

The Dodd-Frank Act: Corporate Governance, Compensation, Disclosure and SEC Enforcement Provisions

August 1, 2011

Overview

ÿ The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”) focused principally on changes to the financial regulatory system, however several corporate governance, compensation, disclosure and SEC Enforcement provisions of the Act target public companies.

ÿ These corporate provisions require:

- ÿ Advisory votes on executive compensation and golden parachute payments;
- ÿ Potential changes to compensation committee composition and operation;
- ÿ Enhanced proxy statement disclosure;
- ÿ The adoption or revision of certain policies;
- ÿ Specialized corporate disclosures for companies in mining, resource extraction and manufacturing businesses;
- ÿ Enhanced whistleblower provisions, including substantial bounties and anti-retaliation protection; and
- ÿ Enhanced SEC Enforcement rules and remedies.

Say-on-Pay

- ÿ The Act requires that companies include a resolution in their proxy statements asking shareholders to approve, in a non-binding vote, the compensation of their executive officers, as disclosed under Item 402 of Regulation S-K (the “Say-on-Pay” vote).
- ÿ A separate resolution is also required to determine whether this Say-on-Pay vote takes place every one, two, or three years (the “Say-on-Frequency” vote).
- ÿ The Say-on-Pay vote and Say-on-Frequency vote was required for the first annual or other meeting of shareholders occurring after January 21, 2011.

Say-on-Pay Rules

- The SEC adopted implementing rules on January 25, 2011.
- The effective date of the rules was April 4, 2011, except that the rules governing the Say-on-Golden Parachute vote requirements and related disclosure became effective for filings on or after April 25, 2011.
- Smaller reporting companies are not subject to the Say-on-Pay or Say-on-Frequency requirements and the SEC's new rules until after the first annual meeting or other meeting of shareholders at which directors will be elected, and for which executive compensation disclosure is required occurring on or after January 21, 2013.
 - This temporary exemption does not apply to the Say-on-Golden Parachute vote requirement, to the extent that such requirement is applicable to a smaller reporting company.

Say-on-Pay Rules

- ÿ Rule 14a-21 provides for a Say-on-Pay vote, a Say-on-Frequency vote and a Say-on-Golden Parachute vote.
- ÿ The exact form of each resolution is not prescribed by the final rules, however, with respect to the Say-on-Pay vote, the SEC provides a non-exclusive example of a resolution:
 - ÿ “RESOLVED, that the compensation paid to the company’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.”
- ÿ The Say-on-Frequency resolution must present the choices of one, two, or three years, or abstain.

Say-on-Pay Rules

- ÿ Item 24 of Schedule 14A requires an explanation of the general effect of the vote (i.e., the vote is nonbinding) and that the vote is required by Section 14A of the Exchange Act.
- ÿ Item 24 also requires disclosure of the current frequency of Say-on-Pay votes and when the next scheduled Say-on-Pay vote will occur.
- ÿ Amended Item 402(b)(1) of Regulation S-K requires an issuer to address in the CD&A whether, and if so, how, the issuer has considered the results of the most recent shareholder advisory vote on executive compensation in determining compensation policies and decisions and, if so, how that consideration has affected the issuer's compensation decisions and policies.
 - ÿ This requirement is included among the "mandatory" CD&A disclosure items specified by Item 402(b)(1) of Regulation S-K.

Say-on-Pay Rules

- An amendment to Item 5.07 of Form 8-K requires that an issuer must disclose its decision as to how frequently the issuer will conduct Say-on-Pay votes following each Say-on-Frequency vote.
 - In order to comply with this requirement, an issuer must either include the information in the required Item 5.07 Form 8-K within four business days after the meeting or file an amendment to its prior Form 8-K filing (or filings) that disclosed the preliminary and final results of the Say-on-Frequency vote.
 - The Form 8-K amendment will be due no later than 150 calendar days after the date of the end of the annual meeting in which the Say-on-Frequency vote occurred, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals as disclosed in the proxy materials for the meeting at which the Say-on-Frequency vote occurred.
 - Specifically with respect to Say-on-Frequency votes, an issuer must disclose the number of votes cast for each of the choices, as well as the number of abstentions in Item 5.07 of Form 8-K.

Say-on-Pay Rules

- The SEC amended Rule 14a-6(a) to add any shareholder advisory votes on executive compensation, including the Say-on-Pay or Say-on-Frequency votes, to the list of items that will not trigger the requirement to file a preliminary proxy statement with the SEC.
 - This amendment encompasses an advisory vote on executive compensation that is not required by Exchange Act Section 14A.
- The SEC amended Rule 14a-4 to specifically allow proxy cards to reflect the choices of one, two, or three years, or abstain for the Say-on-Frequency vote.

Say-on-Pay Rules

- ÿ The SEC added a new Note to Rule 14a-8(i)(10) to permit the exclusion of a shareholder proposal that would provide a Say-on-Pay vote, seek future Say-on-Pay votes, or relate to the frequency of Say-on-Pay votes in certain circumstances.
 - ÿ Such shareholder proposals could be excluded under the new Note if, in the most recent Say-on-Frequency vote, a single frequency received a majority of votes cast and the issuer adopted a policy for the frequency of Say-on-Pay votes that is consistent with that choice.
 - ÿ For the purposes of this Note, the SEC notes that an abstention would not count as a vote cast.

Say-on-Pay Results in 2011

- ÿ As of August 1, 2011, approximately 40 companies failed to obtain majority support for a Say-on-Pay vote.
- ÿ The majority of companies filing proxy statements have recommended an annual Say-on-Pay vote.
- ÿ In over 50 percent of the cases where the company recommended a three-year frequency for the Say-on-Pay vote, stockholders preferred an annual frequency.
- ÿ In the relatively few situations where a frequency of every two years was recommended by the companies, shareholders of 70 percent of those companies preferred an annual frequency.

