. In December 2022, ISS published its most recent general United States Compensation Policies FAQ,¹⁸ which included the following key updates:

- ISS indicated that there are no changes to the three primary quantitative pay-for-performance screens (Relative Degree of Alignment (RDA), Multiple of Median (MOM) and Pay-TSR Alignment (PTA)) for 2023. For meetings on or after February 1, 2023, companies should observe updates to the methodology for the Financial Performance Assessment (FPA) measure and the "Eligible for FPA Adjustment" thresholds.¹⁹

¹⁸ See ISS' FAQ "United States Compensation Policies" (Dec. 16, 2022).

¹⁹ For more information, see ISS' "Pay-for-Performance Mechanics" white paper.

- ISS noted that the potential FPA adjustments may affect companies' overall quantitative concern level, causing certain high-concern companies with strong FPA performance to become medium concerns and certain medium-concern companies with poor FPA performance to become high concerns. ISS research indicates that the updated FPA methodology will impact the overall quantitative concern level for less than 9.5% of all companies subject to the quantitative pay-for-performance screen.
- ISS highlighted some of the key factors it typically considers in conducting the qualitative review of the pay-for-performance analysis. ISS noted that a company should fully disclose in its proxy statement the following factors if the company wants to be eligible to receive any mitigating weight:
 - The ratio of performance to time-based incentive awards.
 - The overall ratio of performance-based compensation to fixed or discretionary pay.
 - The transparency and clarity of disclosure.
 - The complexity of the pay program.
 - Any risks associated with the pay program design.
 - The emphasis of objective and transparent metrics.
 - The rigor of performance goals.
 - The application of compensation committee discretion.
 - The magnitude of pay opportunities.
 - Benchmarking practices of the company's peer group.

- Financial/operational results, both absolute and relative to peers, including clear disclosure in the proxy of any adjustments made for incentive plan purposes.
 - Special circumstances such as CEO and executive turnovers or unusual grant practices (*e.g.*, biannual awards, special one-time grants).
 - Recent changes to the pay program and/or any forward-looking commitments.
 - Realizable and realized pay compared to granted pay.
 - Any other factors deemed relevant.
- ISS indicated that a temporarily increased pay package for an incoming executive is generally acceptable when an executive transition occurs, but compensation levels will be expected to normalize after the transition. ISS added that the presence of inducement awards and make-whole awards could mitigate concerns regarding pay magnitude if a review of the award structure and disclosure reveals positive features. ISS suggests inducement awards should be predominantly performance-based and structured with shareholder-friendly guardrails such as limitations on award vesting in the event of a termination. For make-whole awards, ISS noted it does not expect performance criteria to be attached, but suggests companies disclose that the new grant is economically equivalent to forfeited compensation opportunities from the executive's prior employment and make clear what portion of awards are attributable to inducement/sign-on awards versus those that are strictly make-whole awards.
- ISS described how it evaluates modifier metrics for incentive pay programs based on an assessment of the modifier metric's mechanics, including its applicable goals, the achieved performance level and impact on payouts (as well as the limitations that the modifier metric has on payouts). ISS indicated that modifier metrics that allow for a significant increase in a payout or do not disclose the percentage by which a payout can be increased may be viewed negatively, as will modifier metrics that overemphasize committee discretion.
- ISS noted that it may raise concerns when pay program structures and/or disclosures are overly complex, particularly when it identifies a quantitative pay-for-performance misalignment. Examples of concerning features include a disproportionately large number of metrics, modifiers and/or award vehicles; complicated formulas for vesting or award determinations; or convoluted pay program disclosure without clear and compelling rationale.
- ISS highlighted problematic practices that carry significant weight and are most likely to result in adverse vote recommendations, including the following (which largely aligns with problematic practices noted in prior years):
- Repricing or replacing of underwater stock options/SARs held by named executive officers (NEOs) or directors without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options).
 - Excessive or extraordinary perquisites or tax gross-ups.
 - New or materially amended agreements that provide for (i) excessive termination or change-in-control severance payments (generally exceeding three times [base salary plus average/target/most recent bonus]); (ii) change-in-control severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers) or in connection with a problematic good-reason definition; (iii) problematic good-reason termination definitions that present windfall risks, such as definitions triggered by potential performance failures; (iv) change-in-control excise tax gross-up entitlements (including "modified" gross-ups); (v) multiyear guaranteed awards or increases that are not at risk due to rigorous performance conditions; or (vi) a liberal change-in-control definition combined with any single-trigger change-in-control benefits.
 - Insufficient executive compensation disclosure by externally managed issuers (EMIs) so that a reasonable assessment of pay programs and practices applicable to the EMI's executives is not possible.
 - Severance payments made when the termination is not clearly disclosed as involuntary (for example, a termination without cause or resignation for good reason).
 - Any other provision or practice deemed to be egregious and to present a significant risk to investors.
- ISS clarified that it may consider new disclosures required by the SEC's "pay-versus-performance" rule finalized in August 2022 — particularly for companies that exhibit a quantitative pay-for-performance misalignment. However, ISS indicated that the new disclosures are not expected to replace prior disclosure expectations regarding incentive pay.
- Now that companies are in a position to return to pre-COVID incentive program structures, ISS will negatively view any midyear changes to annual incentive metrics, performance targets and/or measurement periods, or programs that heavily emphasize discretionary or subjective criteria. Additionally, ISS stated that changes to long-term incentive cycles or shifts to predominantly time-vesting incentives or short-term measurement periods will also generally be viewed negatively.
- Relatedly, ISS indicated that it will negatively view one-time awards or other significant increases in executive pay opportunities used to replace foregone compensation due to caps on executive compensation for companies receiving financial assistance under the CARES Act.
- ISS is expected to release a full set of updated compensation FAQs in December 2023, which will provide robust guidance for 2024.

Glass Lewis Guidance

Glass Lewis published its 2024 policy guidelines for the United States in November 2023, which included the following compensation updates in effect for the 2024 proxy season:²⁰

- Glass Lewis indicated that in addition to meeting the new Dodd-Frank Act clawback requirements, effective clawback policies should provide companies the power to recoup incentive compensation when there is evidence of problematic decisions or actions, such as:
 - Material misconduct.
 - A material reputational failure.
 - A material risk management failure.
 - A material operational failure where incentive payments have not already reflected the consequences.

Glass Lewis recommends that clawback policies provide the power to recoup regardless of whether the executive's employment was terminated with or without cause. If the company decides to refrain from recouping compensation, the company should provide a rationale and disclose alternative measures it instead pursued, such as the exercise of negative discretion on future payments.

- Companies are expected to provide clear disclosure in the Compensation Discussion and Analysis section of their proxy statements of their executive share ownership requirements and how various outstanding equity awards are treated when determining an executive's level of ownership. Glass Lewis noted that it is inappropriate to count unearned performance-based full value awards and/or unexercised stock options in determining an executive's level of share ownership.
- Regarding proposals seeking approval for individual equity awards, Glass Lewis will positively view in its holistic analysis provisions that require a vote of abstention (often called a "non-vote") from a shareholder if the shareholder is also the recipient of the proposed grant — especially where a vote from the recipient of the proposed grant would materially influence the passage of the proposal.

Glass Lewis also clarified the following in its 2024 policy guidelines:

- **Pay-for-Performance:** Glass Lewis may use the pay-versus-performance disclosure as part of its supplemental quantitative assessments supporting the primary pay-for-performance grade; however, the pay-versus-performance disclosure does not impact the pay-for-performance methodology and there has been no change to the methodology.

²⁰ See Glass Lewis' 2024 Benchmark Policy Guidelines – United States (Nov. 16, 2023).

- **Non-GAAP to GAAP Reconciliation Disclosure:** Glass Lewis emphasized the need for companies to thoroughly disclose the use of non-GAAP measures in incentive programs to help shareholders reconcile the difference between non-GAAP results used for incentive payout determinations and reported GAAP results. Where significant adjustments materially impact incentive pay outcomes, lack of such disclosure may be a factor in Glass Lewis' say-on-pay recommendation.
- **Company Responsiveness to Say-on-Pay:** Glass Lewis clarified that its calculation of say-on-pay opposition includes votes cast as either "Against" and/or "Abstain," with opposition of 20% or higher treated as significant.

Recommended Next Steps

Overall, proxy advisory firms, institutional investors, the news media, activist shareholders and other stakeholders continue to shine a spotlight on companies' executive compensation programs. This year's proxy season provides an opportunity for companies to clearly disclose the link between pay and performance and efforts to engage with shareholders about executive compensation. As always, these disclosures should explain the company's rationale for selecting particular performance measures for performance-based pay and the mix of short-term and long-term incentives. Companies should also carefully disclose the rationale for any increases in executive compensation, emphasizing their link to specific individual and company performance.

In the year following a say-on-pay vote, proxy firms conduct a thorough review of companies where say-on-pay approval votes fell below a certain threshold: 70% for ISS and 80% for Glass Lewis. ISS' FAQ explains that this review involves investigating the following:

- The breadth, frequency and disclosure of the compensation committee's stakeholder engagement efforts.
- Disclosure of specific feedback received from investors who voted against the proposal.
- Actions taken to address the low level of support.
- Other recent compensation actions.
- Whether the issues raised were recurring.
- The company's ownership structure.
- Whether the proposal's support level was less than 50%.

Attending to these factors should elicit the most robust stakeholder engagement efforts and disclosures.

Looking ahead to 2024, companies that received say-on-pay results below the ISS and Glass Lewis review thresholds should consider enhancing disclosures of their shareholder engagement

efforts in 2023 and the specific actions they took to address potential shareholder concerns. Companies that fail to conduct sufficient shareholder engagement efforts and to make these disclosures may receive negative voting recommendations from proxy advisory firms on say-on-pay proposals and compensation committee member reelection.

Recommended actions for such companies include the following:

- **Assess results of the most recent say-on-pay vote.** As part of this analysis, identify which shareholders were likely the dissenting shareholders and why.
- **Engage key company stakeholders by soliciting and documenting their perspectives on the company's compensation practices.** Analyze stakeholder feedback, determine recommended next steps and discuss findings with relevant internal stakeholders, such as the compensation committee and the board of directors.
- **Review ISS and Glass Lewis company-specific reports and guidance to determine the reason for their vote recommendations in 2023.** Carefully consider how shareholders and proxy advisory firms will react to planned compensation decisions for the remainder of the current fiscal year and recalibrate as necessary. For example, consider compensation for new hires, leadership transitions and any special one-time grants or other arrangements.
- **Determine and document which changes the company will make to its compensation policies** in response to shareholder feedback.
- **Disclose specific shareholder engagement efforts and results in the 2024 proxy statement.** Such disclosures should include information about the shareholders engaged, such as the number of them, their level of ownership in the company and how the company engaged them. This disclosure should also reflect actions taken in response to shareholder concerns, such as a company's decision to offer more robust disclosures or to adjust certain compensation practices.

Companies that have not changed their compensation plans or programs in response to major shareholder concerns should consider disclosing (i) a brief description of those concerns, (ii) a statement that the concerns were reviewed and considered and (iii) an explanation of why changes were not made.