Say-on-Golden Parachutes

- ÿ To the extent that any “golden parachute”-related compensation is not subject to a Say-on-Pay vote, companies must solicit shareholder approval of this compensation through a separate non-binding vote at the meeting where they are asked to approve a merger or similar extraordinary transaction that would trigger golden parachute payments.
- ÿ The proxy statement for the above-referenced meeting needs to include “clear and simple” disclosure of the golden parachute arrangements or understandings and the amounts payable.

Golden Parachute Rules

- New paragraph (t) of Item 402 of Regulation S-K requires additional disclosure regarding golden parachutes in certain circumstances.
- The table quantifies cash severance payments, the value of equity awards that are accelerated or cashed out; pension and nonqualified deferred compensation enhancements, perquisites, and other personal benefits; and tax reimbursements. The “Other” column also must include any additional compensation that is not included in any other column. Separate footnote identification of amounts attributable to “single trigger” and “double trigger” arrangements is also required. The table requires quantification with respect to any type of compensation, whether present, deferred, or contingent, that is based on or relates to an acquisition, merger, consolidation, sale, or other disposition of all or substantially all assets.

Golden Parachute Rules

- ÿ Issuers that wish to take advantage of the ability to exclude a Say-on-Golden Parachute vote in connection with a future vote on a merger or similar transaction must voluntarily include the Item 402(t) disclosures in proxy statements for annual meetings at which a Say-on-Pay vote will be held.
 - ÿ If there are changes to the arrangements after the date of the annual meeting or if new arrangements are adopted that were not subject to a prior Say-on-Pay vote, then a Say-on-Golden Parachutes vote will still be required. In that case, the vote is required only with respect to the amended golden parachute payment arrangements.
- ÿ Only approximately six companies chose this “advance” vote approach in the 2011 proxy season.

Golden Parachute Rules

- Additional forms, schedules, and disclosure requirements have been amended in order to address golden parachute compensation, such as Schedule 14A, Schedule 14C, Forms S-4 and F-4, Schedule 14D-9, Schedule 13E-3, and Item 1011 of Regulation M-A.
- The SEC adopted an amendment to Schedule TO in order to clarify that Item 402(t) disclosure is not required in third-party bidders' tender offer statements, so long as the subject transactions are not also Rule 13e-3 going-private transactions.
- Issuers filing solicitation/recommendation statements on Schedule 14D-9 in connection with third-party tender offers will be obligated to provide the disclosure required by Item 402(t) of Regulation S-K.

Say-on-Pay Trends

- Y Companies have revisited disclosure practices, including the use of an executive summary for the CD&A, streamlining the CD&A disclosure and focusing on the pay for performance story and the relationship between compensation and risk.
- Y Companies have evaluated key compensation policies, including:
 - Y Stock ownership and equity holding policies;
 - Y Clawback policies;
 - Y Perquisite policies; and
 - Y Severance and post-retirement benefits.
- Y Companies have engaged with shareholders over executive compensation and corporate governance issues both before and after the proxy statement is filed.

Independence Considerations

- ÿ The Act requires that stock exchanges adopt listing standards providing that the members of the compensation committee meet enhanced independence standards.
- ÿ The listing standards must also prescribe that a compensation committee may only select compensation consultants, legal counsel, or other advisers after taking into consideration independence standards established by the SEC.
- ÿ Enhanced disclosure will be required of whether the compensation committee retained or obtained the advice of a compensation consultant and whether the consultant's work raised any conflicts of interest, the nature of any such conflict, and how it was addressed.

Comp Committee Independence

- ÿ The new independence standards will direct boards to consider:
 - ÿ The source of compensation received by a compensation committee member, including whether he or she receives any consulting, advisory, or other compensatory fee; and
 - ÿ Whether the compensation committee member is affiliated with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company.

- ÿ Other factors could be imposed in the course of the SEC and exchange rulemaking process.

- ÿ The new standard is comparable, but not identical, to what is required for audit committee members under the Sarbanes-Oxley Act of 2002 and related exchange listing standards.

Adviser Independence

- ÿ The Act requires that advisers retained by compensation committees of listed companies to advise on executive compensation may only be selected after a company has taken into consideration independence factors to be established by the SEC.

- ÿ The Act requires that the independence factors include:
 - ÿ Provision of other services by the person that employs the adviser;
 - ÿ The amount of fees received as a percentage of an entity's total revenue;
 - ÿ Policies and procedures designed to prevent conflicts of interest;
 - ÿ Any business or personal relationship of the adviser with a member of the compensation committee; and
 - ÿ Any stock of the company owned by an adviser.

SEC Rulemaking

- The SEC has proposed Rule 10C-1 under the Section 10C of the Exchange to direct the national securities exchanges, including the New York Stock Exchange and Nasdaq, to adopt listing standards regarding compensation committees and the compensation advisers that they retain.
- Under proposed amendments to Item 407, a company would be required to disclose whether the compensation committee has retained or obtained the advice of a compensation consultant during the last completed fiscal.
- Companies would also be required under the proposed amendments to Item 407 of Regulation S-K to disclose whether the work of the compensation consultant has raised any conflict of interest and, if so, provide a description of the nature of the conflict of interest and how it is being addressed.

Action Items for Independence

Y Compensation Committee Independence – Evaluate whether compensation committee members meet the heightened independence standard and determine if new directors must be appointed to the committee, or whether it is necessary to recruit new independent directors to serve on the compensation committee.

Y Adviser Independence – Consider adopting a specific policy designed to reduce or eliminate potential conflicts of interest with compensation consultants and other advisers. Such policies may:

- Y Prohibit the provision of additional services to the company;
- Y Limit the level of additional services that may be provided to a *de minimis* amount; and/or
- Y Establish a process for pre-approval of any additional services.

These policies also may require that a compensation consultant or other adviser provide a certification to the company as to its independence, to help support the company's disclosure controls and procedures.

Pay for Performance Disclosure

- ÿ The SEC must adopt rules requiring that companies disclose the relationship of the compensation actually paid to their executives versus the company's financial performance, taking into account share price appreciation and dividends or distributions.
- ÿ This disclosure may be required to be presented graphically or in narrative form (or in a combination of both).

CEO Pay vs. Median Employee Pay

Y The SEC must adopt rules requiring that companies disclose the median annual total compensation of all employees (except the CEO), the annual total compensation of the CEO, and the ratio of the amounts of the median employee total compensation to the CEO total compensation.

Employee and Director Hedging

Y The SEC must adopt rules requiring disclosure of whether any employee or director (or designee of such persons) is permitted to purchase financial instruments, such as prepaid variable forwards, equity swaps, collars, and exchange funds, that are designed to hedge or offset any decrease in the market value of equity securities granted as compensation or held directly or indirectly by the employee or director.

Action Items for New Disclosures

- ÿ Pay vs. Performance – Consider preparing the contemplated comparison to determine if adjustments are necessary for executive compensation programs and practices.

- ÿ CEO Pay vs. Median Employee Pay – Consider implementing an “internal pay equity” study and evaluate what, if any, changes should be made in anticipation of the disclosure requirement.

- ÿ Disclosure of Employee or Director Hedging – Consider whether any policies should be implemented to specifically address employee and director hedging transactions, including:
 - ÿ Prohibiting hedging transactions for all employees and directors;
 - ÿ Subjecting hedging transactions to a pre-approval process;
 - ÿ Restricting the types of hedging transactions that may be undertaken; or
 - ÿ Continuing to permit hedging transactions without any specific policy on their use.

Compensation Recovery

- ÿ The SEC must adopt rules directing the exchanges to adopt listing standards requiring that each listed company adopt a compensation recovery policy.

- ÿ The policy must provide that if a company is required to restate its financials due to material noncompliance with the securities laws, the company will:
 - ÿ Recover from any current or former executive officer
 - ÿ Any incentive-based compensation received in the three-year period prior to the restatement
 - ÿ That is in excess of what would have been paid to the executive officer under the restated amounts.

- ÿ Enhanced disclosure will be required of a company's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws.

Action Items for Clawbacks

- Y Even though the clawback provision of the Act is narrowly focused on situations involving accounting restatements, many companies will consider a broader menu of potential triggering events to ensure that the clawback policy is operating as effectively as possible to achieve the company's objectives.
- Y Clear disclosure in the proxy statement regarding a company's clawback policy will also be important, as companies seek to demonstrate how the clawback policy serves the objective of ultimately aligning pay with performance.

Other Governance Provisions

ÿ Chair/CEO Split –The Act directs the SEC to promulgate rules mandating proxy statement disclosure of the reasons why the company has chosen to have one person serve as Chairman and CEO, or to have different individuals serve in those roles.

ÿ The SEC already amended its disclosure rules to require a discussion of this subject, which appeared for the first time in 2010 proxy statements.

ÿ Discretionary Voting – The Act provides that brokers may not use discretionary authority to vote proxies in connection with election of directors, executive compensation, or other significant matters as determined by the SEC.

ÿ Under changes to New York Stock Exchange Rule 452 effective in 2010, no broker discretionary voting is permitted for the election of directors and executive compensation matters. The SEC has not yet specified other matters for which brokers may not use discretionary authority to vote uninstructed shares.

Proxy Access

- The Act authorized the SEC to promulgate rules allowing certain shareholders to include director nominees in the company's proxy materials, but the Act did not prescribe specific standards for those rules. The SEC adopted proxy access rules on August 25, 2010.
- The SEC stayed effectiveness of the rules while litigation challenging the rule was pending.
- On July 22, 2011, the United States Court of Appeals for the District of Columbia Circuit vacated Rule 14a-11, determining that the SEC was arbitrary and capricious in adopting the rule.
- The SEC must now determine whether to appeal the decision of the Court, or alternatively on remand from the Court, the SEC could revisit its economic analysis in its Rule 14a-11 rulemaking and could seek to address the concerns raised by the Court.

Proxy Access - Rule 14a-11

- ÿ If Rule 14a-11 became effective as originally adopted, a nominating shareholder must give advance notice to the company and the SEC of its intent to nominate directors to be included in the company's proxy statement not earlier than 150 days and not later than 120 days before the anniversary of the date of mailing of the company's proxy materials for the prior year's annual meeting.
- ÿ Companies and shareholders would not be permitted to "opt out" of Rule 14a-11 or adopt a more restrictive process for shareholder nominees, even if permissible under state law.
- ÿ Rule 14a-11 would not apply if state or foreign law, or a company's governing documents, prohibit shareholders from nominating directors.

Proxy Access - Amended Rule 14a-8

- ÿ Under Rule 14a-8(i)(8), a company can exclude shareholder proposals aimed at establishing a procedure that might result in a contested board election.
- ÿ If amended Rule 14a-8(i)(8) became effective, a company may no longer exclude a proposal that would amend or request that the company consider amending governing documents to facilitate director nominations by shareholders or disclosures related to nominations made by shareholders, as long as such proposal does not conflict with Rule 14a-11 and is not otherwise excludable under some other procedural or substantive basis in Rule 14a-8.
- ÿ The Court's decision did not address the SEC's amendment to Rule 14a-8(i)(8).

Amended Rule 14a-8

- ÿ The SEC also sought to codify some of the Staff's historical interpretations of 14a-8(i)(8) which permitted exclusion of a shareholder proposal that would:
 - ÿ Seek to disqualify a nominee standing for election;
 - ÿ Remove a director from office before the expiration of his or her term
 - ÿ Question the competence, business judgment or character of a nominee or director;
 - ÿ Nominate a specific individual for election to the board of directors, other than through the Rule 14a-11 process, applicable state law provision, or an issuer's governing documents; or
 - ÿ Otherwise affect the outcome of the upcoming election of directors.