Say-on-Golden-Parachute Proposal Results

Say-on-golden-parachute votes historically have received lower support than annual say-on-pay votes. In 2023, average support for golden parachute proposals decreased slightly from 72% in

2022 to 71% in 2023.²¹ ISS' negative vote recommendations dropped to 32% in 2023 from 41% in 2022. Companies should beware of including single-trigger benefits (e.g., automatic and accelerated vesting of equity upon a change in control without a corresponding termination of employment) in their parachute proposals given that stakeholders cite single-trigger vesting and tax gross-ups as primary concerns. Companies have historically also cited excessive cash payouts and performance awards vesting at maximum value as significant concerns.

The failure rate for say-on-golden-parachute proposals was at an all-time high in 2023 at 32% (up from 26% in 2022).

Equity Plan Proposal Results

Average support for equity plan proposals decreased in 2023:

- 1.4% of equity plan proposals at Russell 3000 companies received less than a majority vote in 2023 through September 2023, as opposed to below 1% in previous years (0.4% in 2022).²²
- Average support for 2023 equity plan proposals as of September 2023 was 86.7%, which was below the 89.6% average support for equity plan proposals observed in September 2022.²³

Most companies garner strong support from shareholders for equity plan proposals, regardless of the say-on-pay results. However, the strength of such equity plan support decreased in 2023:

- As of September 2023, Russell 3000 companies receiving an "Against" recommendation still received 72% support for equity plan proposals.²⁴
- As of September 2023, the ISS "Against" recommendation rate was 28% (up from 22% in 2022).

The threshold number of points to receive a favorable equity plan proposal recommendation from ISS increased:

- From 57 points to 59 points for the S&P 500 model.
- From 55 points to 57 points for the Russell 3000 model.
- From 53 points to 55 points for all other Equity Plan Scorecard (EPSC) models.²⁵
 - Other than the burn rate factor update, ISS did not make changes to the factors, weightings or passing scores for any of the EPSC models.

²¹ See Willis Towers Watson's report "U.S. Executive Pay Votes" (Oct. 2023).

²² See Semler Brossy's report "2023 Say on Pay & Proxy Results" (Sept. 28, 2023).

²³ See Semler Brossy's report "2022 Say on Pay & Proxy Results" (Sept. 29, 2022).

²⁴ See Semler Brossy's report "2023 Say on Pay & Proxy Results" (Sept. 28, 2023).

²⁵ See ISS' FAQ "United States Equity Compensation Plans" (Dec. 11, 2023).

Although ISS has not changed how it assesses a company's clawback policy for EPSC purposes, it clarified that, to receive points, the clawback policy should authorize recovery upon a financial restatement and cover both time- and performance-based equity compensation for all NEOs. A company will not receive credit for a clawback policy that adheres to the minimum requirements of the SEC's finalized clawback rules under the Dodd-Frank Act because the final rules generally exempt time-vesting equity from compensation that must be covered by the policy.

ISS changed how it calculates common shares outstanding (CSO) and market capitalization for shareholder value transfer (SVT) purposes in economic proposals (e.g., mergers, acquisitions or financing transactions). ISS evaluates where the implementation of the equity plan proposal is contingent on the consummation of the economic transaction and analyzes the equity plan proposal on a post-transaction basis, including the common shares issuable upon the economic transaction in the CSO and market cap. For purposes of satisfying NYSE or NASDAQ "20% rule" requirements, the shares issuable will only be included in CSO and market cap if the company discloses that the shares will be issued upon shareholder approval of the proposal.

ISS also changed how it considers a company's burn rate in evaluating stock plans. For meetings before February 1, 2023, ISS used a three-year adjusted average burn rate — as a percentage of weighted average common shares outstanding — as a measure of the company's typical annual equity-based grant rate. ISS compares this rate to a benchmark for the company's industry/index. A company's three-year adjusted burn rate relative to that benchmark is a factor in the EPSC.²⁶ For meetings on or after February 1, 2023, the EPSC burn rate factor instead uses "Value-Adjusted Burn Rate" (VABR), with benchmarks calculated as the greater of:

- An industry-specific threshold based on three-year burn rates within the company's Global Industry Classification Standard (GICS) group (segmented into S&P 500, Russell 3000 index (less the S&P 500) and non-Russell 3000 index companies).
- A de minimis threshold established separately for each of the S&P 500, the Russell 3000 index less the S&P 500, and the non-Russell 3000 index segments.

ISS noted that the VABR seeks to better approximate companies' equity grant rates through compensation plans by using more accurate measures for the value of equity-based awards. A company's annual VABR is calculated as follows:

$$\text{Annual Value} - \text{Adjusted Burn Rate} = ((\# \text{ of options} * \text{option's dollar value using a Black-Scholes model}) + (\# \text{ of full-value awards} * \text{stock price})) / (\text{weighted average common shares} * \text{stock price}).$$

On March 17, 2023, the S&P Dow Jones Indices and Morgan Stanley Capital International (MSCI), Inc. effectuated changes to the GICS structure.

- ISS indicated that for purposes of the EPSC, the GICS changes went into effect for shareholder meetings occurring on or after September 1, 2023.
- ISS also clarified that if a company's Index membership or GICS classification has changed within the last three years, the burn rate benchmarks under the newer classification will apply.

Other Proxy Advisory Firm Takeaways

Each year, companies should consider whether to update the compensation benchmarking peers included in ISS' database. ISS uses these company-selected peers when it determines the peer group it will use for evaluating a company's compensation programs. This year, ISS will accept these updates from November 20, 2023, to December 5, 2023.²⁷

Prepare for 2024 Pay Ratio Disclosures

2024 marks the seventh year that SEC rules will require companies to disclose their pay ratios, which compare the annual total compensation of the median company employee to the annual total compensation of the CEO.²⁸ One key item companies must consider annually when preparing the mandatory pay ratio disclosures is whether the same median employee may be used again for the upcoming year, and, if not, what new factors to consider when identifying the median employee.

Determining Whether To Use the Same Median Employee

Under Regulation S-K Item 402(u), a company only needs to perform median employee calculations once every three years, unless it had a change in the employee population or compensation arrangements that could significantly affect the pay ratio. This requires companies to assess annually whether their workforce compositions or compensation arrangements have materially changed.

²⁷ See ISS' "Company Peer Group Feedback" (2023).

²⁸ Emerging growth companies, smaller reporting companies and foreign private issuers are exempt from the pay ratio disclosure requirement. Transition periods are also available for newly public companies.

²⁶ ISS lists the burn rate benchmarks applicable for meetings on or after February 1, 2023, in the Appendix section of its FAQ; see *id.*

When selecting a median employee for pay ratio disclosures about compensation in fiscal year 2023, companies should consider the following:

- If a company has been using the same median employee for three years, the company will need to perform median employee calculations for fiscal year 2023.
- Other companies that were originally planning to feature the same median employee as last year should not do so if their employee populations or employee compensation arrangements significantly changed in the past year.
- Companies should carefully consider how to incorporate furloughed employees, if applicable, in the median employee pool.²⁹
- Companies should consider how headcount changes may impact their abilities to exclude certain non-U.S. employees from their pay ratio calculations under the commonly relied upon de minimis exception in Item 402(u)(4)(ii): Companies should evaluate whether non-U.S. employees in the aggregate and by jurisdiction, newly constitute or no longer constitute more than 5% of the company's total employees.
- If a company's non-U.S. employees account for 5% or less of its total employees, the company may either exclude all non-U.S. employees or include all non-U.S. employees when identifying its median employee.
- Alternatively, if over 5% of a company's total employees are non-U.S. employees, the company may exclude up to 5% of its total employees who are non-U.S. employees; provided that the company excludes all non-U.S. employees in a particular jurisdiction if it excludes any employees in that jurisdiction, and employees excluded under Item 402(u)'s data privacy exception count toward this limit.
- Non-U.S. jurisdictions with employees that exceed 5% of a company's total employees may not be excluded from the pay ratio calculation under the de minimis exception, although they may be permitted to be excluded under the data privacy exception.

Even if a company uses the same median employee in its proxy statement filed in 2024 as the company used in 2023, it must disclose that it is using the same median employee and briefly describe the basis for its reasonable belief that no change occurred that would significantly affect the pay ratio.

²⁹For information on how to incorporate furloughed employees into pay ratio calculations, see the section titled "Incorporate Lessons Learned From the 2020 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2021 Pay Ratio Disclosures — Prepare for 2021 Pay Ratio Disclosures" in our December 14, 2020, publication "Matters To Consider for the 2021 Annual Meeting and Reporting Season."

To determine whether a material change occurred, companies should continue to evaluate the following factors:

- How has workforce composition evolved over the past year?
 - Review hiring, retention and promotion rates.
 - Consider the applicability of exceptions under the pay ratio rules:
 - Determine whether to incorporate employees from recent acquisitions or business combinations into the consistently applied compensation measure (CACM). For example, for the fiscal year in which a business combination or acquisition becomes effective, a company may exclude individuals that become its employees as the result of the business combination or acquisition, as long as the company discloses the approximate number of employees it is omitting and identifies the acquired business it is excluding.
 - Determine whether the de minimis exception applies within the context of the company's 2023 workforce composition. As described above, under this exception, non-U.S. employees may be disregarded if the excluded employees account for less than 5% of the company's total employees or if a country's data privacy laws make a company's reasonable efforts insufficient to comply with Item 402(u).
 - Analyze how the workforce used for the CACM is distributed across the pay scale and how the distribution has changed since last year.
 - How have compensation policies changed in the past year compared to the workforce composition? For example, an across-the-board bonus that benefits all employees may not materially change the pay ratio, while material special commissions limited to a company's sales team could do so.
 - Have the median employee's circumstances changed since last year? Consider changes to the employee's title and job responsibilities alongside any changes to the structure and amount of the employee's compensation, factoring in the company's broader workforce composition. Additionally, if the median employee's employment was terminated, companies must identify a new median employee.

Although the SEC provides companies with substantial flexibility in calculating their pay ratios, to satisfy the SEC staff and engage with investors, employees and other stakeholders, companies should continue to diligently document and disclose their pay ratio methodology, analyses and rationale.

Plan for the Second Year of Pay-Versus-Performance Disclosures

In August 2022, the SEC adopted final rules requiring public companies to disclose the relationship between the executive compensation actually paid to the company's NEOs and the company's financial performance. Companies were required to incorporate these items into proxy or information statements that include executive compensation disclosure for fiscal years ending on or after December 16, 2022, meaning that calendar-year companies needed to include this disclosure for the first time in their proxy statements filed in 2023. Companies should now prepare for the second year of PvP disclosure by drawing on lessons learned during the 2023 proxy season.

Overview

Item 402(v) of Regulation S-K contains the PvP disclosure requirements, which consist of three key components: (i) a PvP table that includes metrics from the previous five fiscal years such as CEO and NEO "compensation actually paid" (CAP), cumulative total shareholder return (TSR) for the company and its peer groups, financial performance measures and the company's net income; (ii) a tabular list of important financial measures that the company selected to link CAP to the performance metrics; and (iii) a description of the relationship between CAP and the company's performance metrics.

Specifically, the PvP table requires disclosure of:

- The total compensation of the CEO and the average total compensation of the other NEOs, using the information required to be reported in the Summary Compensation Table.
- The compensation "actually paid" to the CEO and the average total compensation "actually paid" to the other NEOs, calculated in accordance with Item 402(v), along with footnote disclosure of any amounts deducted and added to total compensation of the NEOs to determine the amount of compensation "actually paid."
- The TSR of both the company and its peer group.
- The company's net income (under GAAP).
- A financial performance measure selected by the company that in the company's assessment represents the single most important financial measure that it used for the most recent fiscal year to link the company's performance to compensation actually paid to the company's NEOs.