Rule 14a-11: Eligibility

- ÿ To be eligible to make a nomination, a nominating shareholder, either individually or together with other shareholders who are making the nomination as a group, would be required to:
 - ÿ Beneficially own (as of the date of filing notice of an intent to nominate on Schedule 14N) at least three percent of the total voting power of the company's securities that are entitled to vote on the election of directors at the annual meeting.
 - ÿ Have beneficially owned those voting securities for at least three years as of the date of filing the Schedule 14N and must continue to hold at least that amount through the date of the election of directors.
 - ÿ Provide proof of ownership of the voting securities used for the purpose of satisfying the ownership requirement.
 - ÿ State in the Schedule 14N the intent of the shareholder or shareholders to continue to hold the securities satisfying the ownership requirement through the date of the annual meeting.
 - ÿ State in the Schedule 14N the intent of the shareholder or shareholders with respect to ownership of the company's securities after the election.

Rule 14a-11: Ownership

- ÿ In calculating the three percent voting power threshold, the following rules would apply:
 - ÿ The nominating shareholder must hold a class of securities subject to the proxy rules (i.e., not privately held classes of voting securities).
 - ÿ The nominating shareholder must hold *both* voting and investment power (thus excluding, e.g., securities underlying options that are exercisable but have not been exercised).
 - ÿ Shareholders may aggregate holdings in order to meet the threshold, as long as they all meet the length of holding requirement.
 - ÿ Shareholders can include securities that are loaned to a third party, but only if those shares can be recalled, and in fact would be recalled if the nominee is included in the proxy materials.
 - ÿ Borrowed shares and shares sold short are not counted.
- ÿ In determining total voting power, shareholders would be able to rely on information provided in the company's most recent reports, unless the shareholder has reason to know or knows that information is inaccurate.

Rule 14a-11: Nominees

- ÿ A company would not be required to include a shareholder nominee in its proxy materials if the nominee's candidacy or his or her membership on the board (if elected) would violate state or federal law, or stock exchange requirements (other than rules with respect to director independence).
- ÿ A nominee would need to satisfy the *objective* director independence listing standards that apply to the company (if any apply).
- ÿ Each nominating shareholder would need to represent that neither the nominee nor the nominating shareholder has a direct or indirect agreement with the company regarding the nomination (excluding unsuccessful negotiations with regard to the nominee being included as a management nominee, or whether the shareholder nominee could be permissibly included in the proxy under Rule 14a-11).

Rule 14a-11: Numbers

- A company would be required to include no more than the greater of one shareholder nominee or the number of nominees that represent no more than 25% of the company's board (rounding down).
 - With a staggered board, the 25% is based on the total number of board seats, not just the directors up for election.
 - If nominating shareholder owns a class of securities that has the right to elect only a portion of the board, then the maximum number of nominees is based on the number of directors that the class of securities is entitled to elect.
 - Directors previously elected under the Rule 14a-11 process count toward the maximum number of directors, unless the company nominates the shareholder nominee.
 - Management nominees resulting from negotiations that commence after a nominating shareholder or group of shareholders has filed a Schedule 14N count toward the 25% cap.

Rule 14a-11: Multiple Nominees

Y If a company receives more shareholder nominees than it is required to include, or when shareholder nominees are withdrawn or disqualified during the process, then the shareholder or group of shareholders with the highest voting power would have priority for its nominees.