Listing of Important Financial Measures: Companies also must provide an unranked tabular list of at least three and up to seven financial performance measures (the "tabular list") that in each company's assessment represent the most important financial performance measures the company used for the most recent fiscal year to link CAP for the company's CEO and other NEOs to the

company's performance. A company may include nonfinancial performance measures in this list if those measures are among the most important performance measures used by the company to link CAP to performance and the company has disclosed at least three financial performance measures (or fewer, if the company uses fewer than three).

Description of the Relationship Between Pay Versus Performance:

Using values reflected in the PvP table, a company is required to describe: (i) the relationship between (a) the CAP to the CEO and the average total CAP to the other NEOs and (b) the company's TSR, its net income and the company-selected measure (CSM); (ii) how the company's TSR relates to the TSR of its peer group; and (iii) the relationship between (a) the CAP to the CEO and the average total CAP to the other NEOs and (b) any supplemental measures voluntarily included in the PvP table. Companies can describe these relationships either through a narrative discussion, a graphical presentation or a combination of both.

Supplemental Disclosures

A company may supplement the disclosure by providing PvP disclosure (in tabular format or otherwise) based on other compensation measures such as "realized pay" or "realizable pay" if the company believes such supplemental disclosures provide useful information about the relationship between the compensation paid and the company's financial performance. The supplemental disclosure, however, may not be misleading or presented more prominently than the required PvP disclosure. In practice, such supplemental disclosures were not common in the first year of PvP disclosure.

Covered Issuers

- All reporting companies that file proxies or information statements that require executive compensation disclosure are required to comply with this rule.
- Smaller reporting companies are subject to scaled disclosure requirements, including a three-year period subject to a phase-in period for the first applicable filing in which disclosure for only the two most recently completed fiscal years is required. Smaller reporting companies are not required to provide the peer group TSR or a CSM in the PvP table, or include a tabular list.
- Emerging growth companies (EGCs), foreign private issuers and registered investment companies (other than business development companies) are entirely exempt from the disclosure requirements.
- A newly public company is required to include PvP disclosure only for the years in which the company was a reporting company pursuant to Section 13(a) or Section 15(d) of the Exchange Act.

Time Period

Companies are required to disclose the applicable information for their five most recently completed fiscal years (with three years required in the first year of PvP disclosure, and adding another year of disclosure in each of the two subsequent annual filings). Therefore, in 2024, calendar-year public companies will generally include data for four fiscal years in their PvP tables.

Applicable Filings

- The PvP disclosure is required in any proxy or information statement that is required to include executive compensation disclosure, including those regarding the election of directors.
- The disclosure is not required in annual reports on Form 10-K, Securities Act registration statements or Exchange Act registration statements (e.g., registration statements on Form S-1 for IPO companies).

PvP Lessons Learned From the 2023 Proxy Season

In 2023, the SEC released three sets of Compliance & Disclosure Interpretations relating to the PvP disclosure rules. These C&DIs provide helpful clarification and additional guidance.³⁰

- Prior-year equity awards granted to a first-time NEO must be included in CAP adjustments.
- Disclosure of CAP adjustments on an aggregate basis is not permitted.
- Footnote disclosure of CAP adjustments generally is required only for the most recent fiscal year, except for first-time PvP disclosure, or if it is material to an investor's understanding of the information reported in the PvP table for the most recent fiscal year.
- If an award provides for retirement eligibility as the sole vesting condition, then this condition would be considered satisfied (*i.e.*, the award would be counted as vested) for calculation of CAP in the year that the holder becomes retirement eligible. However, if retirement eligibility is not the sole vesting condition, other substantive conditions must also be considered in determining when an award has vested. Examples of such substantive conditions include market conditions or a condition that results in vesting upon the earlier of the holder's actual retirement or the satisfaction of the required period of service.

- Notably, a September 2023 CD&I suggested that time-based awards that vest upon retirement should be counted as vested upon a holder's attainment of retirement eligibility for purposes of calculating CAP, but a November 2023 C&DI appeared to reverse that position, so that unvested time-based awards that vest upon retirement should be counted as "unvested" until the time-based condition is satisfied or a holder's retirement actually occurs.

Identifying Peer Groups

- Companies may use the peer groups that they disclose in the Compensation Discussion and Analysis (CD&A) portion of their proxy statements as long as such peer groups were, even without formal benchmarking, "actually used to help determine executive pay."
- If a company uses the same peer group in its CD&A for 2020 and 2021 but uses a different CD&A peer group for 2022, then the company should present the peer group TSR for each year in the PvP table using the peer group disclosed in the CD&A for the corresponding year.
- If a company uses more than one published industry or line-of-business index for purposes of Item 201(e)(1)(ii) (*i.e.*, its Form 10-K peer group), the company may choose which index to use for PvP disclosure and should footnote disclosure of the chosen index.
- Companies may not use a broad-based equity index as a peer group.
- The market capitalization-based weighting required under Item 402(v)(2)(iv) only applies when the company is not using a published line of business or industry as its peer group.
- If a company that uses a peer group other than a published industry or line-of-business index adds or removes companies in the peer group, the company is required to footnote the changes and compare its cumulative TSR against both the updated peer group and the peer group used in the immediately preceding fiscal year.
 - Such comparison is not required if:
 - An entity is omitted solely due to no longer being in the same line of business or industry.
 - The changes in the composition of the peer index/group occur per preestablished objective criteria.
- The description of, and bases for, the change must still be disclosed, including the names of the companies deleted from the new index/peer group.

³⁰See our February 28, 2023, client alert "[SEC Guidance Clarifies Some Issues Regarding Pay-Versus-Performance Disclosure, but Leaves Questions Unanswered](#)"; September 29, 2023, client alert "[SEC Staff Issues Additional Pay-Versus-Performance Compliance & Disclosure Interpretations](#)"; and November 27, 2023, client alert "[SEC Staff Issues New and Revised Pay-Versus-Performance Compliance & Disclosure Interpretations](#)."

Identifying the CSM

- A CSM may be derived from or similar to net income or company TSR.
- Multiyear measurement periods are not permitted for the CSM. The use of a company's stock price as its CSM is limited: The company may not use its stock price as the CSM if the company did not use that price to directly link CAP to performance during the most recent fiscal year. However, stock price may be used as the CSM if, for example, the company's stock price is a market condition applicable to a performance-based equity award that was outstanding during the most recent fiscal year, or the stock price is used to determine the size of a bonus pool for the most recent fiscal year.
- A company may use its CSM as the financial performance measure used to determine a bonus pool.

Additional Guidance

- Companies may aggregate multiple overlapping principal executive officers for purposes of the relationship disclosure, to the extent the presentation will not be misleading to investors.
- When multiple individuals served as the principal financial officer during a single covered fiscal year, they are counted separately for purposes of calculating the average compensation amounts paid to NEOs (excluding the principal executive officer).
- A company may include the required GAAP reconciliation and other information in an annex to the proxy statement, provided the company includes a prominent cross-reference to such annex. Or, if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporating by reference the proxy statement's Item 402 disclosure as part of its Part III information, the company may comply with Regulation G and Item 10(e) by providing a prominent cross-reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information.
- Awards granted in fiscal years prior to an equity restructuring, such as a spin-off, that are retained by the holder must be included in the calculation of CAP.
- For outstanding stock awards and option awards, the calculations required by Item 402(v)(2)(iii)(C)(1) of Regulation S-K should be determined based on the change in fair value from the end of the prior fiscal year. The fair value of these awards should not be determined based on other dates, such as the date of the company's initial public offering.
- Market conditions should be considered in determining whether the vesting conditions of share-based awards have been met (*i.e.*, until the market condition is satisfied, companies must include in CAP any changes in fair value of any

awards subject to market conditions). Similarly, companies must deduct the amount of the fair value at the end of the prior fiscal year for awards that fail to meet the market condition during the covered fiscal year if that failure results in forfeiture of the award.

- Awards that remain outstanding and have not yet vested, because, for example, performance or market conditions were not met in an eligible year, are not considered to have failed to meet the applicable vesting conditions for the purpose of Item 402(v)(2)(iii)(C)(1)(v).
- If an award with a performance condition requires certification by others (such as the compensation committee) that the level of performance was attained, then whether or not the award is considered vested if certification occurs after year-end depends on whether the certification is considered an additional substantive vesting condition (for example, where an employee does not vest in the award unless and until the employee remains employed through the date such certification occurs).
- Companies may use a valuation technique that differs from the one used to determine the grant date fair value of option or other equity-based awards that are classified as equity in the financial statements as long as the valuation technique would be permitted under the Accounting Standards Codification (ASC) of the Financial Accounting Standards Board (FASB) (Topic 718), including that the method meets the criteria for a valuation technique and the fair-value measurement objective. If the technique differs materially, then disclosure about the change in valuation technique from the grant date and the reason for the change is required.
- The fair value of stock awards and option awards must be computed using a methodology and assumptions consistent with FASB ASC Topic 718, and it is never acceptable to value awards as of the end of a covered fiscal year based on methods not prescribed by GAAP.
- A company is not required to disclose detailed quantitative or qualitative performance conditions for its awards under Item 402(v)(4) (*i.e.*, footnote disclosure of assumptions made in the valuation that differs materially from those disclosed as of the grant date of such equity award) to the extent such information would be subject to the confidentiality protections of Instruction 4 to Item 402(b) of Regulation S-K. However, the company must provide as much information responsive to the Item 402(v)(4) requirement as possible without disclosing the confidential information, such as a range of outcomes or discussion of how a performance condition impacted the awards' fair value. The company should also discuss how the material difference in the assumptions affects how difficult it will be for the executive or how likely it will be for the company to achieve undisclosed target levels or other factors.

- Dividends (including dividend equivalents) not already reflected in the fair value of stock awards or included in another component of total compensation must be included in the CAP calculation.

Transitional Relief

- The SEC will not object if a company that loses its classification as a smaller reporting company as of January 1, 2024, continues to include scaled disclosure under Item 402(v)(8) in its definitive information or proxy statement filed within 120 days after its 2023 fiscal year-end from which the company's Form 10-K will forward incorporate the disclosure required by Part III of Form 10-K. The PvP disclosure must cover fiscal years 2021, 2022 and 2023.
- If a company loses its emerging growth company status, for example, as of December 31, 2024, the company will be required to provide PvP disclosure in its proxy statement filed in 2025. However, any such initial PvP disclosure may be provided for three years instead of five, with one additional year added in each of the two subsequent annual filings (*i.e.*, the company may take advantage of the transitional relief provided by Instruction 1 to Item 402(v)).

Disclosure Errors

SEC comment letters released in 2023 revealed the following key common mistakes in initial PvP disclosures:

- Failing to describe the relationship between (a) CAP and (b) TSR, net income and the CSM.
- Failing to include the tabular list.
- Including multiple CSMs or failing to include the CSM in the tabular list.
- Failing to provide a GAAP reconciliation for non-GAAP CSMs.
- Using a TSR peer group that does not match either the industry group in the company's 10-K performance graph or the compensation peer group disclosed in the CD&A.
- Failing to include or identify all NEOs who served each year.
- Using partial-year compensation (*e.g.*, only including compensation for the time served as an NEO during a given year).
- Valuing awards that vest during the year based on a year-over-year change, rather than valuing them as of the date of vesting.

Preparing for 2024 PvP Disclosure

In addition to reviewing the company's approach to PvP disclosure in the prior year and SEC guidance and comment letters released in 2023, a company should generally consider the following as it prepares for the second year of PvP disclosure:

- Companies will need to include four years of data in their PvP tables (including the three years previously disclosed and data for the most recently completed fiscal year).
- Based on newly released guidance (as described above), a company should review any applicable equity award agreements with retirement vesting language to ensure whether any changes to the CAP amounts disclosed last year in the PvP table may be necessary, and to confirm that the upcoming PvP disclosure appropriately reflects CAP adjustments for equity awards with retirement vesting conditions.
- A company should update its CSM as needed by evaluating the single most important financial performance measure (not otherwise included in the table) that the company used in the most recently completed fiscal year to link CAP to the company's performance.
- A company should consider its tabular list of financial performance measures and update as needed to reflect the most important financial measures (including the CSM) the company used for the most recent fiscal year to link CAP to company performance.
- If a company will use a different peer group in its second-year PvP disclosure, the company must explain the reason for the change in a footnote and provide comparison information with respect to both the old and the new peer groups.
- Footnote disclosure of CAP adjustments will only be required for the most recent fiscal year (if the company included CAP adjustments for three years in its first-year disclosure).

Implement Clawback Policy and Comply With Clawback Policy Listing Standards

With the December 1, 2023, deadline for listed companies to adopt Dodd-Frank Act-compliant clawback policies in the rearview mirror, many compensation committee members have checked "adopt a Dodd-Frank Act-compliant clawback policy" off their to-do lists and are breathing a collective sigh of relief. However, now is not the time to forget about the clawback policy until an event triggers its application. Instead, listed companies should factor the clawback action items below into their agendas.

Background

Most listed companies have adopted clawback policies that meet the stock exchanges' new listing standards issued in response to the SEC's final rules implementing the incentive-based compensation recovery (clawback) provisions of the Dodd-Frank Act.³¹

³¹ See the SEC's final [Listing Standards for Recovery of Erroneously Awarded Compensation](#) (Oct. 26, 2022) and press release "[SEC Adopts Compensation Recovery Listing Standards and Disclosure Rules](#)" (Oct. 26, 2022).

The final SEC rules, which were adopted on October 26, 2022, directed the stock exchanges to establish listing standards requiring companies to develop and implement policies providing for the recovery of erroneously awarded incentive-based compensation received by current or former executive officers (as defined under Rule 16a-1(f) under Section 16 of the Securities Exchange Act of 1934 (Exchange Act)) and to satisfy related disclosure obligations, even if there was no misconduct or failure of oversight on the part of an individual executive officer.³² The Dodd-Frank Act's clawback rules, together with the final SEC clawback rules and the stock exchanges' compensation recovery policy listing standards, are referred to collectively herein as "the Dodd-Frank clawback rules."

Listed companies have a range of clawback policies in practice, from garden-variety Dodd-Frank Act-compliant policies to policies that permit recovery in circumstances absent an accounting restatement. Unless otherwise noted, the term "clawback policy" in this section refers to a Dodd-Frank Act-compliant policy.

Short-Term Action Items

- **Confirm clawback policy adoption on the New York Stock Exchange's Listing Manager, if applicable.** Companies listed on the New York Stock Exchange are required to confirm, via Listing Manager, either (i) their adoption of a clawback policy by December 1, 2023, or (ii) their reliance on an applicable exemption.
 - **File the clawback policy as an annual report exhibit and ensure the annual report cover page is updated.** The Dodd-Frank clawback rules require listed companies to file their clawback policies as exhibits to their annual reports on Form 10-K, 20-F or 40-F, as applicable. Companies can also consider whether to voluntarily file any stand-alone supplemental clawback policies that exceed the Dodd-Frank clawback rules' requirements.
- Additionally, listed companies should indicate by checkboxes on the cover pages of their annual reports whether the financial statements included in the filings reflect a correction of an error to previously issued financial statements and whether any of those error corrections are restatements requiring a recovery analysis of incentive-based compensation under their clawback policies. The new disclosure on the cover page of the Form 10-K, 20-F or 40-F must be tagged in interactive block text tag format using eXtensible Business Reporting Language (XBRL).
- **Obtain written acknowledgement of the clawback policy from executive officers, to the extent not previously obtained.** While executive officers at listed companies will be subject to their company's clawback policy regardless of whether they

acknowledge and agree in writing to be bound by the policy, obtaining each executive officer's written acknowledgement that they knowingly, voluntarily and irrevocably consent to the clawback policy is a best practice to raise executive officer awareness of the policy, mitigate litigation risk and position the company to promptly recover compensation from executive officers, should the need arise. Such written acknowledgement often takes the form of a stand-alone clawback policy acknowledgement form. Alternatively or as a supplement to a stand-alone clawback policy acknowledgement form, companies may feature a clawback policy acknowledgement provision in compensatory agreements, such as equity award agreements, bonus agreements, employment agreements or offer letters.

Medium-Term Action Items

- **Determine which executive officer compensation is incentive-based compensation.** The Dodd-Frank clawback rules apply to "incentive-based compensation," which is "any compensation that is granted, earned, or vested based wholly or in part upon the attainment of any financial reporting measure."³³ Before an accounting restatement clouds the horizon, listed companies would be wise to reflect on which of their executive officer compensation arrangements are incentive-based compensation.
 - Certainly, annual performance-based bonuses set based on achievement of financial reporting measures fall into this category, as do many equity awards that vest based on achievement of performance conditions, such as performance-based restricted stock units that vest based on financial reporting measures such as total stockholder return (TSR). However, other types of executive officer compensation may feature incentive-based compensation more implicitly as an underlying variable, leading aspects of the it to be incentive-based compensation. For example, if a company's executive officer severance plan provides a pro rata bonus for the year of termination of employment that is paid based on actual company performance which is payable when bonuses are normally paid to actively employed executives, that element of severance could potentially be recoverable as erroneously awarded incentive-based compensation.
 - For companies that have a variety of *ad hoc* compensation arrangements with their executive officers, the importance of taking inventory of which arrangements would be incentive-based compensation is heightened. Such preparation can be crucial to positioning companies with complex and varying compensation arrangements to meet the requirement of recovering erroneously award incentive-based compensation "reasonably promptly" if their clawback policies are triggered.

³²For a review of the Dodd-Frank Act clawback rules and related disclosure requirements, see our November 2, 2022, client alert "[SEC Adopts Final Clawback Rules and Disclosure Requirements](#)" and our June 16, 2023, client alert "[SEC Approves Stock Exchange Rules for Dodd-Frank Clawbacks](#)."

³³See the SEC's final [Listing Standards for Recovery of Erroneously Awarded Compensation](#) (Oct. 26, 2022).

- Taken together with proxy statement reporting requirements and the challenges of administering executive compensation programs with many *ad hoc* executive compensation arrangements, the Dodd-Frank clawback rules offer one more compelling reason to simplify and standardize a company's executive compensation program.
- **Reflect on the rationale for and documentation of forms of executive compensation.** Considering the "incentive-based compensation" definition in the context of the SEC's final clawback rule confirms that time-based equity awards, bonuses and other forms of compensation that do not contain performance metrics can fall into the category of "incentive-based compensation" if they are granted in consideration of attainment of a past financial reporting measure. For example, if, in recognition of outstanding revenue performance during 2023, a company granted cash bonuses in 2024 that vest solely based on time-vesting criteria over the next three years, those bonuses would be incentive-based compensation. Therefore, companies should be aware that if they are documenting the rationale for executive compensation as based on prior financial reporting measure performance (whether implicitly or explicitly) in compensation committee resolutions, the Compensation Discussion & Analysis sections of their proxy statements, their executive offer letters or otherwise, that rationale could bring compensation under the umbrella of incentive-based compensation that would have otherwise been excluded from clawback policies, and that could meaningfully increase the scope of recoverable compensation if a clawback policy is triggered.
- **Reinforce the importance of an open line of communication between your accounting, finance, HR and legal functions.** If an accounting restatement occurs, various functions, such as accounting, finance, HR and legal, along with the company's audit committee and compensation committee, will need to work hand-in-hand to determine whether, and the extent to which, the accounting restatement triggers application of the clawback policy and the process for compensation recovery, if applicable.

Clawback policies are typically thought to fall in the realm of the HR and legal functions, but accounting and finance functions play crucial roles in identifying whether an event has occurred that has triggered the application of the clawback policy and how much compensation to recover. These functions should be made aware that an accounting restatement could trigger application of the clawback policy and that they have the obligation to alert the other functions if an accounting restatement due to the listed company's material noncompliance with any financial reporting requirement under the securities laws has occurred. In short, companies should ensure that their accounting, finance, HR and legal functions are all knowledgeable about their clawback policy's requirements and that they are aware of their interdependencies if an accounting restatement occurs.

Long-Term/As-Needed Action Items

- **If stock price or TSR is an input to incentive-based compensation, consider which advisor(s) to engage.** The Dodd-Frank clawback rules do not prescribe how to determine the amount of incentive-based compensation to recover if the underlying financial performance metric is stock price or TSR. Determining how an accounting restatement impacts stock price and TSR may entail technical expertise, specialized knowledge and significant assumptions. Moreover, under Item 402(1)(i)(C) of Regulation S-K, if recovery was triggered under the clawback policy for a given fiscal year, the company would be required to disclose an explanation of the methodology it used to determine how much incentive-based compensation related to stock price or TSR to recover, and the company must maintain and provide documentation of the determination in accordance with the listing standard.

Given the complexity of the analysis and that aspects of the analysis will be disclosed externally, companies that have incentive-based compensation tied to stock price or TSR that experience an accounting restatement triggering the clawback policy should consider engaging a third-party valuation expert to assist.

- **Determine the means of recovering erroneously awarded incentive-based compensation.** Once erroneously awarded incentive-based compensation has been quantified, companies will need to assess how they intend to recover it, such as the means and timing of recovery, as well as how they plan to communicate any repayment obligation to their executive officers. Listed companies should keep in mind that certain states, such as California, have laws that generally prohibit the recovery of wages that have already been paid.³⁴ While the Dodd-Frank clawback rules are currently expected to preempt conflicting state law, litigation activity in the coming years may definitively confirm whether the Dodd-Frank clawback rules preempt state law and indicate which means of recovery mitigate legal risk.
- **If the clawback policy is triggered, consider the tax consequences to the company and executive officers.** The Dodd-Frank clawback rules require recovery of erroneously awarded incentive-based compensation on a pre-tax basis. Therefore, if its clawback policy is triggered, a company will need to carefully assess how much of that compensation is or was properly deductible, and may be required to refund the Internal Revenue Service for deductions taken in previous years. Similarly, executive officers should work closely with tax advisors to determine how their taxes are impacted by the clawback policy's application, including whether any offset is available under Section 1341 of the Internal Revenue Code of 1986 or otherwise, especially to the extent that the offset relates to erroneously awarded incentive-based compensation that was paid in a prior tax year.