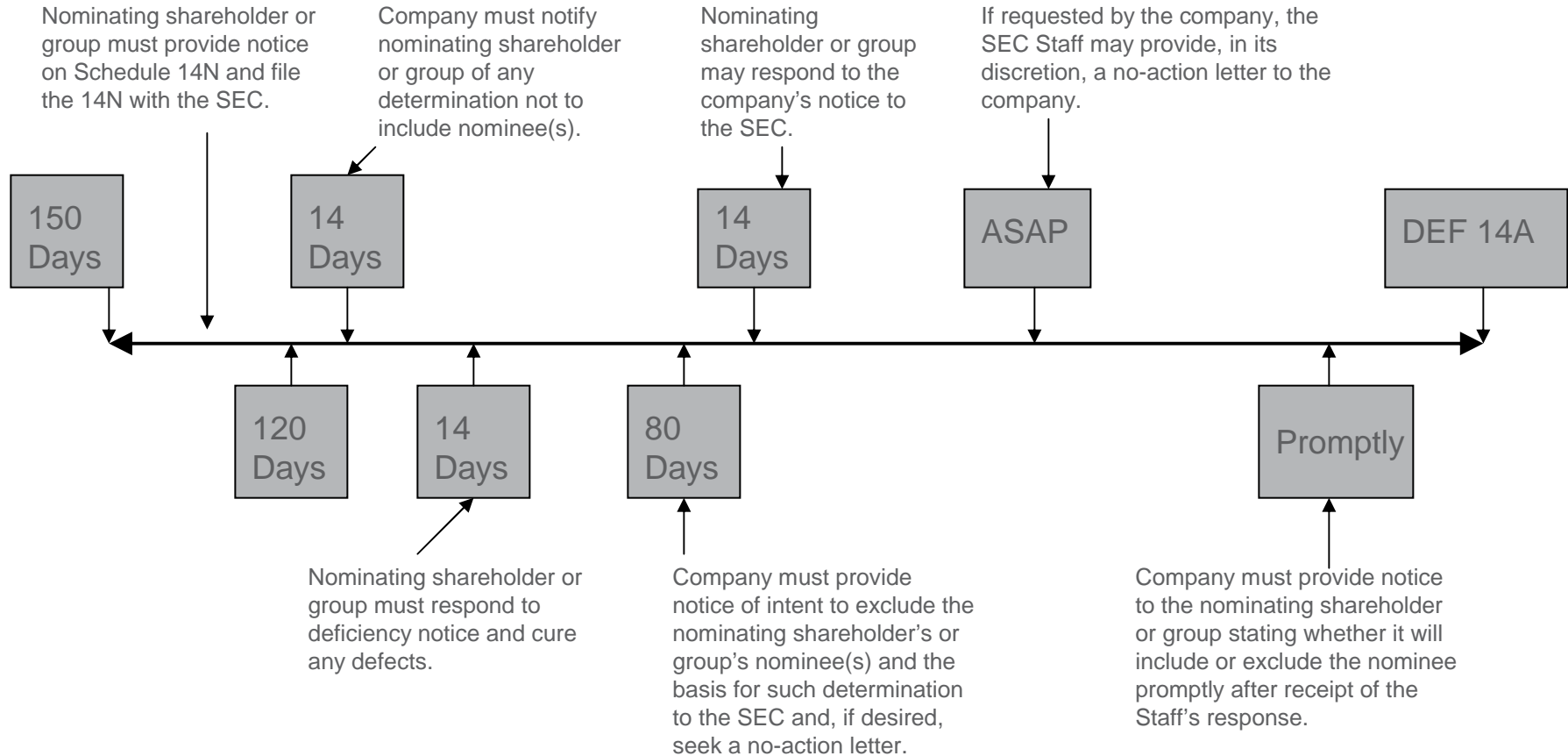
Schedule 14N

- ÿ The nominating shareholder or group would need to provide the company, and file with the SEC, a Schedule 14N, which must include disclosure of:
 - ÿ The amount and percentage of voting securities owned by the nominating shareholder or group;
 - ÿ The length of time of the nominating shareholder's or group's ownership;
 - ÿ Information concerning the nominating shareholder or group and the nominees that is equivalent to what would be provided in a proxy contest;
 - ÿ The nominating shareholder's or group's intent to continue to hold the securities through the date of the meeting;
 - ÿ Whether or not the nominee satisfies the director qualification requirements, if any, as set forth in the company's governing documents; and
 - ÿ At the nominating shareholder's option, a statement of support for the nominee.
- ÿ The nominating shareholder or group would also be required to certify that it is not seeking to change control of the company or to gain more than a minority representation on the board.

Disclosure in the Proxy Statement

- The company would be required to include disclosures in the proxy statement and related materials regarding the nominee or nominees, as well as with respect to each nominating shareholder or group.
 - This disclosure is comparable to what would be required in a contested election.
- The nominating shareholder or group would be liable for any false or misleading statements made about the nomination, regardless of whether such statements are included in the company's proxy statement.
- The company would not be responsible for information provided by the nominating shareholder that is reproduced in the proxy statement.

Rule 14a-11: Process



Interaction with State Law

- ÿ The SEC Staff has expressed the position that the ability to use Rule 14a-11 is premised on a state law right to nominate, and that if, for some reason, a shareholder does not have a right to nominate, then Rule 14a-11 does not provide that right.

- ÿ Bylaw provisions that might be considered an impermissible "opt-out" of the requirements of Rule 14a-11 would include:
 - ÿ Prohibiting the public announcement of a nomination (given that Rule 14a-11 would require that a nominee be publicly announced by the filing of a Schedule 14N);
 - ÿ Providing for higher thresholds for the percentage ownership and/or the duration of ownership than what is contemplated by Rule 14a-11; and
 - ÿ Imposing differential director qualifications on Rule 14a-11 nominees relative to other nominees.

Related Rule Changes

- ÿ **Rule 14a-2(b)(7)** – A narrowly tailored exemption for “solicitations” made in connection with formation of a nominating group.
- ÿ **Rule 14a-2(b)(8)** – Would permit solicitations in support of the election of nominees who are included in the company’s proxy materials under Rule 14a-11.
- ÿ **Rule 14a-18** – Would require that a nominating shareholder or group utilizing procedures established under state law or by a company’s governing documents must also file a Schedule 14N.
- ÿ **Rule 14a-9** – An amendment to Rule 14a-9 would confirm that it is unlawful for a nominating shareholder or group to cause any false or misleading statement to be included in company proxy materials.
- ÿ **Rules 13d-1(b) and (c)** – Would be revised to provide that nominating shareholders or groups may remain on Schedule 13G, notwithstanding activities undertaken with respect to a nomination under Rule 14a-11.

Changes in Meeting Dates

- Y Rule 14a-5 provides that if the company did not hold an annual meeting in the prior year, or if the date of the meeting has changed by more than 30 days from the prior year, then the nominating shareholder or group must provide notice a reasonable time before the company mails its proxy materials.
- Y A new Item 5.08 of Form 8-K would require a company to disclose the date (which is a reasonable time before the company mails its proxy materials) by which a nominating shareholder must submit the Schedule 14N if the company did not hold an annual meeting in the prior year, or if the date of the meeting has changed by more than 30 days from the prior year.
 - Y The Item 5.08 Form 8-K must be filed within four business days after the company determines the date of the meeting.

Proxy Access - Next Steps

- Y Consider your shareholder demographics and who is most likely to be a nominating shareholder or who would potentially form a group of nominating shareholders.
- Y Develop plans for addressing proxy access shareholder proposals.
- Y Review your charter, bylaws and other governance documents to determine if changes may be necessary to adapt to shareholder access if it becomes effective.
- Y Consider your engagement, communications and solicitation strategy in advance of and during any contested election.
- Y Revisit your annual meeting timeline if the rule becomes effective to make adjustments for a potential shareholder nomination.

Specialized Corporate Disclosure

- Title XV of the Dodd-Frank Act, aptly entitled “Miscellaneous Provisions,” contains what the SEC has described as the “specialized” corporate disclosure provisions:
 - Conflict minerals disclosure;
 - Mine safety disclosure; and
 - Payments by resource extraction companies.
- The requirements for Specialized Corporate Disclosures are not based on the fundamental question of whether the information would be considered to be “material” by investors in making voting or investment decisions.
- In December 2010, the SEC proposed rules regarding these provisions. The rules have not yet been adopted.

Conflict Minerals Disclosure

¶ Section 1502 of the Act requires persons to disclose annually whether any “conflict minerals” that are “necessary to the functionality or production” of a product of the person originated in the Democratic Republic of the Congo or an adjoining country and, if so, to provide a report describing, among other matters, the measures taken to exercise due diligence on the source and chain of custody of those minerals.