³⁴See California Labor Code § 221.

The final SEC rules noted “that the extent to which a tax system allows current adjustments for tax paid in prior periods under assumptions that later prove incorrect is a matter of tax policy outside the scope of this rulemaking . . . [but in] any event, we believe any resulting tax burden should be borne by executive officers, not the issuer and its shareholders.”³⁵ Open questions concerning how compensation recovered under clawback policies should be taxed are expected to be answered in the coming years as companies begin implementing their clawback policies.

- **Disclose how the clawback policy has been applied during or after the last completed fiscal year.** The following disclosure requirements generally apply under Item 402(w) of Regulation S-K (or analogous disclosure provisions in the forms applicable to foreign private issuers and listed funds), and the disclosure must be tagged in XBRL. Such disclosure applies in proxy or information statements that call for Item 402 disclosure or the listed company’s annual report on Form 10–K (if not incorporated by reference from the proxy statement):

- If during or after the last completed fiscal year the listed company was required to prepare a restatement that required recovery of erroneously awarded incentive-based compensation under the company’s clawback policy, or there was an outstanding balance as of fiscal year-end of erroneously awarded incentive-based compensation to be recovered from a previous application of the policy, the listed company is required to disclose:
 - The date it was required to prepare the restatement.
 - The aggregate dollar amount of erroneously awarded incentive-based compensation, including an analysis of how the amount was calculated (with enhanced disclosure if the financial reporting measure related to stock price or TSR).
 - The aggregate dollar amount of erroneously awarded incentive-based compensation that remains outstanding at the end of the last completed fiscal year; provided that alternative disclosure would be required if the aggregate dollar amount of erroneously awarded incentive-based compensation had not yet been determined.
- If recovery would be impracticable in accordance with the narrow exceptions in the Dodd-Frank clawback rules, companies are required to briefly disclose why recovery was not pursued and the amount of recovery foregone for each current and former named executive officer and for all other current and former executive officers as a group.
- For each current and former named executive officer from whom, as of the end of the last completed fiscal year, erroneously awarded incentive-based compensation had been

outstanding for 180 days or longer since the date the listed company determined the amount owed, the dollar amount of outstanding erroneously awarded incentive-based compensation due from each such individual should be disclosed.

- If the company was required to prepare a restatement during or after its last completed fiscal year and concluded that recovery of erroneously awarded incentive-based compensation was not required under the clawback policy, the company is required to briefly disclose the reasoning behind that conclusion.
- Any recoupment of compensation must be reflected in the Summary Compensation Table by subtracting the amount recovered from the amounts reported in that table for that year and quantifying the amount recovered in a footnote.
- **Consider whether to amend or supplement the clawback policy.** Compensation committees (or boards of directors, if applicable) should consider at least annually whether the clawback policy should be updated in response to proxy advisory firm guidance, other clawback rules and other factors that arise in the coming years as the Dodd-Frank clawback rules are implemented.
 - For example, Glass Lewis’ United States 2024 Benchmark Policy Guidelines published in November 2023 expressed a strong preference for clawback policies that permit recovery in circumstances that extend beyond the Dodd-Frank clawback rules’ requirements. Specifically, Glass Lewis stated that recovery policies should permit companies to recover variable incentive payments (whether time-based or performance-based) “when there is evidence of problematic decisions or actions, such as material misconduct, a material reputational failure, material risk management failure, or a material operational failure, the consequences of which have not already been reflected in incentive payments and where recovery is warranted” and regardless of whether the executive officer was terminated with or without cause.³⁶
 - Glass Lewis also expects robust disclosure about a company’s decision not to pursue recovery under a clawback policy, and, if applicable, how the company has corrected the disconnect between executive pay outcomes and negative impacts of their actions on the company.³⁷ The absence of such enhanced disclosure could affect Glass Lewis’ overall say-on-pay recommendation.³⁸
 - Similarly, ISS only awards equity plan scorecard points for the clawback policy factor if a company’s clawback policy authorizes recovery upon a financial restatement of all or most equity based compensation for named executive officers,

³⁵See the SEC’s final [Listing Standards for Recovery of Erroneously Awarded Compensation](#) (Oct. 26, 2022), p. 78.

³⁶See Glass Lewis [2024 Benchmark Policy Guidelines — United States](#) (Nov. 16, 2023), p. 62.

³⁷See *id.*

³⁸See *id.*

including time-based and performance-based equity awards.³⁹ ISS' explicit inclusion of time-based awards extends beyond the Dodd-Frank clawback rules' requirements.

- The impact of the U.S. Department of Justice's Criminal Division's three-year Pilot Program Regarding Compensation Incentives and Clawbacks (Pilot Program) remains to be seen. Under the Pilot Program, where a criminal resolution is warranted, public and private companies may qualify for reduced fines if they have implemented a compensation recovery program that permits recovery from employees who engaged in misconduct in connection with the conduct under investigation, or others who both had supervisory authority and knew of, or were willfully blind to, the misconduct.⁴⁰
- Chief executive officers (CEOs) and chief financial officers (CFOs) remain subject to the clawback provisions of the Sarbanes-Oxley Act of 2002 (SOX), which provide that if a company is required to prepare an accounting restatement because of "misconduct," the CEO and CFO are required to reimburse the company for any incentive or equity-based compensation and profits from selling company securities received during the year following issuance of the inaccurate financial statements. If the Dodd-Frank clawback policy and SOX cover the same recoverable compensation, the CEO or CFO are not subject to duplicative reimbursement. Recovery under the Dodd-Frank clawback will not preclude recovery under SOX to the extent any applicable amounts have not been reimbursed to the listed company.

While 2023 was the year of clawback policy adoption, 2024 will be the year of clawback policy implementation. As clawback policies are implemented, prevailing recoupment practices and answers to open questions about the Dodd-Frank clawback rules are expected to emerge, shaping companies' approaches to implementing their clawback policies.

Prepare for New Option Grant Practice Disclosures

On December 14, 2022, the SEC adopted a new disclosure requirement under Regulation S-K Item 402(x). Under new Regulation S-K Item 402(x), issuers (including smaller reporting companies and EGCs) will be required to disclose on Form 10-K or in the annual meeting proxy statement the issuer's policies and practices regarding the timing of awards of options in relation to the disclosure of material nonpublic information. Issuers will need to discuss:

- How the timing of awards is decided.
- How material nonpublic information is considered, if at all, when determining the timing and terms of awards.
- Whether disclosure of material nonpublic information is timed to affect the value of such awards.

Issuers will also need to disclose in a new table any options granted in the last completed fiscal year to NEOs that were granted within four business days before or one business day after the (i) filing of a periodic report on Form 10-Q or 10-K, or (ii) filing or furnishing of a current report on Form 8-K that contains material nonpublic information (other than disclosure of a material new option award grant under Form 8-K Item 5.02(e)). The table should provide the following:

- Each award (including the grantee's name, the number of securities underlying the award, the date of the grant, the grant-date fair value and the option's exercise price).
- The percentage change in closing market price of the securities underlying each award on the trading day before and after disclosure of the material nonpublic information.

These disclosure requirements will be effective for the proxy filing that covers the first full fiscal year beginning on or after April 1, 2023 (or October 1, 2023, for smaller reporting companies).

This focus on equity grant timing includes an accounting aspect as well. In November 2022, the SEC issued Staff Accounting Bulletin No. 120 (SAB 120), which addresses how companies should recognize and disclose the cost of providing "spring-loaded" equity awards to executives for purposes of Accounting Standards Codification 718.

A "spring-loaded award" is one made prior to (and proximate to) the company's disclosure of positive and previously material nonpublic information. Under SAB 120, a company that grants an equity award while in possession of positive material nonpublic information should consider whether adjustments to the following are appropriate when determining the fair-value-based measure of the award for purposes of ASC 718:

- The current price of the underlying share; or
- The expected volatility of the price of the underlying share for the expected term of the share-based payment award. Significantly, SAB 120 applies to all equity awards and not just awards of options.

³⁹See ISS' [United States Equity Compensation Plans Frequently Asked Questions](#) (updated Dec. 11, 2023), p. 21.

⁴⁰See The Department of Justice's "[The Criminal Division's Pilot Program Regarding Compensation Incentives and Clawbacks](#)" (March 3, 2023).

Taken together, the new 402(x) disclosure requirements and SAB 120 indicate that committees should be aware of the timing of equity grants and the public disclosure context in which the grants are made. While focus most often falls on the interplay of grant timing and disclosure of material nonpublic information in the context of stock options and positive disclosure, a company that grants full-value awards that are sized based on a market value for the underlying shares — and makes such a grant in advance of the public announcement of material nonpublic information — should at a minimum have a record of considering whether those awards were sized appropriately given the potential impact of the announcement on the award value.

Whether companies will react to this focus by adopting policies of fixed timing of grants or through other means (such making grants only during open trading windows) remains to be seen. In anticipation of potential expanded scrutiny of the interplay between material nonpublic information and equity awards, some companies are also timing vesting and settlement of their equity awards to occur during open trading windows.

Evaluate Hart-Scott-Rodino Act Implications on Executive Compensation

Officers and directors who hold at least \$111.4 million⁴¹ in voting securities in their companies should consider the need to make Hart-Scott-Rodino (HSR) filings whenever they increase their holdings through an acquisition of voting securities. A company's annual preparation of its beneficial ownership table provides a regular opportunity to assess whether any of its officers or directors may be approaching an HSR filing threshold. HSR counsel can advise when exemptions are available to obviate the need to file notifications.

For HSR purposes, an “acquisition” is the receipt of new voting securities whether formally (technically) purchased or not. An acquisition is considered to occur only when the officer or director obtains beneficial ownership of the shares (*i.e.*, receives the present right to vote for the board of directors). Therefore, acquisitions may include, without limitation:

- Grants of fully vested shares as a component of compensation.
- The vesting or settlement of restricted stock units and performance-based restricted stock units.
- The exercise of stock options.
- Open market purchases of shares.
- The conversion of convertible nonvoting securities into voting shares.

⁴¹The HSR Act establishes a set of notification thresholds that are adjusted annually based on changes to the gross national product. The initial filing threshold for 2023 is \$111.4 million and new thresholds will be established in the first quarter of 2024.

However, an officer or director would not be deemed to “acquire” shares underlying restricted stock units or performance-based restricted stock units that have not vested or shares underlying stock options that have not yet been exercised.

Generally, an “acquisition” can trigger a filing obligation. For example, an annual grant of voting securities pursuant to an officer or director's long-term incentive plan can require HSR Act filings to be completed in advance of the grant, even if the value of the granted shares does not exceed a filing threshold and if the total percentage amount to be held after closing of the grant does not significantly increase the person's aggregate holdings.⁴² By contrast, a filing requirement is not triggered solely by an increase in the value of an officer's existing holdings from \$110 million to \$112 million, for example, as a result of share price appreciation. However, if such officer subsequently wanted to exercise a stock option to acquire more stock, an HSR obligation could be triggered because the value of the officer's current holdings already exceeds the filing threshold.

The need for a filing is triggered whenever — after the acquisition of voting securities — the aggregate value of an officer or director's holdings of voting securities in the company exceeds an HSR filing threshold (the lowest of which is currently \$111.4 million). Current holdings plus the proposed acquisition are considered to determine whether a threshold has been met or crossed.

There are also higher HSR reporting thresholds and, if an acquisition of voting securities causes an officer's or director's holdings to exceed those thresholds, additional notifications are required. The next two adjusted filing levels are currently \$222.7 million or higher and \$1.1137 billion or higher.⁴³

If an HSR filing is required, both the individual and the company would need to make a filing and wait 30 days before completing the triggering acquisition. The filer has one year from the time of clearance to cross the applicable acquisition threshold and may make additional acquisitions for five years after the end of the waiting period with no further HSR filings, provided that the filer does not acquire sufficient shares to cross the next HSR threshold above the level for which the notification was filed.

⁴²Note that an increase in a shareholder's voting power (*i.e.*, holding or acquiring voting securities that provide more than one vote per share) can trigger an HSR reporting obligation, even if new shares are not technically received. This can happen when there is a change in the voting power of a class of securities that are already held by an officer or director. HSR counsel can analyze the impact of this type of change on the filing requirements.

⁴³See the Federal Trade Commission's [HSR Threshold Adjustments and Reportability for 2023](#) (Feb. 16, 2023) for all current notification thresholds.

The Federal Trade Commission and the Department of Justice have historically followed an informal “one free bite at the apple” enforcement practice in response to certain missed HSR filings, meaning that, if an officer or director inadvertently fails to make a required HSR filing, that person should notify the agencies and submit a corrective filing detailing his or her previous acquisitions and explaining the missed filing and how he or she plans to track and meet filing obligations in the future. This one “free bite” may address all prior missed filings that occurred before the corrective filing.

However, the Federal Trade Commission and the Department of Justice have otherwise pursued enforcement actions and may

impose material civil penalties of up to \$50,120 per day⁴⁴ for each day of noncompliance if an executive officer or director subsequently fails to make a required HSR filing, even if such failure was truly inadvertent.⁴⁵ Therefore, officers and directors who have made corrective filings should be especially vigilant and consult HSR counsel regularly before a potential “acquisition” event is expected to occur.

⁴⁴The HSR civil penalty amount is adjusted by the Federal Trade Commission each January based on the percentage change in the consumer price index. The maximum civil penalty for an HSR violation in 2023 is \$50,120 per day, and the new maximum will be established in January 2024.

⁴⁵See the Federal Trade Commission’s press releases “[FTC Fines Capital One CEO Richard Fairbank for Repeatedly Violating Antitrust Laws](#)” (Sept. 2, 2021) and “[FTC Fines Clarence L. Werner, Founder of the Truckload Carrier Werner Enterprises, Inc. for Repeatedly Violating Antitrust Laws](#)” (Dec. 22, 2021).

Annual Meeting and Corporate Governance Trends

Consider Amending Governance Documents To Provide for Officer Exculpation

In August of 2022, Section 102(b)(7) of the Delaware General Corporation Law (DGCL) was amended to permit Delaware corporations to exculpate certain senior officers to provide them with protection from liability for monetary damages in a manner similar to the protections that have long been available for directors under the DGCL.

To take advantage of the new protection afforded by the amendments, Delaware corporations must “opt in” by including an officer exculpation clause in their certificates of incorporation. For existing corporations, this means that they must adopt an amendment to their certificates of incorporation. Subject to limited exceptions, under Section 242(b) of the DGCL, amendments require an affirmative vote of a majority of outstanding stock entitled to vote on the proposed amendment (unless a greater number of votes, or approval by holders of any separate class or series of stock, is required to adopt such amendment to the corporation’s certificate of incorporation pursuant to the terms thereof or the DGCL).

Heading into the 2023 proxy season, it was unclear how many Delaware corporations would seek to take advantage of this new officer exculpation provision and, if so, whether their stockholders and proxy advisory firms would support the proposed amendments. To date, nearly 300 publicly traded Delaware corporations proposed amendments to their certificates of incorporation to provide for officer exculpation for approval at their 2023 annual meetings, and approximately 80% received stockholder approval.

Proxy advisory firms were mixed in their support of proposals to adopt officer exculpation amendments.

- ISS adopted a policy of making recommendations on a case-by-case basis, but generally recommended stockholders vote “For” proposals to adopt officer exculpation (absent other factors, such as the impact of the proposal on stockholder rights when it was “bundled” with other proposals that affected such rights, which would warrant stricter scrutiny from ISS).
- Glass Lewis also indicated it would evaluate officer exculpation proposals on a case-by-case basis, but took the position of “generally recommend[ing] a vote against . . . unless compelling rationale for the adoption is provided by the board, and the provisions are reasonable.” Nevertheless, Glass Lewis’ policy did not appear to meaningfully impact overall votes, with the market and stockholders being overwhelmingly receptive to officer exculpation amendment proposals.

Heading into the 2024 proxy season, Delaware corporations considering officer exculpation amendments should be encouraged by the results from 2023. Despite the overall success of these amendments, corporations seeking to adopt these provisions should consult their legal advisors and should carefully consider their stockholder bases, and any views previously expressed by significant stockholders.

Evaluate Impacts on Form S-8 of Officer Exculpation Amendments

As noted in the “Consider Amending Governance Documents to Provide for Officer Exculpation” section of this checklist, Section 102(b)(7) of the DGCL now permits Delaware corporations to conditionally exculpate certain senior officers from liability for monetary damages. Companies that have adopted exculpation amendments to their certificates of incorporation should consider whether these amendments will impact new registration statements on Form S-8 that the company files with the SEC.

Form S-8, in Item 6 to Part II, requires the company to provide a general description of the effects of, *inter alia*, any statute or charter provisions under which directors and officers may

be indemnified against liability that arises from his or her capacity as such.⁴⁶ The disclosure provided in response to this line item is often overlooked and sometimes has been carried forward for years without much thought.

If the company has adopted an exculpation amendment, it should revisit any legacy indemnification disclosures when filing a new Form S-8. If the new Form S-8 uses the abbreviated format permitted by General Instruction E, the filing should include superseding Item 6 indemnification disclosure.⁴⁷ No changes are needed for effective Forms S-8 (which will be updated for any charter amendments automatically via forward incorporation by reference of the company's relevant SEC filings).

Confirm Provisions in Employment/Separation Agreements and Related Documents Comply With SEC Rules

In light of increasing activity in recent SEC enforcement actions, companies should revisit confidentiality provisions in their employment and separation agreements, as well as related policies, to ensure both comply with the SEC's whistleblower protection rules under the Dodd-Frank Act.

Overview

Under the SEC's whistleblower rules, no person may take an action to impede an individual from communicating directly with the SEC about possible securities law violations, including by enforcing or threatening to enforce confidentiality agreements with respect to such communications, subject to certain limited exceptions.⁴⁸ Companies should note that the SEC interprets this provision broadly and has brought enforcement actions even where the problematic language did not, in fact, impede an employee from speaking to the SEC or where the employee did not interpret the language to restrict communications with the government.

Recent Enforcement Actions

Since 2015, the SEC has initiated over 20 enforcement actions alleging activity to impede reporting by potential whistleblowers.

⁴⁶Other Securities Act registration statements include the same line-item requirements. See, e.g., Form S-3, at Item 15 to Part II. Companies preparing any Securities Act registration statement that includes the same or a similar line-item requirement should consider the guidance provided herein.

⁴⁷General Instruction E to Form S-8 provides a procedure for the filing of a simplified registration statement covering additional securities of the same class as other employee benefit plan securities for which a previously filed Form S-8 registration statement or registration statements are effective. Generally, there is no need to repeat in the new Form S-8 previously filed information. The registration statement would consist only of the facing page; a statement indicating that the contents of the earlier registration statement, identified by file number, are incorporated by reference; the signature page; the legality opinion; the consents of the accountant and counsel; and any information required in the new registration statement that is not in the earlier registration statement.

⁴⁸Exchange Act Rule 12F-17(a).

Companies should avoid the following types of provisions, which the SEC deemed as problematic and resulted in SEC settlements in 2023:

- Separation agreements requiring a waiver of rights to monetary whistleblower awards in connection with filing claims with or participating in investigations by government agencies.⁴⁹ The SEC's order found that such waiver impeded participation in the SEC's whistleblower program by requiring employees to "forgo important financial incentives that are intended to encourage people to communicate directly with SEC staff about possible securities law violations."
- Separation agreements requiring former employees to notify the company if they received a request from a government administrative agency in connection with a report or complaint.⁵⁰ The SEC's order found that this notice provision undermined the purpose of the whistleblower rules, notwithstanding a clause stating that nothing in the release would prevent the former employee from truthfully testifying or responding to a subpoena, or communicating with a government or regulatory entity such as the SEC.
- Requirements for employees to sign releases attesting that they had not filed complaints against the company with any federal agency.⁵¹ The SEC's order finds that by conditioning separation pay on employees' signing the release, the company took action to impede potential whistleblowers from reporting complaints to the SEC.
- Requirements for employees to sign agreements prohibiting the disclosure of confidential corporate information to third parties, unless authorized by the company, without an exception for potential SEC whistleblowers.⁵²
- Requirements for departing employees to sign releases affirming that they had not filed any complaints with any government agency in order for the employees to receive deferred compensation.⁵³

Additional Considerations

Companies should review their applicable agreements (which may include consulting agreements) and policies (e.g., the code of conduct), and ensure consistency across all documents. Review

⁴⁹See the SEC's press releases "[SEC Charges Privately Held Monolith Resources for Using Separation Agreements That Violated Whistleblower Protection Rules](#)" (Sept. 8, 2023); "[SEC Charges Internet Streaming Company for Overstating Paying Subscribers and Violating the Whistleblower Protection Provisions](#)" (May 23, 2023).

⁵⁰See the SEC's press release "[Activision Blizzard to Pay \\$35 Million for Failing to Maintain Disclosure Controls Related to Complaints of Workplace Misconduct and Violating Whistleblower Protection Rule](#)" (Feb. 3, 2023).

⁵¹See the SEC's press release "[SEC Charges CBRE, Inc. With Violating Whistleblower Protection Rule](#)" (Sept. 19, 2023).

⁵²See the SEC's press release "[SEC Charges D. E. Shaw With Violating Whistleblower Protection Rule](#)" (Sept. 29, 2023).

⁵³See *id.*

should include coordination and consultation with appropriate regulatory counsel such as executive compensation/benefits, enforcement and labor/employment counsel. Companies may want to consider updating any existing provisions that the SEC could view as problematic and notifying relevant individuals of any such updates.

Reassess Disclosure Controls and Procedures

SEC rules require public companies to maintain and regularly evaluate the effectiveness of disclosure controls and procedures (DCPs). CEOs and CFOs also must certify the effectiveness of the company's DCPs on a quarterly basis.⁵⁴ While these requirements are not new, a number of high-profile SEC actions were brought and settled based on the SEC's view that the companies failed to maintain adequate DCPs. As a result, we recommend that companies periodically reassess their DCPs and consider any necessary changes to help ensure the consistency, accuracy and reliability of their required and voluntary disclosures.

Third-Party Messaging Applications

Companies have increasingly been using third-party messaging applications, including those that allow users to send messages using end-to-end encryption and those that offer options for the automatic deletion of messages. Given this trend, companies should consider enhancing policies and procedures governing the use of such applications among employees to ensure that their practices comply with regulatory requirements. In particular, companies should be mindful of recordkeeping requirements related to the use of such applications and other risks associated with their use.