¶ This must include an independent private sector audit of the report that is certified by the person filing the report.

Conflict Minerals Disclosure

¶ Section 1502 was adopted to promote transparency and consumer awareness regarding the use of certain minerals mined in the Congo and adjoining region that, in some cases, benefit the armed groups engaged in conflict in that region.

¶ It would appear that ultimately the objective may be to discourage the use of these minerals by manufacturing companies, principally by exposing the use of conflict minerals through the public disclosure process.

¶ The Democratic Republic of the Congo, in west-central Africa, is bordered by the Republic of Congo, the Central African Republic, the Sudan, Uganda, Rwanda, Burundi, Tanzania, Zambia and Angola. The requirements of Section 1502 apply to this entire region, not just the Democratic Republic of the Congo.

Conflict Minerals Disclosure

- Y The term “conflict minerals” refers to “columbite-tantalite (coltan), cassiterite, gold, wolframite or their derivatives[,]” and “any other mineral or its derivatives determined by the Secretary of State [of the United States] to be financing [armed] conflict in the Democratic Republic of the Congo or an adjoining country.”
- Y These minerals are ubiquitous in many products manufactured across a number of industries, notably including the jewelry and electronics industries, and manufacturers who regularly utilize tin, gold, or tungsten in the manufacturing process.
- Y Given the wide range of uses for these conflict minerals, the SEC expects that the conflict minerals disclosure requirements will apply to many different companies across a wide array of industries.

Conflict Minerals Disclosure

- ÿ In accordance with Section 1502, the conflict minerals disclosure provision only applies to a “person described,” defined as one for whom conflict minerals are “necessary to the functionality or production of a product manufactured by such person.”
- ÿ Under the SEC’s proposed rules, an issuer meeting this definition would be required to disclose, based on a reasonable country of origin inquiry, in the body of its annual report, whether its conflict minerals originated in the Democratic Republic of the Congo countries.

Conflict Minerals Disclosure

- Y The SEC's proposed rules would specify that if an issuer concludes that its conflict minerals did not originate in the Democratic Republic of the Congo countries, then the issuer would be required to "disclose this determination and the reasonable country of origin inquiry process" that was used in making that determination in the body of its annual report.
- Y In addition, such an issuer would be required to: (1) provide on its Internet website the determination that its conflict minerals did not originate in the Democratic Republic of the Congo countries; (2) disclose that this information is available on the issuer's website and the Internet address of that site in the body of its annual report; and (3) maintain records demonstrating that its conflict minerals did not originate in the Democratic Republic of the Congo countries.

Conflict Minerals Disclosure

- ÿ If an issuer concludes that its conflict minerals did originate in the Democratic Republic of the Congo countries, or the issuer is unable to conclude that its conflict minerals did not originate in the Democratic Republic of the Congo countries, then the issuer would similarly disclose [this] conclusion in its annual report.”
- ÿ The SEC’s proposed rules also require that a more comprehensive Conflict Minerals Report is furnished as an exhibit to the annual report, requiring that the issuer furnish that Conflict Minerals Report with the SEC with the annual report filing, post the Conflict Minerals Report on its Internet website, disclose that the Conflict Minerals Report is posted on the issuer’s Internet website, and provide the Internet address of that website.

Conflict Minerals Disclosure

- ÿ The SEC's proposed rules would require an issuer that has concluded that its conflict minerals did originate in the Democratic Republic of the Congo countries (or an issuer that is unable to conclude that its conflict minerals did not originate in the Democratic Republic of the Congo countries) to provide, in a Conflict Minerals Report, a description of the measures that the issuer has taken to exercise due diligence on the source and chain of custody of its conflict minerals.
 - ÿ This report would have to include a certified, independent, private sector audit of the Conflict Minerals Report that identifies the auditor and is furnished as part of the Conflict Minerals Report.
 - ÿ Further, the issuer would be required to include in the Conflict Minerals Report a description of its products manufactured or contracted to be manufactured containing conflict minerals that are not 'DRC conflict free,' the facilities used to process those conflict minerals, those conflict minerals' country of origin, and the efforts to determine the mine or location of origin with the greatest possible specificity.

Conflict Minerals Disclosure

- Section 1502 does not provide for a *de minimis* standard regarding the amount of conflict minerals that an issuer must use in order to be subject to the above-referenced reporting requirements.
 - As a result, issuers using a very small amount of conflict minerals must nonetheless go through the disclosure exercise if that small amount “is necessary to the functionality or production of a product manufactured” (or contracted to be manufactured).
- In its proposed rules, the SEC has not proposed any *de minimis* standard, citing the absence of such flexibility in Section 1502 itself.
- Moreover, the SEC has chosen to not specifically define some of the key terms that are used in Section 1502, such as “necessary to the functionality or production of a product manufactured by such person” or what is contemplated by the terms “manufacture” or “contracted to be manufactured.”

Conflict Minerals Disclosure

- ÿ The breadth of the due diligence and reporting requirements contemplated by Section 1502 and the SEC's implementing rules will likely lead to very significant compliance costs for issuers in a wide variety of circumstances.
- ÿ While it is possible that more fully developed information and due diligence processes will be developed regarding the raw materials supply chain and the sourcing of conflict minerals, issuers will still be compelled by the rules to determine whether they are in fact engaged in the manufacturing of products and the extent to which conflict minerals will potentially be necessary to functionality or production of the issuer's products.

Mine Safety Disclosure

- Section 1503 of the Act requires any reporting issuer that is an operator of a coal or other mine, or has a subsidiary that is a mine operator, to disclose in each periodic report filed with the SEC information related to health and safety violations, including the number of certain violations, orders, and citations received from the Mine Safety and Health Administration (“MSHA”), among other matters contemplated in the statute.
- Issuers must also disclose in their Current Reports on Form 8-K the receipt from MSHA of any “imminent danger orders or notices indicating that a mine has a pattern or potential pattern of violating mandatory health or safety standards.” and make additional disclosures regarding these and other matters in their periodic reports.

Mine Safety Disclosure

Y The current reporting requirements of Section 1503 require each issuer that is an operator, or that has a subsidiary that is an operator, of a coal or other mine to report on Form 8-K the receipt of certain notices from MSHA, including: (i) an imminent danger order under section 107(a) of the Mine Safety Act; (ii) written notice from MSHA of a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under Section 104(e) of the Mine Safety Act; or (iii) written notice from MSHA of the potential to have a pattern of such violations.

Mine Safety Disclosure

- Y The periodic reporting requirements of Section 1503 applied to any quarterly report on Form 10-Q or annual report on Form 10-K filed on or after August 20, 2010, which must include for the period covered:
 - Y the total number of violations of mandatory health or safety standards that could significantly and substantially contribute to a mine safety or health hazard under Section 104 of the Mine Safety Act for which the mine operator received a citation from the MSHA;
 - Y the total number of orders issued under Section 104(b) of the Mine Safety Act;
 - Y the total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under Section 104(d) of the Mine Safety Act;
 - Y the total number of flagrant violations under Section 110(b)(2) of the Mine Safety Act;
 - Y the total number of imminent danger orders issued under Section 107(a) of the Mine Safety Act; and
 - Y the total dollar value of proposed assessments from the MSHA under the Mine Safety Act; and
 - Y the total number of mining-related fatalities.

Mine Safety Disclosure

- ÿ In addition, an issuer's periodic reports must include a list of coal or other mines operated by the issuer (or a subsidiary of the issuer) that receive written notice from the MSHA of either a pattern, or the potential to have a pattern, of violations of mandatory health or safety standards that are of such a nature as could have significantly and substantially contributed to mine health or safety hazards under Section 104(e) of the Mine Safety Act.
- ÿ Further, an issuer must disclose "[a]ny pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine."

Mine Safety Disclosure

- Most of the information called for by these disclosure requirements is already publicly disclosed by MSHA and, as a result, is readily available to issuers, who receive the notices, orders and citations directly from MSHA and can also access relevant information through MSHA's data retrieval system.
- The SEC's proposed rules under Section 1503 largely implement the statutory requirements that were already in effect following enactment of the Dodd-Frank Act.
 - The proposed rules seek to implement and specify the scope and the application of the Section 1503 disclosure requirements, as well as require some additional disclosure to provide context for certain items required by the Section 1503.
- The proposed rules would apply to both U.S. companies and to foreign private issuers, requiring disclosure in each Form 10-K, Form 10-Q, Form 20-F and Form 40-F filed with the SEC, as applicable.

Resource Extraction Payments

- Y Section 1504 of the Dodd-Frank requires reporting issuers engaged in the commercial development of oil, natural gas, or minerals to disclose, in an annual report, certain payments made to the United States or a foreign government. The SEC must make a compilation of the electronically-provided information available online.
- Y Section 1504 was enacted against a backdrop of international efforts seeking to encourage greater transparency and accountability in countries dependent on the revenues from oil, gas and mining.

Resource Extraction Payments

- ¶ Section 1504 defines “commercial development of oil, natural gas, or minerals” to include the “exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity, as determined by the [SEC].”
- ¶ The payments covered by the disclosure requirements under Section 1504 include “taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the [SEC] . . . determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.”

Resource Extraction Payments

- ÿ The required disclosures under Section 1504 include “the type and total amount of such payments made for each project . . . relating to the commercial development of oil, natural gas, or minerals [and] the type and total amount of such payments made to each government.”
- ÿ Section 1504 provides that a payment that is of a *de minimis* amount will not require disclosure.
- ÿ The disclosures required under Section 1504 must be made in the issuer’s annual report, and must be submitted to the SEC in an interactive data format.

Resource Extraction Payments

- ÿ Under the SEC's proposed rule and form amendments, an issuer would be required to provide the information mandated by Section 1504 about resource extraction payments in an exhibit filed in HTML or ASCII format, which would allow prospective investors and shareholders to read the disclosure about payment information without the aid of additional computer programs or software.
- ÿ In addition, a resource extraction issuer would be required to file a second exhibit with the information about resource extraction payments electronically tagged in XBRL format, which would be readable through a viewer.
- ÿ The SEC's proposed rule and form amendments would also require a resource extraction issuer to provide a statement, under an appropriate heading in the issuer's annual report, referring to the payment information provided in the exhibits to the report.

Resource Extraction Payments

- ÿ The Section 1504 payment disclosure requirements would apply to U.S. and foreign resource extraction issuers as contemplated by the SEC's proposed rules.
- ÿ A new Item 105 to Regulation S-K proposed by the SEC would “require a resource extraction issuer to provide information relating to any payment made by it, a subsidiary, or an entity under its control to a foreign government or the U.S. Federal Government during the fiscal year covered by the annual report for the purpose of the commercial development of oil, natural gas, or minerals.”
- ÿ The disclosure requirements under Section 1504 of the Dodd-Frank Act will take effect beginning with the annual report for the first fiscal year ending on or after the first anniversary of the date on which the SEC issues final rules implementing Section 1504.

Whistleblower Provisions

Y Provisions of the Act seek to encourage whistleblowers to report violations of securities laws to the SEC by offering bounties for information leading to successful enforcement actions and by shielding whistleblowers from employer retaliation.

Y Bounties – New provisions of the federal securities laws provide for payments to whistleblowers who voluntarily provide “original” information that leads to a successful enforcement action by the SEC.

Y Whistleblower Protections – The Act prohibits employers from discharging, demoting, suspending, threatening, harassing, or discriminating against a whistleblower in the terms of conditions of employment because the whistleblower provided information to the SEC, initiated, testified, or otherwise assisted an SEC investigation or action, or made statutorily required or protected disclosures.