Exchange Act Section 13(b) requires companies to retain all records, including written communications that reflect the transactions and dispositions of the company's assets. Specifically, Section 13(b) requires companies to:

- Make and keep books, records and accounts that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company.
- Devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:
 - Transactions are executed in accordance with management's general or specific authorization.

- Transactions are recorded as necessary (i) to permit preparation of financial statements in conformity with GAAP (or the applicable accounting standard) and (ii) to maintain accountability for assets.
 - Access to assets is permitted only with management's general or specific authorization.
 - Recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any difference.
- Ensure that individuals may not knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record or account described above.

For the purpose of these provisions, the terms "reasonable assurances" and "reasonable detail" mean: a level of detail and degree of assurance that would satisfy prudent officials in the conduct of their own affairs.

To date, the SEC has not brought any actions alleging violations of Section 13(b) in connection with the use of third-party messaging apps. Where the SEC has brought such actions, they have generally been limited to the more stringent broker/dealer-specific recordkeeping requirements. Nonetheless, companies should be mindful of Section 13(b) and remember that sensitive material that is not adequately recorded and archived could be subject to scrutiny, including claims that the company lacks adequate internal controls.

Considerations for Implementing More Robust DCPs

Given the ongoing SEC focus on the effectiveness of DCPs, companies should periodically reassess their DCPs to help ensure existing processes bring all potentially material information to management's attention in a timely manner and result in adequate disclosures. In particular, companies may consider adopting a policy that prohibits employees from using any third-party messaging platform not approved by the company for communications pertaining to the transactions and dispositions of the company's assets, per the SEC's recordkeeping requirement. Additionally, a policy may permit the company's legal department to authorize certain persons who are subject to the policy to use specified third-party messaging platforms for communications that fall outside the SEC's recordkeeping requirements.

⁵⁴SEC rules define DCPs as controls and other procedures designed to ensure that information required to be disclosed in all SEC filings is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and (ii) accumulated and communicated to the company's management as appropriate to allow timely decisions regarding required disclosures. See Exchange Act Rules 13a-15(e) and 15d-15(e).

Update Insider Trading Policies To Address Amended Rule 10b5-1 and Other Recent Developments

The SEC continues to focus on insider trading issues. In December 2022, the SEC adopted several amendments to Exchange Act Rule 10b5-1 imposing new disclosure requirements intended to address what the agency perceives may be abusive practices relating to Rule 10b5-1 trading plans, certain equity awards and gifts of securities. The SEC continued to bring insider trading enforcement actions in 2023, including, for example, charges against an executive for trading pursuant to Rule 10b5-1 plans that he allegedly entered into while in possession of material nonpublic information.⁵⁵

Notably, companies are required to annually file copies of their insider trading policies and procedures as exhibits, beginning with their annual reports for the first full fiscal year beginning on or after April 1, 2023 (e.g., Form 10-K or 20-F for the fiscal year ending December 31, 2024, for calendar-year companies). If no such policies or procedures are in place, the company will need to explain why. For companies that do not publicly disclose their insider trading policies today, the new exhibit requirement could result in the SEC's and investors' scrutiny of those policies.

In light of the Rule 10b5-1 amendments, related new disclosure requirements and the SEC's continuing focus on insider trading issues, particularly Rule 105b-1 plans, companies should consider any necessary updates to their insider trading policies as well as related disclosure controls.

Rule 105b-1 Plans

Before the December 2022 amendments, the Rule 10b5-1 affirmative defense against insider trading was generally available when a person adopted a Rule 10b5-1 plan while not in possession of material nonpublic information and the plan terms were set in advance without any subsequent influence by the person.

While many companies and brokers still imposed cooling-off periods between the date a Rule 10b5-1 plan is adopted or modified and when trading commences under the plan and under other parameters on Rule 10b5-1 plans, those periods were not legal requirements and were voluntarily adopted to help reduce potential insider trading liability. As a result, many insider trading policies either did not specifically address Rule 10b5-1 plans or addressed plan requirements only at a high level.

Rule 10b5-1, as amended, now specifies requirements that employees and companies must satisfy to avail themselves of the Rule 10b5-1 affirmative defense. As discussed in detail in our December 20, 2022, client alert "[SEC Amends Rules for Rule 10b5-1 Trading](#)

[Plans and Adds New Disclosure Requirements](#)," these new requirements include:

- Minimum cooling-off periods.
- Director and officer representations regarding the adoption and operation of a Rule 10b5-1 plan.
- An expanded "good faith" requirement.
- Prohibitions against multiple, overlapping plans.
- Limitations on single-trade arrangements.

Accordingly, to the extent companies permit the use of Rule 10b5-1 plans by directors, executive officers or other employees, insider trading policies should address all of the enumerated requirements under the amended Rule 10b5-1.

In addition, companies should consider requiring pre-clearance for all Rule 10b5-1 plan adoptions and modifications to help ensure that proposed plans comply with all of the Rule 10b5-1 requirements.

While Rule 10b5-1 does not restrict the early termination of a plan, such a termination could call into question whether the plan was adopted and operated in good faith, which could impact the availability of the Rule 10b5-1 affirmative defense with respect to the transactions that previously occurred under the terminated plan. For that reason, companies should consider requiring advance clearance for plan terminations and/or permitting plan terminations only when the person seeking to terminate a plan is not subject to a blackout period and not otherwise in possession of material nonpublic information.

Gifts of Securities

In both the proposing and adopting releases for the December 2022 amendments, the SEC indicated its concerns with potentially problematic practices involving gifts of securities, such as making stock gifts while in possession of material nonpublic information or backdating stock gifts in order to maximize the tax benefits associated with the gifts. In particular, the SEC noted that a scenario in which an insider gifts stock while aware of material nonpublic information and the recipient sells the gifted securities while the information remains nonpublic and material is economically equivalent to a scenario in which the insider trades on the basis of material nonpublic information and gifts the trading proceeds to the recipient.

To address these concerns, effective February 27, 2023, the SEC amended Exchange Act Rule 16a-3 to require the reporting of dispositions by gift of securities on Form 4 (due within two business days) rather than on a deferred basis on Form 5 (due within 45 days of the end of the issuer's fiscal year). Acquisitions by gifts of securities may still be reported on Form 5 rather than on Form 4. Insider trading policies that address Section 16 reporting requirements should reflect this reporting requirement.

⁵⁵See the [SEC's settlement order](#).

Companies should consider imposing in their insider trading policies specific parameters on gifts. For example, companies can require advance clearance for gifts by directors, executive officers and certain employees who are subject to quarterly blackout periods, since these individuals are generally more likely to be in possession of material nonpublic information than other employees are. As a more conservative option, a company can treat gifts the same way the company treats ordinary open market purchases and sales, which would prohibit gifts of securities by anyone subject to the policy while subject to a blackout period or in possession of material nonpublic information.

Consider Shareholder Proposal Trends and Developments

The 2023 proxy season saw the continuation of some trends that developed in 2022 regarding shareholder proposals, along with some new developments. Below is a brief summary of observations relating to Exchange Act Rule 14a-8 and some considerations for the 2024 proxy season.

2023 Proxy Season Summary

Declining Shareholder Interest

One of the most significant developments in the 2023 proxy season was an overall decline in investor support for shareholder proposals. This occurred amid (and perhaps as a result of) an overall increase in the number of shareholder proposals submitted to companies, which rose slightly from 902 in 2022 to 948 in 2023 (a 4% increase).

- The number of proposals voted on at annual meetings also increased by 11% from the 2022 proxy season.
- Nevertheless, average support dropped from 31% to 23%.

The SEC staff took a less restrictive posture toward no-action requests to exclude shareholder proposals than in 2023, granting relief in 58% of cases as compared to 38% in 2022. However, this may not be indicative of a modified position by the staff but instead simply reflect the more limited pool of no-action requests considered by the staff, as 25% fewer no-action requests were submitted in 2023 than in 2022.

Highlights of Specific Proposal Topics

Environmental and Social (E&S) Proposals: For the seventh year in a row, E&S proposals outnumbered governance proposals, with 617 E&S proposals submitted compared to 247 governance-focused proposals. Unsurprisingly, more E&S proposals than governance proposals ultimately landed on companies' ballots, with 338 E&S proposals voted on versus 197 governance proposals.

- Consistent with the general trend of decreased support for shareholder proposals in 2023, only eight E&S proposals received majority support, down markedly from 37 in 2022.
- Notably, 212 environmental proposals were submitted to companies, which addressed a broad range of topics.
- Average support for those environmental proposals that appeared on ballots, however, declined dramatically — to 20.2% compared to 33% in 2022.
- Proposals addressing social issues in 2023 increased 13% in 2023 over 2022, with 405 social proposals submitted compared to 359 in 2022. The number of social proposals voted on also increased to 227 proposals versus 209 in 2022.
- Average support for these social proposals decreased, however, to 18% compared to 25% average support for social proposals in 2022.
 - Six social proposals received majority support in 2023, significantly less than the 19 proposals that received majority support in 2022.

Continuing a trend seen in 2021, diversity, equity and inclusion (DEI) issues remained a focal point in proposals. However, many of these saw decreased support from shareholders. For example, proposals calling for companies to conduct third-party racial or civil rights equity audits achieved average support of only 22.3% and none of them received majority support, compared with 44.9% average support in 2022 and eight that received majority support.

Governance Proposals: Compared to the 2022 season, fewer proposals concerning governance topics were voted on: 197 compared to 221 in 2022.

- 23 governance proposals received majority support in 2023, a decrease from 33 in 2022.
- The most popular governance topic in 2023 was requests for an independent board chair, with 82 proposals coming to a vote. None of these proposals received majority support in 2023 and average support was 30%, similar to the 29% average support these proposals received in 2022.
- 42 special meeting-related shareholder proposals proceeded to a vote in 2023, with average support of 35% and eight receiving majority support.
 - This was down significantly from 2022, when 107 special meeting proposals proceeded to a vote, achieving average support of 37%. Nine of these proposals received majority support in 2022.
- Seven written consent proposals proceeded to a vote in 2023, with average support of 34.4% and one receiving majority support.

- This was essentially the same as in 2022, where six written consent proposals proceeded to a vote with average support of 34.6% and one proposal receiving majority support.

Executive Compensation Proposals: The number of executive compensation-related proposals submitted in 2023 increased to 84 from 53 in the 2022 proxy season. The number of proposals that moved forward to a vote also increased — to 70 in 2023 from 36 in 2022. Once again, however, the proposals voted on in 2023 had lower average support of approximately 22%, compared with approximately 33% in 2022.

The most common executive compensation proposal type requested adoption of a policy that the board of directors seek shareholder approval of any senior manager’s new or renewed pay package that provides for severance or termination payments — including the vesting of equity awards — with an estimated value exceeding 2.99 times the sum of the executive’s base salary and short-term bonus. There were 45 of these proposals voted on and they received average support of 24%, with four receiving majority support.

No-Action Letter Highlights

Following the 2022 shareholder proposal no-action letter season, which proved surprising and complicated, the 2023 season produced fewer surprises. While no-action requests were marginally more successful, companies continued to struggle to obtain no-action relief under many bases of Exchange Act Rule 14a-8. A few notable developments are discussed below.

Success of Micromanagement Grounds: One of the most interesting developments in 2023 was that despite overall difficulty obtaining no-action relief, a number of companies made successful micromanagement arguments. Most notably, the SEC staff granted relief in some instances involving environmental proposals.

- In one instance, the staff granted relief for a proposal that asked the board of an insurance company to adopt a policy to eliminate underwriting risks associated with fossil fuel exploration and development projects.
- In another instance, the staff granted relief for a proposal asking a company to measure and disclose Scope 3 emissions, where the company argued that the proposal would impose a prescriptive standard that differed from the company’s existing approach to measuring such emissions.

Successful micromanagement arguments were not only limited to environmental proposals.

- The staff agreed that a proposal requesting adoption of a policy requiring shareholder approval for any future agreements and corporate policies that could obligate the company to make certain payments or awards following the death of a senior executive constituted micromanagement.

- In another case, the staff granted relief for a proposal requesting a detailed public report of information relating to shareholder ownership of company securities.

Thus, while heavily fact-dependent, micromanagement arguments remain viable.

Challenges With Substantial Implementation Grounds:

Consistent with results from the 2022 proxy season, substantial implementation arguments remained challenging.

- In one example, the staff denied relief for a proposal asking the company to adopt a director resignation policy requiring that directors who do not receive majority support only serve for 180 days or fewer. The company already had a majority voting policy with a market-standard requirement to submit a resignation for the board’s consideration, but without the 180-day limit on board service. Nonetheless, the company’s no-action request was denied.

Ordinary Business Arguments Remain Viable: The 2023 proxy season also featured multiple examples where the staff concurred with the company that the proposal related to an ordinary business matter even though the proponent portrayed the proposal as relating to a broader social policy matter. For example, the staff granted relief for requests to exclude proposals that:

- Would have required hospitals to provide plant-based food options to patients and employees.
- Sought a report on the rationale behind the company’s participation in and support of external organizations and interest groups.
- Related to establishing, terminating or continuing certain business relationships.
- Sought a report on the number and categories of user account suspensions and closures that could result in limiting free speech.
- Requested that a company issue dividends in the form of NFTs.

Thus, while ordinary business arguments have generally been less successful at garnering relief, there remain proposals and topics that can be excluded under strict ordinary business grounds.

Updated Submission Process for No-Action Requests

For the 2024 proxy season, the staff recently announced a new submission intake process for shareholder proposal no-action requests and all other communications. Going forward, companies must submit these requests and related correspondence using a new online shareholder proposal form on the SEC’s website. The SEC will no longer accept emailed materials. Companies must still forward relevant correspondence to proponents (by mail or email).

The new [submission portal is available here](#).

Proposed Amendments to Rule 14a-8

On July 13, 2022, the SEC proposed amendments that would modify the standards for exclusion of a proposal under the “substantial implementation,” “duplication” and “resubmission” grounds in Rule 14a-8. Although presented as an effort to provide greater certainty and transparency to shareholder proponents and companies, the amendments (if adopted as proposed) likely would increase the number of shareholder proposals received by companies and make it less likely that proposals could be excluded.

Substantial Implementation: Rule 14a-8(i)(10) allows a company to exclude from the company’s proxy materials a shareholder proposal that “the company has already substantially implemented.” In determining whether a proposal has been substantially implemented, the SEC staff assesses whether a company’s particular policies, practices and procedures “compare favorably” with the guidelines of the proposal, whether the company has addressed the proposal’s underlying concerns and whether the essential objectives of the proposal have been met. Historically, a proposal could be excluded on the basis of substantial implementation even if a company had not implemented all of the proposal’s requested elements.

The proposed amendments would provide that a company may exclude a proposal as substantially implemented “[i]f the company has already implemented the essential elements of the proposal.” In particular, the proposing release notes that the amendment would permit a shareholder proposal to be excluded as substantially implemented only if the company has implemented all of the shareholder proposal’s essential elements.

Duplication: Rule 14a-8(i)(11) provides that a company may exclude a shareholder proposal from the company’s proxy materials if the proposal “substantially duplicates [by sharing the same “principal thrust” or “principal focus”] another proposal previously submitted to the company by another proponent that will be included in the company’s proxy materials for the same meeting.” The proposed amendments specify that a proposal “substantially duplicates” another proposal previously submitted for the same shareholder meeting if the new proposal “addresses the same subject matter and seeks the same objective by the same means.”

Resubmission: Rule 14a-8(i)(12) provides that a company may exclude a shareholder proposal from the company’s proxy materials if the proposal “addresses substantially the same subject matter” as a proposal that was included in the company’s proxy materials, voted on in the last three years and failed to receive support above a certain threshold. A proposal would qualify as a resubmission only if it “substantially duplicates” a previous proposal that failed to receive support above a certain threshold, meaning that the new proposal “addresses the same subject matter and seeks the same objective by the same means.”

Assess the Impact of Proxy Advisory Voting Guidelines and Significant Investor Publications

Proxy advisory firm ISS has proposed updates to its voting guidelines,⁵⁶ and Glass Lewis has updated its voting guidelines for the 2024 annual meeting season.⁵⁷ Companies should assess the potential impact of these updates when considering changes to their corporate governance practices, shareholder engagement and proxy statement disclosures.⁵⁸ Notably, none of ISS’ proposed updates for 2024 are related to U.S. voting guidelines. Companies should keep in mind, however, that ISS often includes policy updates in its final voting policy that did not appear in the proposed updates.

To the extent a company’s significant shareholders include institutional investors, such as BlackRock, Vanguard and State Street, their voting guidelines should also inform the company’s decisions on corporate governance practices, shareholder engagement and proxy statement disclosures.

Cyber Risk Oversight

In light of the SEC’s new rules requiring cybersecurity risk management, strategy, governance and incident disclosure, Glass Lewis now considers cyber risk material for all companies.

In the absence of material cybersecurity incidents, Glass Lewis generally will not make voting recommendations based on a company’s oversight or disclosure concerning cyber-related issues. If, however, cybersecurity incidents have materially impacted a company or caused significant harm to shareholders, Glass Lewis (i) will closely evaluate the board’s oversight of cybersecurity as well as the company’s response and disclosures, (ii) will expect periodic updates from the company on ongoing progress toward resolving and remediating the impact of the incident and (iii) may recommend against certain directors if the board’s oversight, response or disclosures concerning cybersecurity-related issues are deemed insufficient or are not provided to shareholders.

Board Oversight of Environmental and Social Issues

Glass Lewis’ updated guidelines state that the board’s role in overseeing the company’s environmental and social risks should be formally designated and codified in the appropriate committee charters or other governing documents. When evaluating the

⁵⁶ See ISS’ [Proposed ISS Benchmark Policy Changes for 2024](#) (Nov. 21, 2023). ISS’ final proxy voting guidelines for 2024 are expected to be released in mid-December 2023. For ISS’ current proxy voting guidelines, see ISS’ [Proxy Voting Guidelines — United States](#) (Dec. 13, 2022) and [Sustainability Proxy Voting Guidelines — United States](#) (Jan. 17, 2023).

⁵⁷ See Glass Lewis’ [2024 Benchmark Policy Guidelines — United States](#) (Nov. 16, 2023) and [2024 Benchmark Policy Guidelines — Shareholder Proposals & ESG-Related Issues](#) (Nov. 16, 2023).

⁵⁸ For compensation-related updates in ISS and Glass Lewis’ 2024 guidelines, see the “Incorporate Lessons Learned From the 2023 Say-on-Pay Votes and Compensation Disclosures” section of this checklist.

board's role in overseeing environmental and/or social issues, Glass Lewis will examine a company's committee charters and governing documents to determine if the company has codified a meaningful level of oversight of and accountability for its material environmental and social impacts.

Climate Change: In 2023, Glass Lewis applied its policy on board accountability for climate-related issues only to the largest, most significant GHG emitters. Beginning in 2024, however, Glass Lewis will apply its policy to most large-cap companies operating in industries where the Sustainability Accounting Standards Board (SASB) has determined that companies' greenhouse gas emissions represent a financially material risk. Specifically, Glass Lewis will assess whether such companies have (i) provided disclosures in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) and (ii) disclosed explicit and clearly defined board-level oversight responsibilities for climate-related issues. In instances where Glass Lewis finds either of these disclosures to be absent or significantly lacking, it may recommend voting against responsible directors.

ISS' current guidelines provide that, for companies that are significant GHG emitters, ISS generally will vote against the chair of the responsible committee (or other directors on a case-by-case basis) if the company does not provide both (i) detailed disclosures of climate-related risks (e.g., in line with the TCFD recommendations) and (ii) appropriate GHG emissions reduction targets (currently for Scope 1 and Scope 2 emissions).

Material Weaknesses: Glass Lewis will consider recommending voting against all members of an audit committee who served on the committee during the time when a material weakness in internal control over financial reporting was identified (i) if a material weakness is reported and the company has not disclosed a remediation plan or (ii) when a material weakness has been ongoing for more than one year and the company has not disclosed an updated remediation plan that clearly outlines the company's progress toward remediating the material weakness.

Monitor the Status of the PCAOB's Proposal To Expand the Scope of Audits and the Role of Auditors

In June 2023, the Public Company Accounting Oversight Board (PCAOB) proposed sweeping amendments to its auditing standards.⁵⁹ If adopted, the amended standards would significantly expand the scope of audits and the role of auditors. The proposed amendments would, among other things, require auditors to:

- Identify laws and regulations with which noncompliance could reasonably have a material effect on the company's financial statements.

- Assess and respond to risks of material misstatements arising from noncompliance with laws and regulations.
- Identify whether there is information indicating noncompliance has, or may have, occurred.
- If auditors become aware of information indicating that noncompliance with laws and regulations has, or may have, occurred, evaluate and communicate those matters to the company's senior management and audit committee.

The proposal has proven controversial, as the PCAOB received nearly 140 comments, with a number of accounting firms, public companies, professional membership associations and other key stakeholders raising concerns. In addition, in a rare occurrence, PCAOB board members Christina Ho and Duane DesParte — the only two certified public accountants on the board — issued public dissents when the PCAOB issued the proposal.

Common areas of concern raised in the comment letters included the following:

- Expanding the role of auditors in this manner would require auditors to undertake analyses and make judgments requiring expertise outside their core competencies.
- The proposal would substantially increase audit costs without any basis to evaluate whether the changes would provide commensurate benefits.
- Requests from auditors mandated by the proposed rules could compromise the attorney-client privilege.

Any final rule changes based on the proposal will require approval by the PCAOB, which has not stated publicly the status of the proposal or the timing of any further action. Whether or when the PCAOB might proceed with any final rule amendments remains unclear. Based on the strong negative feedback included in the comment letters, however, we anticipate that the PCAOB will proceed slowly and cautiously with the proposal.

Furthermore, some comment letters contended that the PCAOB may lack statutory authority to expand auditors' responsibilities to include evaluating potential noncompliance with laws and regulations. Accordingly, if adopted as proposed, the new standards could face legal challenges, which, at a minimum, could delay implementation.

Given the potential significant impacts of the proposed changes, including the potential for substantial additional audit costs and internal controls and procedures, companies and their audit committees should track developments of the PCAOB's proposal.

⁵⁹See our September 14, 2023, client alert "[Comments Raise Concerns About PCAOB's Proposal To Expand the Scope of Audits and the Role of Auditors.](#)"

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