Whistleblower Rules

- ÿ In adopting the final rules on May 25, 2011, the SEC sought to provide incentives for individuals to report possible violations of the securities laws first to their employers, rather than — or before — reporting to the SEC.
- ÿ However, the final rules continue to provide substantial financial incentives for individuals to report directly to the SEC and bypass a company's internal compliance process.
- ÿ The new rules will take effect on August 12, 2011.

Whistleblower Rules

- The final rules provide the following new incentives:
 - When determining the size of a bounty, the SEC may pay larger awards to whistleblowers who report a possible violation through internal compliance processes before providing information to the SEC, and smaller awards to whistleblowers who obstruct or interfere with internal compliance policies and reporting procedures;
 - Whistleblowers can receive a bounty for reporting information internally when the company subsequently self-reports the possible violation discovered as a result of whistleblowers' internally reported information; whistleblowers would then be given credit by the SEC for *all* of the information self-reported to the SEC by the company; and
 - Whistleblower reports to the SEC relate back to the date whistleblowers reported a possible violation internally, as long as the whistleblowers contact the SEC within 120 days of the internal report (this grace period was 90 days under the proposed rules)

Whistleblower Rules

- The final rules allow more whistleblowers to qualify for bounties.
 - For example, whistleblowers can now collect a bounty for information provided to the SEC even after the government begins an investigation and requests information from the whistleblower's employer.
 - Only if the government requests information directly from the whistleblower or anyone representing the whistleblower will the whistleblower be deemed ineligible for a bounty.
- In addition, while virtually any state authority's request for information from whistleblowers would have disqualified them from collecting a bounty, the new rules provide that only a request from state attorneys general or securities regulators would serve as a disqualification if made in connection with an investigation, inspection, or examination.

Whistleblower Rules

- The final rules broadened the criteria for “information” that qualifies whistleblowers for a bounty by including information that causes the SEC to reopen closed investigations or pursue a new line of inquiry in existing investigations.
- Whistleblowers who report information regarding an ongoing investigation that is “critical” to its success may also be eligible for a bounty.
- The final rules clarify that information need only relate to a “possible” violation of the federal securities laws that “has occurred, is ongoing, or is about to occur.”

Whistleblower Rules

- Y The rules create new exceptions for attorneys, auditors, and internal compliance and similar personnel to receive bounties as whistleblowers.
 - Y Attorneys, for example, can now qualify as whistleblowers where disclosure of information learned in connection with the legal representation of a client is otherwise waived or if disclosure is permissible pursuant to the SEC's attorney conduct rules, applicable state statutes, or local bar rules.
 - Y Auditors and internal compliance and similar personnel can now qualify as whistleblowers when they have a "reasonable basis to believe" that (1) disclosure is necessary to prevent their company from engaging in conduct "likely to cause substantial injury to the financial interest or property of the [company] or investors"; (2) the company is engaging in conduct that will impede an investigation of the misconduct; or (3) at least 120 days have elapsed since information was provided to the company's audit committee, chief legal officer, chief compliance officer, or similar responsible persons or governance bodies.

Whistleblower Rules

Y The final rules make clear that the availability of whistleblower protections does not depend on an ultimate adjudication, finding, or conclusion that the concerns identified by the whistleblower constitute a violation of the securities laws. Indeed, the anti-retaliation protections are available to whistleblowers who possess a “reasonable belief that the information [they are] providing relates to a possible securities law violation . . . that has occurred, is ongoing, or is about to occur.”

Action Items – Whistleblower Rules

- ÿ Update internal compliance and ethics programs and controls.
- ÿ Train employees regularly on internal reporting procedures and resources.
- ÿ Train management to recognize, report, and respond to concerns raised by employees.
- ÿ Cultivate a culture of compliance.
- ÿ Establish an effective whistleblower hotline.
- ÿ Update anti-retaliation and document retention policies.
- ÿ Respond to internal reports and discoveries of misconduct quickly and effectively.
- ÿ Understand risks and benefits of self-reporting.
- ÿ Reduce subsequent liability after learning an employee is a whistleblower and provided information to the SEC.
- ÿ Analyze insurance coverage.

SEC Enforcement Powers

- Y Expanded Aiding and Abetting Liability – Section 929M-O of the Act empower the SEC to prosecute “any person that knowingly or recklessly provides substantial assistance to another person” in violation of the federal securities laws.
- Y Control Person Liability – Section 929P(c) of the Act makes “any person who, directly or indirectly, controls any person liable under any provision” of the 1933 Act jointly and severally liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts.
- Y Extraterritorial Jurisdiction – Section 929P(b) of the Act expands the SEC’s jurisdiction with respect to certain antifraud actions.
- Y Civil Penalties in C&D Proceedings – Section 929P(a) empowers the SEC to impose civil monetary penalties on any person in an administrative cease and desist proceeding.

SEC Enforcement Powers

- Y Collateral Bars – Section 925 of the Act empowers the SEC to bar persons associated with regulated entities not only from their specific securities business, but also from the entire securities industry.
- Y Nationwide Service of Subpoenas – Section 929E of the Act authorizes parties in proceedings instituted by the SEC to serve subpoenas nationwide “to compel the attendance of a witness or the production of documents or tangible things (or both) at a hearing or trial.” Prior to the Act, a potential trial witness who did not live within the federal district where the proceeding was pending or within 100 miles of the district could not be compelled to appear in person at trial.

Dodd-Frank Act Implementation

- ÿ The SEC has completed rulemaking on the Say-on-Pay provisions and whistleblower provisions.
- ÿ The SEC expects to adopt rules with regard to the compensation committee and adviser independence provisions in the second half of 2011. The exchanges will also promulgate standards during this timeframe.
- ÿ The SEC expects to adopt rules implementing the “specialized corporate disclosure” provisions in the second half of 2011.
- ÿ The SEC plans to adopt rules regarding executive compensation disclosure, compensation recovery, and disclosure regarding employee and director hedging in the first half of 2012.
- ÿ Rule 14a-11 has been vacated and remanded to the SEC, and the SEC has not yet determined how it will proceed.